EB-2022-0200

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an Application by Enbridge Gas Inc., pursuant to section 36(1) of the *Ontario Energy Board Act, 1998,* for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas as of January 1, 2024

COMPENDIUM OF THE SCHOOL ENERGY COALITION
(EGI – Deferral & Variance Accounts Panel)

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Table 1
Utility O&M

Line No.	Particulars ($ millions)	Utility	2018 Actual (1) (a)	2019 Actual (b)	2020 Actual (c)	2021 Actual (d)	2022 Estimate (e)	2023 Bridge Year (f)	2024 Test Year (g)	
1	Business Development & Regulatory	EGI	43	37	28	33	35	40	47	
2	Customer Care	EGI	153	131	118	117	118	124	135	
3	Distribution Operations	EGI	275	281	268	274	309	331	338	
4	Energy Services	EGI	21	17	14	16	17	19	18	
5	Engineering & STO	EGI	113	110	96	111	146	158	155	/u
6	Central Functions	EGI	231	237	245	280	337	353	377	/u
7	BU Benefits	EGI	144	158	148	143	104	112	111	/u
8	Overhead Capitalization	EGI	(227)	(237)	(224)	(234)	(269)	(301)	(310)	
9	Utility O&M excl. Integration and DSM	EGI	753	734	692	739	797	835	871	/u
10	Integration-Related Costs	EGI	0	52	124	50	35	20	0	
11	DSM	EGI	130	129	132	132	132	167	175	/u
12	Utility O&M	EGI	883	915	948	921	964	1,022	1,046	/u

Note:

(1) 2018 reflects combined EGD and Union actuals.

CAPITALIZATION OF OVERHEAD

COLIN HEALEY, DIRECTOR FINANCIAL PLANNING & ANALYSIS

1. The purpose of this evidence is to request OEB-approval for Enbridge Gas's harmonized overhead capitalization methodology and resulting capitalized overhead amounts for the 2024 Test Year. This evidence summarizes the overhead capitalization methodologies previously in place for EGD and Union. This evidence also sets out the harmonized overhead capitalization methodology, identifies how the harmonized overhead capitalization methodology addresses OEB guidelines, accounting standards and other relevant policies, and summarizes the change in capitalization resulting from application of the harmonized overhead capitalization methodology. Ernst & Young (EY) was retained by Enbridge Gas to assist management in its determination of the Company's harmonized overhead capitalization methodology.

2. Enbridge Gas is also requesting approval of the amounts contained within the Accounting Policy Change Deferral Account (APCDA) associated with the change in overhead capitalization methodology adopted in 2020. This evidence details the 2020 and 2021 actual amounts, along with the 2022 and 2023 forecasted amounts, determined by comparing the overhead capitalization methodologies of EGD and Union to the Enbridge Gas harmonized overhead capitalization methodology. Please see Exhibit 9, Tab 2, Schedule 1, Attachment 3 for the resulting revenue requirement impact recorded in the APCDA.

3. This evidence is organized as follows:
    1. Background and Purpose of Overhead Capitalization
    2. History of Overhead Capitalization
    3. Proposed Harmonized Methodology

4. Comparison to EGD and Union Methodologies
5. Impact of Methodology Change (including APCDA)
6. Allocation of Capitalized Overheads to Plant Assets
7. Summary

1. Background and Purpose of Overhead Capitalization

4. The objective of overhead capitalization is to ensure all indirect costs associated with the creation of capital assets are captured as part of the asset cost. Costs that are directly related to asset creation (e.g., construction labour costs, materials/supplies) are identifiable and directly assigned to the appropriate capital projects. These costs are not subject to overhead capitalization. Indirect overhead are costs associated with the activities that support asset creation but cannot be directly associated with any particular asset or asset group. Indirect overhead costs include, but are not limited to, supervision and oversight of capital activities or support functions such as Finance, Legal, Supply Chain, Human Resources, Technology and Information Services (TIS), etc. Cost drivers are used to associate indirect overhead costs with capital activity.

5. Overhead capitalization has historically been in place at EGD and Union based on separate and distinct OEB-approved methodologies. The amalgamation of EGD and Union, effective on January 1, 2019, required an alignment of accounting policies. The capitalization of indirect overheads was one such area of alignment to provide a harmonized approach for the Company that meets the guidelines specified by the OEB Uniform System of Accounts for Class A Gas Utilities, and US GAAP.

2. History of Overhead Capitalization

6. Prior to amalgamation, EGD and Union applied overhead capitalization methodologies that were approved by the OEB and conformed to US GAAP. The following sub-sections establish the underlying regulatory approvals, the cost categories, and cost drivers for each of the pre-amalgamated Company's methodologies. Cost category represents a grouping of costs based on the inherent nature of the cost. Cost drivers are determined by the nature of the underlying causal activity and ultimately determine the degree of capitalization.

2.1. EGD Overhead Capitalization

7. EGD's overhead capitalization methodology prior to amalgamation consisted of two categories: Capitalized Administrative & General Overhead (A&G) and Departmental Labour Costs (DLC).

8. A&G represented common services that support capital activities. The OEB-approved methodology and rates were applied to A&G costs, such as Finance, Legal, Supply Chain, Human Resources, Benefits and TIS, to determine a total amount of A&G eligible for capitalization. The total amount was then allocated to capital projects proportionally based on capital expenditures.

9. DLC were salaries and employee expenses for the departments within Operations and Engineering where the respective functions of these departments contributed to capital projects but were not directly attributable to specific capital projects. Examples of these functions include system capacity planning, distribution plant drafting, pipeline inspection, field operations, customer attachment and records management. Capitalization rates were applied to each eligible department's O&M and allocated to Mains, Services and Measurement and Regulation assets. Any

costs within A&G and DLC, that were directly tied to capital projects, were directly charged and not subject to overhead capitalization.

10. A&G capitalization rates were determined by cost drivers based on the classification of activities into the following three types:
    a) Consultative: This cost type refers to activities of a 'consulting' nature where the activity is primarily project-specific and the level of activity is not consistent year-over-year. Examples of such activities would be found in functions such as Legal services or Finance. The use of time is considered practical and appropriate as the driver for these activities and provides the strongest link between costs and services provided.
    b) Administrative: This cost type refers to activities that support other activities. Examples of support activities include functions performed by administrative support staff (e.g., mail distribution, telephone support, etc.) and in some cases department management. As these activities and related costs typically directly support other activities, they are usually best allocated in the same proportion as the activities which they are supporting.
    c) Repetitive: This cost type refers to activities that are repetitive in nature and are consistent over time in terms of the level of effort per unit of service provided. Examples of such activities are Payroll, Human Resources, and Accounts Payable. Processes are standardized and consistent and costs track accordingly. As such, this category of costs is best allocated based on volumetric measures reflecting or causing the activity to be performed and therefore the cost to be incurred. For example, headcount related to the various programs or capital assets is a suitable driver for Human Resource support or the Payroll function.

11. OEB approval of the A&G methodology was granted in 1998 as part of the 1999 Test Year Rates Application[1]. The Application detailed the capitalization study undertaken and formalized the definitions and approach for A&G. Subsequent settlement agreements and OEB decisions have approved the continued application of the A&G methodology. The DLC capitalization methodology has been referenced and included in the determination of O&M and capital submissions that have received OEB approval. A&G and DLC were most recently approved in 2012 as part of the 2013 Cost of Service Application Settlement Agreement [2] and in 2014 as part of the 2014 to 2018 IRM Application[3].

2.2. Union Overhead Capitalization

12. Union's overhead capitalization methodology prior to amalgamation consisted of two categories: Loadings and Indirect Overhead.

13. Loadings are costs that can be attributable to capital activity, but due to the nature of the costs, it is difficult to allocate them to specific projects. These costs included benefits and incentive pay, non-productive labour (i.e., vacation and sick time), fleet maintenance, fleet depreciation, planning and dispatch, construction oversight and warehouse costs. A Loadings rate was used to assign these costs to specific capital projects based on the labour charged to the specific capital projects.

14. Indirect Overhead are costs that support the production or construction of an asset but cannot easily be directly associated with any particular asset or working group. These costs can be broken down as:

[1] In E.B.R.O 497 Decision, Issue 3.8.
[2] In EB-2011-0354, Settlement Agreement, Issue B.1 (Capital Expenditure) and Issue D.1 (O&M).
[3] In EB-2012-0459, OEB Decision, pp.30-33 (Capital Expenditure) and pp.44-51 (Other O&M).

a) Specific Capital costs which include evaluation, design, and implementation related to capital projects generally rather than to specific or identifiable projects;
b) Supervision costs which represent functions that support, supervise, and monitor direct project activities; and
c) Support Functions which include budgeting and reporting, building maintenance, TIS help desk, Human Resources, Strategic Development, Procurement, Plant Accounting, and Accounts Payable.

15. Overhead capitalization rates were determined by an appropriate cost driver for each department with costs eligible for capitalization. The four cost drivers were as follows:
    a) Time Analysis: An estimate was developed by the managers of each individual department to allocate each employee's time between capital and O&M. A weighted average of capital to O&M time was calculated among all employees in the department and applied to all costs.
    b) Work Plan: Support costs related to tasks carried out by front-line workers were allocated using a work plan. The work plan represented the type and volume of "jobs" that related to capital activity versus general O&M activity. As individuals within these groups supported front-line workers directly, their time was highly correlated to capital activity.
    c) Volume or Other: In certain situations, unit-based measures of work related to capital (such as for warehousing) or total capital spend relative to total spend (capital and O&M combined) was used as a way to determine how much of that department's costs were capital in nature.
    d) Composite Ratio: For support functions, departments and groups within the Company that supported various other parts of the business, a composite ratio was used to determine the rate at which overhead was capitalized.

16. Approval of Union's overhead capitalization methodology was obtained in 2006 as part of the 2007 Cost of Service Application[4] Settlement Agreement. Union submitted an update to the methodology, which was implemented in 2010, and approved as part of the 2013 Cost of Service Application[5] Settlement Agreement. The update introduced "Loadings" which facilitated the direct assignment of certain capitalized overheads to capital projects. The update was not deemed to be a change in the capitalization policy.

3. Proposed Harmonized Methodology

17. Prior to amalgamation, EGD and Union applied different OEB-approved overhead capitalization methodologies that used similar underlying principles, cost categories and cost drivers. As an amalgamated company, it was necessary for Enbridge Gas to establish a harmonized methodology that aligned to the Company's new structure and assess how the functional groupings contributed to capital activity.

18. Enbridge Gas retained EY to assist management in its determination of a harmonized capitalization methodology. EY was informed by the historical methodologies of EGD and Union, Enbridge Gas's structure and relevant accounting guidance. EY's assessment is documented in a report entitled "Enbridge Gas Inc: Overhead Capitalization Study" (EY Study). This report is provided at Attachment 1. The harmonized capitalization methodology was implemented January 1, 2020.

[4] In EB-2005-0520 Settlement Agreement, Issue 3.11.
[5] In EB-2011-0210 Settlement Agreement, Issue 3.1.

19. The following sub-sections outline the harmonized methodology's guiding principles and development, accounting guidance supporting overhead capitalization, cost categories and drivers, and the process to update overhead capitalization rates.

3.1. Guiding Principles and Development

20. For the harmonized overhead capitalization methodology to reflect the amalgamated operations of Enbridge Gas, the following guiding principles were identified:
    a) Establish a single, consistent methodology for Enbridge Gas;
    b) Promote accuracy and transparency through a streamlined model that reflects the underlying capital activity;
    c) Support the practical implementation of the model allowing for regular (annual) updates; and
    d) Comply with accounting standards and OEB policies.

    Application of these guiding principles result in a methodology that appropriately accounts for the geographical diversity of Enbridge Gas's operations and provides a consistent approach in determining how each department or function supports capital activity.

21. In helping management develop the methodology, EY used a combined approach of relying on accounting guidance, cost causation linkages (including the identification of cost categories and drivers), discussions with Enbridge Gas personnel, and understanding industry best practices. Further overview on accounting guidance and cost categories, drivers and causality can be found in Sub-Sections 3.2 Accounting Guidance and 3.3 Cost Categories and Cost Drivers for the EY Study.

3.2. Accounting Guidance

22. Overhead capitalization is allowable based on the accounting guidance noted in Section VI of the EY Study. The OEB's Uniform System of Accounts provides support for this conclusion in the Overhead Charged to Construction section of Appendix A. US GAAP Accounting Standards Codification (ASC) 360 – Property, Plant, and Equipment specifies that asset capitalization includes "costs incurred for activities to bring them to the condition and location necessary for their intended use". Furthermore, US GAAP ASC-980 – Regulated Operations allows the capitalization of overhead costs if future recovery through rates is probable. As provided at Exhibit 2, Tab 4, Schedule 1, Enbridge Gas is requesting approval to continue capitalizing overheads, as previously approved by the OEB for EGD and Union.

3.3. Cost Categories and Cost Drivers

23. The harmonized overhead capitalization methodology uses four cost categories. These categories are Operations Costs, Business Costs, Shared Services Costs and Pension and Benefits Costs. Each cost category has a cost driver applied, typically determined by the nature of the underlying cost relationship or linkage to capital activity. Cost drivers include capital expenditures, time analysis, weighted average rates, and burdening. Please see pages 6-9 and pages 15-16 of the EY Study for additional detail.

Operations Costs

24. The Operations Costs category consists of groups that support Enbridge Gas's core field operations within the Company's seven geographic regions which were realigned post amalgamation. These groups provide oversight for and support direct capital activity related to the natural gas delivery infrastructure.

25. To determine overhead capitalization for the Operations Costs category, the following methodology is applied:
    a) Operations Regional groups apply each region's proportion of capital spending, resulting in seven separate rates. Due to the diversity of each region, both in geographic features (i.e., urban and rural) and infrastructure, it was concluded that allocation rates for each region would best reflect the capitalizable portion of overhead. Regional capital spend was determined to be an appropriate driver as it represents the actual allocation of labour and material resources by Enbridge Gas to capital projects versus O&M.
    b) Operations Services and Governance (OSG) group (excluding 'c' and 'd'), which provides support services to the regions, uses a weighted average of the seven Operations Regional rates.
    c) Customer Attachment group is considered 100% capital due to the fully capitalizable nature of activity supported.
    d) Leak Survey and Locates are considered 100% O&M as they are preventative measures not contributing to asset creation.[6]
    e) Operations VP Admin uses a weighted average of the preceding rates in a), b), c) and d).

Business Costs

26. The Business Costs category includes certain departments/groups within Enbridge Gas that support core operations. Although their work can be linked to capital activity, it cannot be directly associated with any particular asset or asset group. Examples of these support areas include Engineering, Asset Management, System Improvement, and Integrity. Time spent on work was determined to be an

[6] Locate costs are included in O&M in the 2024 Test Year Forecast. As a result of Bill 93, other utilities may begin charging Enbridge Gas for locate delivery services for its own operations. At which time, a portion of the locate costs may be capitalized.

appropriate driver given the varied nature of these groups and their activities. Time analysis is necessary to appropriately identify the relationship between the functions of these groups and capital activities.

27. To determine overhead capitalization for the Business Costs category, the following time analysis methodology is conducted annually:
    a) Managers in the groups identified in this cost category identify all the activities carried out by their teams. Each employee's time is allocated among the various activities in an activity template. The activities are classified as Capital or O&M based on US GAAP and OEB guidance.
    b) A weighted average rate of capital time relative to O&M time is calculated using the employee activities within the manager group.
    c) Each resulting rate per manager group is grouped within their respective director group and weighted to derive an average rate for the director group.
    d) Validation is performed within each director group using a comparison of the current and prior year director level rates. For any significant increases or decreases, activities are reviewed to identify key activities driving the change and assess if their categorization is appropriate.
    e) Director level weighted average rate is applied to all costs incurred within the director group to determine the overhead capitalization amount.

Shared Services Costs

28. The Shared Services Costs category contains groups that support overall business activities including general functions required to complete capital projects. Examples of these services are Finance, Legal, Real Estate and Workplace Services, TIS, etc. Human Resources employee labour costs and related expenses are included in this category, and Pension and Benefits costs are treated separately (see Pension and Benefits Costs below). Shared Service Costs are incurred by

Enbridge Gas through the Central Functions Cost Allocation Model (CFCAM). EY's report categorizes Shared Services and CFCAM costs as separate overhead capitalization categories. However, as the Central Functions departments within Enbridge evolved post-merger with Spectra Energy, most Shared Services costs are incurred by Enbridge Gas via CFCAM. Therefore, they are combined in this evidence except for Pension and Benefits. Please see Exhibit 4, Tab 4, Schedule 3 Program Delivery Costs and Variance Analysis for more detail on CFCAM.

29. For Shared Services Costs, a single overhead capitalization rate was calculated by taking a weighted average of Operations Costs and Business Costs rates and non-capitalizable costs (groups that do not support capital activity). A single rate was determined to be most appropriate for overhead capitalization as the groups in this cost category support all of the business activities of Enbridge Gas.

Pension and Benefits Costs

30. The Pension and Benefits Costs category contains pension and benefits incurred by Enbridge Gas. In the context of this evidence, benefits are defined as Short-Term Incentive Pay (STIP), Long-Term Incentive Pay (LTIP) and employee medical, dental, disability and statutory benefits as provided at Exhibit 2, Tab 4, Schedule 3. For labour that is directly charged to capital projects, a burden rate for pension and benefits is applied to appropriately reflect the entire compensation cost associated with employees. Pension and benefits costs for indirect labour need to be similarly treated as the same cost relationship exists. Salary grade burden rates provided by Human Resources are used as an input to calculate a single weighted average burden rate for all employees. The weighted average burden rate is determined by:

a) Calculating capitalized labour by applying the capitalization rate to gross labour costs for each employee (based on the cost categories identified in Operations Costs, Business Costs and Shared Services Costs). The results are summarized by salary grade excluding directors and above and contractors to reflect only employees likely to be involved with capital activity.
b) Associating the current year's burden rate, obtained from Enbridge Gas Human Resources, with each eligible salary grade. Please see Exhibit 2, Tab 4, Schedule 3 for further information on the Human Resources burden rate.
c) Calculating the single Enbridge Gas burden rate by taking a weighted average of the salary grade burden rates from (b) and weighing it by the proportion of capitalized labour from (a).

The single weighted average burden rate allows for ease of application across all direct and indirect capitalized labour, regardless of employee salary grade, as part of the burdening process to layer on pension and benefits.

31. Enbridge Gas's harmonized overhead capitalization methodology calculates a weighted average burden rate of 41.7% for the 2024 Test Year budget. The weighted average burden rate more appropriately capitalizes pension and benefits costs because it is applied to the capitalized labour. This results in a better association of total employee compensation to capital activity as employee involvement in capital activity shifts annually. Table 1 outlines the calculation used to determine the harmonized weighted average burden rate.

Table 1
Pension and Benefits Burden Rate Calculation

Line No.	Organizational Level	2024 Test Year HR Burden Rate	Weighting	EGI Burden Rate
		(a)	(b)	(c)
1	E310 – Clerical	42.4%	0.1%	0.1%
2	E320 – Clerical / Technical	45.1%	1.1%	0.5%
3	E400 – Technical / Professional	43.4%	2.0%	0.9%
4	E410 – Technical / Professional	41.9%	8.0%	3.3%
5	E420 – Technical / Professional	40.5%	19.4%	7.9%
6	E500 – Specialist	44.2%	9.8%	4.3%
7	E510 – Specialist	43.1%	14.9%	6.4%
8	E600 – Manager	61.5%	5.7%	3.5%
9	Unionized Staff	38.1%	39.0%	14.8%
10	Total			41.7%

Notes:

(1) Weighting in column (b) calculated using estimated capitalized labour for each organization level as a proportion of total estimated capitalized labour.

3.4 Update Process

32. To ensure that the overhead capitalization rates closely reflect the underlying capital activity, the inputs to harmonized methodology are updated annually. Calculations are carried out on the latest actuals and applied to the prospective year. For instance, capitalization rates applied in 2022 are based on the 2020 actuals as those would have been the most recent actuals at the time the 2022 budget is prepared. Identical capitalization rates are applied for both actuals and budget within the same year. Capitalization for the 2024 Test Year is based on 2021 actuals and are identical to those used for the 2023 budget.

4. Comparison to EGD and Union Methodologies

33. EGD and Union previously applied separate overhead capitalization methodologies that identified cost categories, drivers and causal relationships relevant to each

company. The amalgamation provided an opportunity to streamline and improve the efficiency of the previously approved methodologies into a harmonized methodology that complies with relevant accounting and OEB guidance. Table 2 depicts how the cost categories from the prior methodologies align to the harmonized methodology.

Table 2
Harmonized and Historical Cost Category Alignment

Harmonized Cost Categories	Historical Cost Categories					
	EGD		Union			
	DLC	A&G	Loadings	Specific	Supervision	Support Functions
Operations Costs	X		X		X	
Business Costs	X			X	X	
Shared Services Costs		X		X		X
Pension & Benefits Costs		X	X			

34. EGD's DLC cost category, which was primarily comprised of Operations and Engineering costs, is now captured under the Operations and Business cost categories in the harmonized methodology. The A&G cost category, which was comprised of common or support costs, is now captured under the Shared Services and Pension & Benefits cost categories.

35. Union's Loadings cost category, which included benefits and incentive pay, non-productive labour (i.e., vacation and sick time), fleet maintenance, fleet depreciation, planning and dispatch, construction oversight and warehouse costs, is now captured under the Operations and Pension & Benefits cost categories depending on the nature of the cost. Union's Indirect Overhead cost category could be broken down into Specific, Supervision and Support costs. Specific, which included evaluation, design, and implementation costs, is now captured under the

Business and Shared Services cost categories. Supervision, which included support and monitoring costs for direct capital activity, is now captured under the Operations and Business cost categories. Support, which included costs for functions that provided overall support to business activities, is now captured under the Shared Services cost category.

36. By aligning cost categories and assigning appropriate drivers, the harmonized methodology better accounts for the geographical diversity of Enbridge Gas's operations and provides a consistent approach in determining how each department or function supports capital activity. The methodology also improved efficiency by simplifying the calculation of capitalization rates which reduces the number of capitalization rates that need to be maintained. For example, Operations Regional and Director level rates, Business Unit Director level rates, a single Shared Services rate and a single Pension and Benefits burden are simpler to update on an annual basis as opposed to capitalization rates set using more financial segments. Fewer rates also make system updating less complicated and allow for better understanding and visibility of departmental financial results.

37. Table 3 compares capitalized overhead by cost category under the harmonized methodology to the EGD and Union methodologies using 2024 Test Year costs. The calculation of capitalized overhead using prior methodologies was performed by applying the combined EGD and Union capitalization rates based on the proportion of capitalization for each department to the eligible 2024 Test Year costs. These proportional calculations were performed using the 2020 budget which was the last instance where the previously approved OEB capitalization rates were used.

Table 3
Comparison of Overhead Capitalization Methodologies - 2024 Test Year

Line No.	Particulars ($ millions)	Historical Method		EGI Harmonized Method		Variance
		Capitalized Amount	Capitalization Rate	Capitalized Amount	Capitalization Rate	Capitalized Amount
		(a)	(b)	(c)	(d)	(c) - (a)
1	Operations Costs	121.9	36.0%	118.2	35.0%	(3.6)
2	Business Units Costs	56.1	11.1%	54.5	10.8%	(1.6)
3	Shared Services Costs	63.8	20.5%	72.7	23.4%	8.8
4	Pension & Benefits Costs (1)	53.2	35.9%	65.1	43.9%	11.9
5	Total	295.1	22.7%	310.5	23.8%	15.4

Notes:

(1) Pension and Benefits costs include total net periodic pension costs and postretirement benefit costs to align with utility income statement presentation, however only the service cost component is eligible for capitalization. The capitalization rates after removing the non-service cost components of pension and OPEB are 23.9% for the historical methodologies and 29.3% for the harmonized methodology.

38. The harmonized methodology results in total overhead capitalization of $310.5 million for the 2024 Test Year, which represents an overall capitalization rate of 23.8%. The prior methodologies used by EGD and Union would have resulted in total overhead capitalization of $295.1 million which represent an overall capitalization rate of 22.7%. The net change is an increase of $15.4 million in overhead capitalization and 1.1% in the overall capitalization rate. The main drivers of the increase in capitalization are discussed below.

39. Operations Costs $3.6 million decrease in capitalization is primarily due to the harmonized methodology resulting in lower regional capitalization rates based on the proportion of capital spend to total spend. The lower regional rates reduced Regional Operations capitalization by $9.7 million. This was offset by higher support services (OSG and VP Admin) capitalization of $6.1 million resulting from the harmonized methodologies weighted average of regional capitalization rate being higher than the previously approved rates. OSG and VP Admin capitalization is now

more reflective of the groups they support as their rate is a weighted average of the Regional Operations rates.

40. Business Unit Costs capitalization has remained stable with a $1.6 million decrease. Historical rates and harmonized rates were closely aligned after conducting a time analysis for the functions in this costs category.

41. Shared Service Costs $8.8 million increase in capitalization is primarily due to a 2.9% higher harmonized weighted average rate as compared to previously approved rates. The harmonized methodology better associates EGI's level of capital activity built into Operations and Business Unit rates and the Shared Services that support those groups.

42. Pension and Benefits Costs $11.9 million increase in capitalization is primarily due to the introduction of a weighted average burden rate that reflects all components of employee compensation apart from base salary. Furthermore, the burden rate is applied to all direct and indirect capitalized labour. In Attachment 1, page 16, EY asserts that burdening is one of the most evident forms of cost causality that allows for associating pension and benefits with capitalized labour.

5. Impact of Methodology Change (including APCDA)

43. The Accounting Policy Change Deferral Account (APCDA) was established as an outcome of the MAADs proceeding to record the impact of accounting policy changes. The APCDA amount for overhead capitalization changes is calculated as the difference between the capitalization rates from the EGD and Union methodologies and the capitalization rates from the harmonized methodology, applied to each respective year's cost base since implementation in 2020. Table 4 outlines the actual O&M impact for 2020 and 2021, along with the forecasted O&M

impact for 2022 and 2023. Please see Exhibit 9, Tab 2, Schedule 1 for the resulting revenue requirement impact recorded in the APCDA.

Table 4
Change in Overhead Capitalization Methodology - O&M Impact

Line No.	Particulars ($ millions)	Utility	2020 Actual	2021 Actual	2022 Estimate	2023 Bridge Year
			(a)	(b)	(c)	(d)
1	EGI Harmonized Methodology	EGI	(224.3)	(234.2)	(268.9)	(301.1)
2	Historical Methodology	EGI	(218.7)	(228.0)	(260.0)	(284.4)
3	O&M Impact	EGI	(5.6)	(6.2)	(8.9)	(16.6)

Notes:
(1) Negative amounts represent a decrease to Operating & Maintenance (O&M) expense and an increase to capital expenditures

44. The impact from the change in overhead capitalization is a reduction in O&M because of an increase in overhead capitalization under the harmonized methodology due to a higher average capitalization rate. This higher average capitalization rate is primarily driven by the harmonized weighted average Shared Service rate and weighted average burden rate for Pension and Benefits as outlined in Section 4 of this evidence. From 2020 to 2023, the magnitude of the change increases from $5.6 million to $16.6 million because of increasing overhead capitalization rates as capital expenditures increase and an increasing pool of eligible capitalizable costs as gross O&M is forecasted to increase. Exhibit 4, Tab 4, Schedule 2 provides details on gross O&M.

6. Allocation of Capitalized Overheads to Plant Assets

45. Historically, EGD and Union allocated capitalized overheads to assets using different methods. EGD allocated based on cost category. A&G overheads were allocated proportionally to projects based on actual monthly capital expenditures

and as a result, were attributed to specific plant assets. DLC was allocated to Mains, Services and Measurement and Regulation asset classes based on the nature of work typically performed by the source departments or functions. Union allocated capitalized overheads to individual plant assets based on forecasted capital expenditures for the corresponding year. The individual plant assets were based on the asset groups defined by the OEB (Distribution, Storage, Transmission and General Plant).

46. A specific allocation of capitalized overheads to projects would be the most precise method; however, this is administratively difficult to implement as overheads are collected as a pool of costs and are not directly attributable to specific projects. As such, the Union approach of allocating capitalized overheads based on forecasted capital additions by asset class was adopted for both the EGD and Union rate zones. The Union approach offers the following benefits compared to the EGD approach:
    a) Aligns capitalized overhead to the asset classes they are supporting in a given year.
    b) Administrative ease and cost of implementation.
    c) Annual adjustments to allocations based on forecasted capital.

    The capitalized overhead allocation methodology was reviewed in 2021 to ensure that it aligned with the EY Study. The revised allocation methodology was implemented in 2021 for the EGD rate zone with no change in process for the Union rate zone. The change in allocation resulted in a $1.0 million increase to depreciation expense in 2021 which is immaterial in terms of total depreciation expense for Enbridge Gas. The amount was not recorded in the APCDA as this is a change in estimate and not a change in policy.

47. Enbridge Gas is proposing to align the presentation of overheads as part of PPE reporting. Enbridge Gas intends to eliminate the use of regulatory overhead asset accounts for the Union rate zone and adopt the EGD rate zone approach of presenting capitalized overheads within PPE asset classes. The December 31, 2023, balances of Union rate zones' regulatory overhead asset accounts will start being presented within the related asset groups on January 1, 2024, in alignment with the implementation of the new depreciation study provided at Exhibit 4, Tab 5, Schedule 1, Attachment 1. This presentation change results in an immaterial impact to depreciation expense as the depreciation rates of the Union rate zone's regulatory overhead asset accounts historically already represented the average for each asset group.

7. Summary

48. Enbridge Gas's harmonized overhead capitalization policy delivers an approach consistent with the previous OEB-approved methodologies, the guiding principles set out prior to the development process and relevant accounting guidance. The cost categories identified best reflect the Company's organizational structure, functions and geographical diversity which allows for the assignment of appropriate costs drivers. The result is an improvement in the causal linkage between overhead costs and capital activity, along with a more efficient process of updating inputs annually.

Ernst & Young LLP (EY) prepared the attached Report only for Enbridge Gas Inc. (Client) pursuant to an agreement solely between EY and Client. EY did not perform its services on behalf of or to serve the needs of any other person or entity. Accordingly, EY expressly disclaims any duties or obligations to any other person or entity based on its use of the attached Report. Any other person or entity must perform its own due diligence inquiries and procedures for all purposes, including, but not limited to, satisfying itself as to the financial condition and control environment of Client, as well as the appropriateness of the accounting for any particular situation addressed by the Report.

EY did not perform an audit, review, examination or other form of attestation (as those terms are identified by CPA Canada, the AICPA or by the Public Company Accounting Oversight Board) of Client's financial statements. Accordingly, EY did not express any form of assurance on Client's accounting matters, financial statements, any financial or other information or internal controls. EY did not conclude on the appropriate accounting treatment based on specific facts or recommend which accounting policy/treatment Client should select or adopt.

The observations relating to accounting matters that EY provided to Client were designed to assist Client in reaching its own conclusions and do not constitute our concurrence with or support of Client's accounting or reporting. Client alone is responsible for the preparation of its financial statements, including all of the judgments inherent in preparing them.
This information is not intended or written to be used, and it may not be used, for the purpose of avoiding penalties that may be imposed on a taxpayer.

Enbridge Gas Inc: Overhead Capitalization Study

15 May 2020

Table of Contents

I. Executive summary

EY was retained by Enbridge Gas Inc. (Company or EGI) to assist management in its determination of the Company's harmonized capitalization methodology, subsequent to a January 2019 amalgamation of Enbridge Gas Distribution (Enbridge Gas or EGD) and Union Gas Limited (Union Gas or UGL).

EY obtained an understanding of the current practices and methodology at the legacy entities, EGD and UGL. As part of our assistance to management in documenting a comprehensive overhead capitalization methodology for EGI, EY then utilized a combined approach of relying on accounting guidance, cost causation linkage, discussions with EGI personnel, and understanding industry best practices. Through these procedures, EY developed a better understanding of the nature of costs incurred, the causation of these costs as they relate to capital activity, and the criteria by which capital allocations are determined.

Based on our interviews with staff, EY observed that the updated methodology for EGI incorporates various cost drivers that management has determined to best represent capital activity. EY documented management's rationale in determining the cost drivers, basis for allocations, and causality to capital projects. Further, as a result of the amalgamation and change in organizational structure, the Company determined that a harmonization of the indirect overhead methodology was required to reflect the operations and structure of the amalgamated Company.

II. Background and purpose

As of 1 January, 2019, Enbridge amalgamated Union Gas and Enbridge Gas to form EGI. As rate-regulated entities, EGD and UGL filed a joint application to the Ontario Energy Board (OEB) for approval to amalgamate the entities to form one entity — EGI. As part of the application, the submission detailed that there would be an alignment of accounting policies to combine the two entities for purposes of financial reporting in accordance with US GAAP.

Prior to the amalgamation, EGD and UGL capitalized indirect overhead using their respective legacy methodologies that, as asserted by management, conformed with US GAAP and that were also previously (and separately) approved by the OEB. After the amalgamation, EGI pursued a harmonized capitalization methodology due to the need for more a streamlined and efficient approach to capitalize overhead and incorporating industry best practices that have developed since the time of legacy approaches. Further, the new methodology is inspired by the need for unified accounting policies and meeting the regulatory requirement of ensuring that capitalization rates actually reflect the capital work within the newly amalgamated entity.

As part of our engagement, EY assisted management in the documentation of a harmonized policy, provided accounting and financial reporting assistance in connection with EGI's review of overhead capitalization rates and provided observations to management as a result of our procedures performed.

This report has been prepared for Enbridge Gas Inc.

III. Methodology and rates

Application of indirect overhead

Overhead costs that can be linked to the creation of capital are expenses that support the production or construction of an asset, but cannot be directly associated with any particular asset or working group. In general, the types of overhead costs that the Company has historically capitalized are as follows:

Specific capital support: This category encompasses processes for evaluating, designing and implementing specific capital projects. This would been seen in a situation where a project has been approved but the costs for this activity are not charged directly to capital as a specific project cannot be identified. A practical example at EGI is when a manager or director is involved in supporting multiple projects and cannot track time to specific projects due to the volume of projects.

Support and oversight of activities: This category encompasses processes for the supervision and administration of those activities that are charged directly to capital projects. Functions that support, supervise and monitor these direct capital project activities will have an appropriate portion of their costs allocated to indirect capital overhead.

Support functions: A function can be defined as a group of employees that collectively perform a particular function or role. This category includes the support functions that enable the various departments that perform the capital function to do their work. These support functions include: budgeting/reporting, building maintenance, IT help desk, human resources, legal, regulatory, strategic development, procurement, plant accounting and accounts payable.

The basic premise behind the allocation of overhead costs is that it is linked to the root cause of the capital activity, reflects the actual capital activity and is indicative of the operations of the business. The Company intends to apply a model that will ensure the consideration of two key areas:

- Consideration of geographical regions
- Causality of the overhead cost with respect to capital activity

In the proposed harmonized framework, the Company intends to implement three different cost drivers based on the nature and function of the business unit to ensure that costs are being capitalized based on the most relevant driver.

Capital spend (geographical considerations) for operations costs:
Through the amalgamation, EGI will service a larger geographical area than the previous legacy companies. As such, management has determined that the level of capital activity within geographical regions may differ, and therefore the capitalization rate of business groups that directly support these regional groups (and are not centralized) should reflect the respective region. For example, capital activity will likely be greater in a region experiencing higher development growth. On the contrary, Operations & Maintenance ("O&M") activity may be greater in a region where housing developments have already peaked. As a result, the overhead costs relating to operations groups will be capitalized using a ratio of direct internal capital expenses to the total of all non-overhead costs for each region. As determined by the Company, there are seven regions: Toronto, GTA East, GTA West/Niagara, Eastern, Northern, Southwest and Southeast.

The formula for the calculation of the indirect overhead capitalization rate below. Using this formula, EGI will be able to update the operations costs capitalization rates for indirect overhead on an annual basis in order to ensure that the capitalization rate closely reflects the capital activity of the Company.

[Direct Labour + Direct Materials] / [Total Direct Capital Costs + Total Direct O&M Costs – Outside Services and Contractor Costs]

Direct labour and direct materials comprise of internal costs, and do not include outside services and contractor costs as a part of this calculation. Once the unique rate is calculated for each region, it will be applied to the total pool of O&M costs for each respective region to determine the indirect overhead allocation.

Time analysis for business costs:
Certain areas of the Company support the operations of the business, but are not necessarily directly involved in capital projects. For these groups to better understand and accurately depict their capital involvement, time analysis has been determined to be the best indicator of capital activity. Time analysis is an estimate that is developed by the managers of each individual department through the completion of templates, which incorporate the allocation of each individual employees' time within that department between the various activities and responsibilities of the respective group. Based on the appropriate accounting guidance as defined in ASC 360-10, and enterprise capitalization policies, these activities are grouped between Capital and O&M, as appropriate. A weighted average of Capital to O&M time is calculated between all employees in that manager group. This average is then applied to all costs incurred within a specified director group based on the completed templates and capitalized at that respective rate.

In some situations, where labour hours data was not available or reflective of the group's activities, the capitalization rate was determined by the company through calculating the proportion of indirect capital spend compared to the gross costs of the group.

Using the time analysis templates, EGI will be able to update the business costs capitalization rates for indirect overhead on an annual basis in order to ensure that the capitalization rate closely reflects the capital activity of the Company.

Shared services costs:
Certain areas of the Company that support all activities of the business will be grouped as part of a shared services pool. Costs from these groups will not be capitalized using the time analysis or capital spend approach. Due to the nature of these groups, expenses are tracked at an aggregate level, but support the capital operations of the business. For example, HR would play an integral role in the developing of job postings, determining roles and responsibilities and ultimately hiring individuals whose function would be to complete capital projects. As a result, a single capitalization rate has been computed for this pool taking into the account the average capital activity of the areas of the business that are supported by the shared services group.

Using the weighted average methodology, EGI will be able to update the shared service costs capitalization rates for indirect overhead on an annual basis in order to ensure that the capitalization rate closely reflects the capital activity of the Company.

Human Resources (Direct and Indirect Loadings):
Under EGI's capitalization methodology, HR pension and benefits associated to employees charging time directly to capital projects (i.e. HR pension and benefits related to direct labour costs), will be capitalized directly to projects. This is referred to as direct loadings.

HR pension and benefits associated with employees not charging time directly to capital projects (i.e. HR pension and benefits related indirect labour costs), is referred to as indirect loadings. For indirect labour costs that are capitalized, a rate will be applied to the salaries and wages capitalized to allocate the appropriate amount of HR pension and benefit costs to capital.

The remaining costs of the HR group (i.e. non-pension and benefits costs), which cannot be allocated based on either the direct loadings or indirect loadings methodology will be allocated through the shared services allocation method discussed above.

Corporate Allocations:
Corporate allocations are comprised of charges that reflect EGI's net share of the costs incurred by other subsidiaries or corporate to support EGI. These costs are composed primarily of two categories: shared services and human resources.

The first category of cost allocations are similar in nature to shared services costs. They are centralized functions carried out by another lines of businesses or Enbridge Inc. that support EGI. As a result, when these centralized functions costs are allocated down to EGI, they are capitalized at EGI using the shared services rate discussed above. This is because the costs allocated to EGI were incurred to support the overall EGI business, and are no different in principle from a shared service cost incurred at EGI.

The second category of cost allocations are related to the HR function (i.e. pension and benefits and HR department costs) that support EGI. These HR cost allocations are capitalized at EGI using a weighted average HR rate reflects the nature of costs being allocated down to EGI. The HR rate is comprised of pension and benefits (i.e. direct loadings and indirect loadings) and HR department costs (i.e. capitalization of HR department costs via shared services method).

IV. Final summary of costs and rates

Presented below is a summary of EGI's 2020 indirect overhead capitalization based on the harmonized capitalization methodology being adopted. All amounts are based on 2020 budgeted figures.

Cost Category	Amount
Operations	$93,465,509
Business Costs	$47,439,612
Human Resources	$61,386,770
Shared Services	$21,656,247
CAM Costs	$29,352,208
Total	$253,300,346

For a summary of capitalization rates calculated under the harmonized capitalization methodology, please see Appendix II.

V. Procedures taken by EY in providing management assistance

As part of EY's assistance to management in determining the new overhead capitalization methodology, several steps were taken to document the overhead rates used for various functions:

1. Obtained an understanding of the overhead capitalization practices at the legacy companies;

2. Documented all cost centres and calculated the overhead percentage for each one based on raw data provided by the Company. EY further segmented the cost centres into the various departments within the organization;

3. Interviewed with key personnel for the selected sample functions: EY interviewed several managers and directors from various functions who were responsible for completing the capitalization template for their respective group. Through this interview process, EY obtained the following information:

    a. The role and responsibility of each individual within the department/function. This included examples of day-to-day responsibilities as well as ad-hoc tasks that would be expected from each individual within the functional unit. Please refer to the discussion below on cost drivers;
    b. An understanding of the basis used to determine the amount of time each individual spends on capital-related tasks and document the linkage to causality. Please refer to the discussion below on cost causation linkage.
    c. Any additional costs that are incurred within the department outside of labour-related costs and whether those costs should or should not be capitalized on the same basis as labour;
    d. An understanding of the project life cycle, including when a project is considered to be a capital activity in relation to the life cycle; and
    e. An understanding of any considerations made by management with regards to the hierarchy of individuals within a department when evaluating the amount of time they spend relating to capital projects. Please refer to the discussion below on cost causation linkage;

4. Assisted management by providing alternative and best practices within industry;

5. Worked collaboratively with the Company to assist in documenting an updated framework for indirect overhead capitalization for the amalgamated Company;

6. Documented US GAAP and other technical guidance as issued by the OEB;

7. Detailed observation of all significant director groups to understand the cost drivers in legacy environment in order to work with management to determine cost drivers for future state capitalization methodology;

8. Understood the policies and procedures relating to the capitalization of indirect overhead at Enbridge Inc. These policies can be found in Appendix I;

9. Obtained an understanding of the cost causation linkage. Further documentation has been included below; and

10. Examined Capital vs O&M considerations: EY worked with management to categorize activities into capital and O&M. EY relied on the following OEB and US GAAP guidance below and the EGI Capitalization Policy (See Appendix I).

VI. Accounting guidance

Whilst this list is not comprehensive in nature, as part of our study, the following guidance was considered:

"Ontario Energy Board: Uniform system of accounts for Class A gas utilities – Appendix A"

"Overhead Charged to Construction: includes engineering, supervision, administrative salaries and expenses, construction engineering and supervision, legal expenses, taxes and other similar items. The assignment of overhead costs to particular jobs or units shall be on the basis of a reasonable allocation of actual costs. The records supporting the entries for overhead charged to construction costs shall be maintained so as to show the total amount for each element of overhead for the year and the basis of allocation."

US GAAP

ASC 360–10: *"Property, plant and equipment should be recorded at historical cost, which includes the costs incurred for activities to bring them to the condition and location necessary for their intended use. Interest costs incurred during the period the assets are brought to that condition and location are also included in the historical cost of acquiring the asset, if material."*

ASC 980-340: *"25-1 Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:*

a. It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost.

A cost that does not meet these asset recognition criteria at the date the cost is incurred shall be recognized as a regulatory asset when it does meet those criteria at a later date."

Based on the accounting guidance above, the OEB allows for the capitalization of overhead. Further, US GAAP calls for the capitalization of all costs *incurred for activities to bring assets to the condition and location necessary for their intended use*. The guidance as per the regulatory standard (ASC 980) further allows for any costs to be included as long as future recovery through rate base is probable.

VII. Cost causality

Cost causality is the relationship between the cost incurred and capital activity. For clarity, it would be expected that a cost driver used by management would be the most appropriate to determine the linkage with capital activity.

As part of assisting management in documenting an updated cost capitalization framework, EY observed the various mechanisms management intends to use to capitalize indirect overhead. EY conducted several interviews with various areas of the business to better understand cost causality.

Capital spend (geographical regions) – As noted earlier, the seven operational regions within EGI will capitalize overhead based on a direct capital spend ratio. This ratio has been determined by management to be the best indicator of cost causality for the indirect overhead costs relating to operations, as it represents the actual allocation of labour and materials resources by the Company to capital versus O&M projects. As a result, management asserts that the operations support groups who indirectly support the direct projects allocate their resources based on the same breakdown of capital versus O&M. Through discussion with management and observations based on our understanding of the business and other industry participants, this approach is a consistent way to allocate overhead costs for support services closely linked to active projects.

Time analysis (labour) – Several director groups across the Company will be capitalizing overhead based on a time analysis completed by their respective manager groups. These groups will use a labour cost driver (otherwise referred to as a time analysis) as the basis of determining the percentage of time an individual spends on capital activity. Management has determined that labour hours are the most appropriate cost driver in these situations as the time spent on performing capital work would be most reflective of the amount of effort involved in relation to capital activity. Through our understanding of best practices and interviews held with divisional managers, EY observed that the templates completed by the respective groups are segmented by the nature of the activity performed, which can then further be aligned to capital and O&M activities. EY observed that the hierarchy of an individual has been incorporated in the assessment of the individual departments and functional units. Therefore, an individual who is of a more senior rank would have a lower capitalization rate than an individual who is closer to the capital activity.

Shared service rates – Shared services are administrative groups within the Company (or at an EI level) that inherently support all capital and O&M projects in various ways. The determination of an overhead rate for these groups is determined based on the capital activity associated with the seven operational regions of the Company as well as indirect overhead for business costs allocated at the director level, supported by the shared services groups. As a result, based on a review of industry best practices and the fact that shared services support the Company as a whole, management asserts that a weighted average rate for administrative groups is the most appropriate method.

Burdening (HR Benefits) – One of the most evident forms of cost causality can be noted within human resources benefits. When an employee spends an hour working on a capital project, then that portion of that employee's pension and benefits costs are incurred as a result of that capital project. At EGI, this is the case as overhead costs incurred via the cost of employee benefits are caused by the fact that the employees, whether direct or indirect labour, are working to support various projects within EGI. Therefore, management has determined that a loadings rate will be used in order to charge the capital of HR benefits to capital projects that the employees are working on.

VIII. Industry best practices

As part of the overhead capitalization study, EY reviewed best practices through our understanding and discussions with peers in the industry. Several areas of importance were identified and have been listed below:

Direct to capital – One of the primary areas of focus involves the importance of tracking actual costs to projects. Rather than applying an estimated overhead rate, being able to directly charge to a capital project eliminates the estimation and provides the most accurate and reliable information. As companies continue to find ways to increase direct costing, this continues to be a leading practice. Management's proposed framework has introduced loadings for all employees who are currently charging direct to capital, and also indirect loadings in order to burden the costs of employees who are indirectly supporting capital projects.

Project life cycle considerations – The life cycle of a project generally dictates when costs can be capitalized to a project. Due to the fact that this can be somewhat ambiguous, it is generally best practice to start capitalization once management approval is granted for a project, after the completion of surveys/studies required to determine project viability. Through our discussions and observations, this is a benchmark followed by EGI in its capitalization policies and methodologies.

Regional and geographical considerations – Due to the amalgamation, EGI now operates over a much larger geographical area than the legacy companies. Through our observation and understanding, other industry participants have factored in the geographical area of certain functions within their business. For the purposes of clarity, if a function operates in multiple geographical areas, the overhead rate for each geographic area (albeit for the same function) may be different based in the nature of the capital activity in that function. Similarly, the proposed EGI model will incorporate geographical and regional considerations for certain operations groups in the determination of their overhead rate.

Documenting capital activity – In order to support the indirect capitalization rates, specifically in areas where the cost driver has been determined to be labour, industry participants document and annually review the calculation of such rates. Through EGI's proposed model, the Company will join these industry participants by annually providing a template to the different business functions to link the labour-based capitalization rates to reflect the capital activity within those functions.

Allocation of indirect overhead based on capital dollars spend – An area of alternate practice amongst other companies is the determination of the cost driver. In certain instances, the capital spend of a group would better reflect the capital activity within the group rather than labour hours or another alternative measure. Through our understanding and discussions with management, EY has observed that the capital activity of departments within the operational groups is allocated based on their capital spend ratio.

When determining the overhead rate for regional operational groups, EGI allocates using the

capital spend ratio. However, when determining director-level rates for business costs, EGI allocates indirect overhead based on a time analysis completed by employees, as in management's view this allows for a more accurate rate.

Annual or bi-annual road shows – There is a growing trend in the industry to have road shows run by internal leadership to focus on key finance issues. Given the amalgamation and proposed changes in the capitalization framework, management may find it useful to communicate capitalization rate and method updated throughout the business using this approach.

IX. Findings and observations

The harmonized capitalization methodology that will be used by EGI includes an assessment of cost driver analysis and basis for allocation via management's completion of the templates, and the related causality to capital projects. Based on our observations, the application of this harmonized model considers the applicable accounting framework and the enterprise wide capitalization policy. In addition, interviews conducted with managers and staff provide management with an understanding of capital activity, to allow for an allocation based on an expected time analysis.

Appendix I – EGI Capitalization policy

EGI Enterprise Wide Capitalization Policy.p

Appendix II – Summary of EGI Capitalization Rates

Director Group	Sub-category	Actuals Cap Rate
Marketing & Energy Conservation	N/A	0.0%
Customer Care Development	N/A	0.0%
Customer Care Operations	N/A	0.0%
Large Volume Contracting & Policy	N/A	0.0%
VP Admin Customer Care	N/A	0.0%
Energy Services - Director	N/A	0.0%
Gas Control & Management	N/A	0.0%
Gas Supply.	N/A	0.0%
S&T Joint Ventures	N/A	0.0%
VP Admin-Energy Services	N/A	0.0%
VP Admin Operations	VP Admin Operations - Synergy	0.0%
Business Development & Regulatory (excluding Market Development & Energy Conservation)	Business Development	0.0%
Business Development & Regulatory (excluding Market Development & Energy Conservation)	Regulatory Affairs	19.8%
Business Development & Regulatory (excluding Market Development & Energy Conservation)	Public Affairs & Ombudsmen	4.8%
Business Development & Regulatory (excluding Market Development & Energy Conservation)	VP Admin Bus Development	9.7%
Major Projects	N/A	100.0%
Distribution in Franchise Sales	N/A	8.3%
S&T Business Development	N/A	6.3%
Asset Management Director	N/A	57.0%
Engineering	N/A	50.8%
Integrity & IMS	Integrity	21.0%
Integrity & IMS	Integrity - Inline Inspection	0.0%
System Improvement	N/A	53.5%

Director Group	Sub-category	Actuals Cap Rate
VP Admin Engineering & Asset Management	N/A	53.1%
IMO	N/A	27.5%
Storage Operations.	Storage Operations	4.5%
Storage Operations.	Storage Operations - Excluded	0.0%
Trans & Compression - Engineering & Execution	Trans & Compression Engineering & Execution - Included	25.3%
Trans & Compression - Engineering & Execution	Trans & Compression Engineering & Execution - Excluded	0.0%
Trans & Compression Operations	N/A	4.5%
VP Admin – STO & IM	N/A	9.9%
Warehouse - SCM	N/A	100.0%
Human Resources	Pension and benefits	N/A
Human Resources	Non-Pension and benefits	19.5%
Human Resources	LUG Direct Loadings	N/A
Eastern Region Operations	Eastern Region Ops.	66.0%
Eastern Region Operations	Eastern Region Ops. - Direct O&M	0.0%
GTA East Operations	GTA East Ops.	54.7%
GTA East Operations	GTA East Ops. - Direct O&M	0.0%
GTA West/Niagara Operations	GTA West/Niagara Ops	60.4%

Director Group	Sub-category	Actuals Cap Rate
GTA West/Niagara Operations	GTA West/Niagara Ops - Direct O&M	0.0%
Northern Region Operations	Northern Region Ops	44.4%
Northern Region Operations	Northern Region Ops - Direct O&M	0.0%
Operations Support	Operations Support	49.5%
Operations Support	Operations Support - Customer Attachments	100.0%
Operations Support	Operations Support - Distribution Protection - Locates & Leak Survey	0.0%
Southeast Region Operations	Southeast Region Ops	45.2%
Southeast Region Operations	Southeast Region Ops - Direct O&M	0.0%
Southwest Region Operations	Southwest Region Ops	40.4%
Southwest Region Operations	Southwest Region Ops - Direct O&M	0.0%
Toronto Region Operations	Toronto Region Ops	70.0%
Toronto Region Operations	Toronto Region Ops - Direct O&M	0.0%
VP Admin Ops	VP Admin Ops	44.1%
EHS	N/A	19.5%
Accounting	N/A	19.5%
Business Partners	N/A	19.5%
Finance Admin	N/A	19.5%
FP&A	N/A	19.5%

Director Group	Sub-category	Actuals Cap Rate
Utility Finance Alignment	N/A	19.5%
Facilities & Workplace Services	N/A	19.5%
Supply Chain Other	N/A	19.5%

Below is a listing of Cost Centres that do not have a Director Group affiliated to them. As a result, rates are presented by Cost Centre as opposed to Director Group. These cost centres belong to shared services and O&M groups.

Cost Centre	Actuals Cap Rate
CC25263-COST TO ACHIEVE (GL)	0.0%
CC10899-Auditfees	19.5%
CC25206-AUDIT SERVICES	19.5%
CC25257-LANDS (PROJECT ACCOUNTING)	19.5%
CC25000-EXECUTIVE	19.5%
CC25228-IT GD GRAPHIC COMMUNICATION SERVICES	19.5%
CC25233-IT ISS END USER SERVICE	19.5%
CC25234-IT ISS CORE INFRASTRUCTURE	19.5%
CC25280-IT GD ADMINISTRATION	19.5%
CC25281-IT GD Data & Support Services	19.5%
CC25282-IT ES EFS	19.5%
CC25284-IT ISS Network Services	19.5%
CC25286-IT GD TECHNOLOGY PLANNING	19.5%
CC25287-IT GD BA & OAM	19.5%
CC25291-IT GD BA Capital	19.5%
CC25293-IT GD Productivity Services	19.5%
CC10990	19.5%
CC25002-LAW DEPARTMENT	19.5%
CC25005	19.5%
CC25007-CORPORATE SECRETARY	19.5%
CC25009-ETHICS & COMPLIANCE	19.5%
CC25205-RISK MANAGEMENT	19.5%
CC25207-TAX	19.5%
CC25246 - PAC EXTERNAL AFFAIRS CAN	19.5%
CCUN_21150-Energy Services - IMO CTA	0.0%
CCUN_21151-Operations -IMO CTA	0.0%
CCUN_21152-Engineering & Asset Management - IMO CTA	0.0%
CCUN_21153-Customer Care - IMO CTA	0.0%
CCUN_21154-Business Development & Regulatory -IMP CTA	0.0%
CCUN_21155-Storage Transmission & IMO - IMO CTA	0.0%
CCUN_20798-O&M Affiliate Revenue : Corporate	19.5%
CCUN_22738-CTL:OM	19.5%

Cost Centre	Actuals Cap Rate
CCUN_22758-CTL:OH	19.5%
CCUN_22789-AUDIT:OM	19.5%
CCUN_22106-DEGT - Env Health & Safety - OM	19.5%
CCUN_22124-Environment	19.5%
CCUN_22196-DEGT - Env Health & Safety S&R - OM	19.5%
CCUN_20398-FI:Credit OM	19.5%
CCUN_20399-FI:Credit OH	19.5%
CCUN_20410-Senior Mgmt - President	19.5%
CCUN_20480-Senior Mgmt - Overhead Capitalized	19.5%
CCUN_22150-IT Enterprise Projects OH	19.5%
CCUN_22701-IT:OM	19.5%
CCUN_22739-IT:OH	19.5%
CCUN_22763-DCAN:IM:OM	19.5%
CCUN_22765-IM:OH	19.5%
CCUN_22776-ITI:OM	19.5%
CCUN_22777-ITI:OH	19.5%
CCUN_22791-IT Enterprise Projects O&M	19.5%
CCUN_22792-SE:ITI:OM	19.5%
CCUN_22793-SE:ITI:OH	19.5%
CCUN_22811-Gas Supply - Tech Support	19.5%
CCUN_22821-Gas Supply - Tech Support	19.5%
CCUN_23776-ITI Client Services OM	19.5%
CCUN_23777-ITI Client Services OH	19.5%
CCUN_24776-ITI Core Infrastructure OM	19.5%
CCUN_24777-ITI Core Infrastructure OH	19.5%
CCUN_22512-Insurance Services - OM	19.5%
CCUN_22513-Insurance Services - OH	19.5%
CCUN_22510-Legal Services - OM	19.5%
CCUN_22511-Legal Services - OH	19.5%
CCUN_20684-AP - Capitalization	19.5%
CCUN_22324-A/P - Administration - Admin	19.5%
CCUN_20303-FBS - Taxation - Admin	19.5%
CCUN_20713-Government & Indigenous Affairs - OH	19.5%
CCUN_22938-MCC VP,SS O&M cost centre	19.5%
CCUN_22948-Government Relations	19.5%
CCUN_22951-Government Affairs	19.5%

ENBRIDGE GAS INC.

Answer to Interrogatory from
Energy Probe Research Foundation (EP)

Interrogatory

Reference:

Exhibit 2, Tab 4, Schedule 2, Table 3, Page 17 and Paragraph 41, Page 18

Question(s):

Please provide more detail behind the quantities shown for Shared Services Costs in Line 3 of Table 3 by showing the amounts for each of the departments or groups included in Shared Services Costs including the number of FTE's whose costs are included in each of these departments or groups.

Response:

Please see Table 1 for the shared services cost breakdown. The number of FTEs whose costs are included in each of these departments is not available, CF Costs are allocated amounts to Enbridge Gas as part of the Central Functions Cost Allocation Methodology. FTE details are not available for these allocations.

Table 1
2024 Shared Services Overhead Capitalization Costs

Line No.	Particulars ($ millions)	Historical Method Capitalized Amount	Historical Method Capitalization Rate	EGI Harmonized Method Capitalized Amount	EGI Harmonized Method Capitalization Rate	Variance Capitalized Amount
		(a)	(b)	(c)	(d)	(e) = (c - a)
1	Aviation	0.0	20.5%	0.0	23.4%	0.0
2	Corporate Development Office	0.5	20.5%	0.6	23.4%	0.1
3	EAWM	0.4	20.5%	0.4	23.4%	0.1
4	Executive & Other	0.2	20.5%	0.3	23.4%	0.0
5	Finance	7.5	20.5%	8.6	23.4%	1.0
6	REWS	5.9	20.5%	6.7	23.4%	0.8
7	Human Resources	5.3	20.5%	6.0	23.4%	0.7
8	Information Technology	28.7	20.5%	32.6	23.4%	4.0
9	Legal	3.1	20.5%	3.6	23.4%	0.4
10	Public Affairs and Communication	1.4	20.5%	1.5	23.4%	0.2
11	Safety and Reliability	1.5	20.5%	1.8	23.4%	0.2
12	Supply Chain Management	2.5	20.5%	2.9	23.4%	0.3
13	Depreciation	5.2	20.5%	6.0	23.4%	0.7
14	Insurance	1.5	20.5%	1.7	23.4%	0.2
15	Total Gross EGI CF excluding Benefits	63.8		72.7		8.8
16	*Capitalization Rate*	*20.5%*		*23.4%*		

ENBRIDGE GAS INC.

Answer to Interrogatory from
Energy Probe Research Foundation (EP)

Interrogatory

Reference:

Exhibit 2, Tab 4, Schedule 2, Attachment 1, E&Y Report, page 4

Question(s):

Please confirm that E&Y was not engaged by Enbridge Gas to present independent Expert Evidence as specified by Rule 13A of the OEB Rules of Practice and Procedure. Please explain you answer.

Response:

Confirmed. Enbridge Gas describes EY's engagement at Exhibit 2, Tab 4, Schedule 2, paragraph 18.

ENBRIDGE GAS INC.

Answer to Interrogatory from
School Energy Coalition (SEC)

Interrogatory

Reference:

2-4-2, p.17

Question(s):

With respect to capitalized overheads:

a) Please provide a table (or tables) that show, using a similar breakdown as provided in Table 3 (i.e. operations, business unit, shared services, pension and benefits costs), for each year between 2013 and 2024. both capitalized amounts and capitalization rates, for each utility (Union, EGD, EGI).

b) Please provide a table that shows for each year, between 2013 and 2024, by category of capitalized overheads (operations, business unit, shared services, pension and benefits costs), the amounts charged to OM&A, for each utility (Union, EGD, EGI).

c) For each category of capitalized overheads (operations, business unit, shared services, pension and benefits costs), please provide the amount of costs approved (or included in rates) in each of Union and EGD's 2013 rebasing application, broken down into amounts capitalized and amounts charged to OM&A. Please provide a citation for the source of the information (i.e. application, rate order, etc).

Response:

a) The harmonized overhead capitalization methodology requires the amalgamated O&M structure to group costs into the appropriate cost categories. Furthermore, the Business Cost category requires an activity analysis that is performed each year based on the O&M and capital work expected for the year. As such, this harmonized approach cannot be applied to years prior to 2020 when it was implemented.

Please see response at Exhibit I.2.4-STAFF-55 for Exhibit 2, Tab 4, Schedule 2, Table 3 for 2020 to 2024.

b) For years prior to 2020, please see response at part a). Please see Table 1 for 2020 to 2024 amounts charged to OM&A for Enbridge Gas.

Table 1

EGI O&MA Costs Breakdown by Category

Line No.	Particulars ($ millions)	2020 Actual	2021 Actual	2022 Actual	2023 Bridge	2024 Test Year
1	Operations Costs	184.9	177.6	207.7	215.3	219.9
2	Business Unit Costs	351.3	368.3	399.9	455.2	475.5
3	Shared Services Costs	167.3	181.1	200.0	218.1	238.3
4	Pension & Benefit Costs	120.8	143.7	164.2	113.5	112.1
5	**Total**	**824.3**	**870.7**	**971.7**	**1,002.2**	**1,045.8**

c) Please see response at part a).

ENBRIDGE GAS INC.

Answer to Interrogatory from
Ontario Energy Board Staff (STAFF)

Interrogatory

Reference:

Ref 1: Exhibit 2, Tab 4, Schedule 1, pp.3-6
Ref 2: Exhibit 9, Tab 2, Schedule 1, pp.7-8

Question(s):

It states that after the amalgamation, Enbridge Gas identified differences in the historical capitalization treatment for certain costs between EGD and Union Gas due to how EGD and Union Gas applied USGAAP to specific costs. USGAAP Accounting Standard Codification (ASC) 360 – Property, Plant, and Equipment requires these costs to be expensed as incurred, while ASC 980 – Regulated Operations allows the programs and costs to be capitalized if approved by a regulator. The costs Enbridge Gas identified with different capitalization treatments were capitalized by EGD in accordance with ASC 980 and expensed as incurred by Union Gas in accordance with ASC 360.

a) Please explain whether there were costs Union Gas capitalized in accordance with ASC 980, but would have been expensed in accordance with ASC 360 if ASC 980 were not applied.

    i. If yes, please identify and explain the types of these costs, and quantify the annual revenue requirement impact for each type of cost from January 1, 2019, to December 31, 2023.

b) Please also explain whether there were costs EGD capitalized in accordance with ASC 980, but would have been expensed in accordance with ASC 360 if ASC 980 were not applied, beyond those already identified in the Accounting Policy Changes Deferral Account resulting from harmonization.

    i. If yes, please identify and explain the types of these costs, and quantify the annual revenue requirement impact for each type of cost from January 1, 2019, to December 31, 2023.

c) Please explain whether Enbridge Gas has proposed to capitalize any costs that would be expensed in accordance with ASC 360 if ASC 980 is not applied.

i. If yes, please identify and explain the types of these costs, and quantify the annual revenue requirement for each type of cost from 2024 to 2028.

Response:

a-b) Prior to amalgamation both EGD and Union Gas did capitalize some costs in accordance with ASC 980, based on regulatory approval. These costs would have been expensed in accordance with ASC 360, had ASC 980 not applied. The remaining undepreciated balances for these assets are included in the opening 2024 rate base.

Since amalgamation in 2019, other than the capitalization of indirect overheads, noted below, Enbridge Gas has not capitalized costs in accordance with ASC 980, that would have otherwise been expensed in accordance with ASC 360.

Indirect overheads are not capitalized under US GAAP. Both EGD and Union Gas had OEB approved overhead capitalization policies that supported capitalization under ASC 980. Enbridge Gas has proposed a combined methodology for 2024 that continues this treatment.

It should be noted that there is a portion of Enbridge Gas's overheads that are direct in nature but are being capitalized as indirect because Enbridge Gas's current processes are not designed for these costs to be directly capitalized to specific capital projects. These direct in nature costs can be capitalized under US GAAP by applying the guidance in ASC 360.

Enbridge Gas is unable to isolate and quantify the revenue requirement for this subset of costs due to the lack of visibility within the current system that pools all direct and indirect overhead costs and does not segregate this detail at a capitalization level.

c) Other than the capitalization of overheads, as noted in part a-b), Enbridge Gas has not proposed to capitalize any further costs that would be expensed in accordance with ASC 360 if ASC 980 is not applied.

ENBRIDGE GAS INC.

Answer to Interrogatory from
Ontario Energy Board Staff (STAFF)

Interrogatory

Reference:

Exhibit 2, Tab 4, Schedule 2, pp.13-14, 21

Question(s):

Enbridge Gas noted that the inputs to the harmonized methodology are updated annually to ensure that the overhead capitalization rates closely reflect the underlying capital activity.

Furthermore, Enbridge Gas intends to eliminate the use of regulatory overhead asset accounts for Union Gas and adopt the EGD approach of presenting capitalized overheads within PPE asset classes.

a) Please explain if Enbridge Gas performs any year-end review or analysis to determine if the capitalized overhead amounts are appropriate. If yes, please describe the review or analysis, and the results of the most recent review or analysis.

b) It states that overhead capitalization rates for 2024 is based on 2021 actuals and is identical to those used for the 2023 budget. Please explain whether Enbridge Gas considered using an average of prior year actuals instead of only using 2021 actuals, and explain Enbridge Gas's rationale for only using 2021 actuals.

    i. Please quantify the capitalized amount if capitalization amounts were based on an average of 2020, 2021 and 2022 actual rates and compare this capitalized amount with the proposed one.

c) With regards to eliminating the use of regulatory overhead asset accounts, please explain whether Enbridge Gas will still be able to quantify the total amount of overhead capitalized if required.

    i. If no, please explain why Enbridge Gas does not feel that this information is necessary.

Response:

a) Overhead capitalization rates are determined for the upcoming year during the budget process. This process replaces the overly administrative, time-consuming, and costly process of time sheeting for support departments. For certain components of the harmonized methodology, such as the Business Costs category activity analysis, the inputs from the prior year are reviewed as an initial step in determining the overhead capitalization rates for the new year. Capitalized overhead is trued up based on actual O&M costs each month. Monthly variance analysis is performed to confirm variances compared to budget.

b) Within Enbridge Gas's capitalization model for the 2023 budget, only regional operations capitalization rates are based on 2021 actuals. Business unit capitalization rates are based on future estimates of activity performed. The rationale for using one-year actuals instead of a three-year average is that since amalgamation the regional operations groups have undergone multiple organizational changes therefore the historical information dated three to four years back will not be comparable to the current organization structure. Also, at the time the 2023 and 2024 budget was developed, 2022 actuals were not available and 2021 actuals were the most recent and relevant data available. Enbridge Gas will continue to monitor the overhead capitalization process and will update if needed to reflect the most accurate rates.

   i. Since the regional operations capitalization rates were the only rates based on 2021 actuals, the 2024 overhead capitalization for this group was recalculated using the actual capitalization rates from 2020, 2021 and 2022. The recalculated regional operations capitalization using the three-year average is $114.5 million. This is $3.7 million lower than the current calculated 2024 overhead capitalization amount of $118.2 million. This variance is mainly due to increased direct capital spend relative to direct O&M spend in Operations in 2021 compared to 2020 as result of increased customer connections work.

c) Enbridge Gas will be able to quantify the total amount of capitalized overhead as the amounts will be gathered into a single overhead capital project prior to being allocated and unitized to plant accounts as provided at Exhibit 2, Tab 4, Schedule 2, pages 19 to 21.

ENBRIDGE GAS INC.

Answer to Interrogatory from
Ontario Energy Board Staff (STAFF)

Interrogatory

Reference:

Ref 1: Exhibit 2, Tab 4, Schedule 2, pp.15-19
Ref 2: EB-2018-0305, Exhibit JT 1.7, May 8, 2019

Question(s):

Table 2 in Reference 1 shows how cost categories from the prior EGD and Union Gas methodologies align with the harmonized cost categories. Table 3 in the noted reference provides the capitalized amount and capitalization rate under the historical method and harmonized method for 2024. Table 4 provides the O&M/capital expenditure amounts using the historical and harmonized overhead capitalization methodologies for 2020 to 2023.

a) Please indicate whether there are cost categories that were not included in EGD and Union Gas's capitalization of indirect overheads but are proposed to be included in the harmonized capitalization policy.

   i. If yes, please list the cost categories, quantify the costs capitalized and explain why these costs are included for capitalization.

b) Please indicate whether there were cost categories included in EGD and Union Gas's capitalization of indirect overhead that are proposed to be excluded in the harmonized capitalization policy.

   ii. If yes, please list the cost categories, quantify the costs no longer capitalized and explain why these costs should not be included for capitalization.

c) Please provide Table 3 annually for 2020 to 2024, with the historical capitalized amount and capitalization rate broken down for each of EGD and Union Gas. If there are material changes to the 2024 amounts presented in Table 3 as a result of finalizing the 2022 financial results, please provide updated 2024 amounts.

d) Table 3 shows the combined historical capitalization rate for EGD and Union Gas using the historical method. The total combined historical capitalization rate is 22.7%. In Reference 2, it states that EGD and Union Gas allocated indirect overheads on a percentage basis to all capital projects. Union Gas's allocation rate

for the noted ICMs was 14.8% and EGD's allocation rate for the noted ICM was 36.4%. Please reconcile these rates to the rates shown in Table 3 or the response to Part c) above.

Response:

a) Cost categories represent a grouping based on the inherent nature of the cost. This categorization allows for the application of cost drivers which are determined by the nature of the underlying causal activity that ultimately determines the degree of capitalization. Both the historical methodologies and the harmonized methodology account for all O&M costs in their respective cost categories.

   There are components of the harmonized cost categories that for one of EGD or Union were either 1) not capitalized under the historical methodologies but are now fully or partially capitalized or 2) fully or partially capitalized under the historical methodologies but are no longer capitalized. For EGD, pension, which historically was not capitalized, is now partially capitalized via the harmonized methodology's burden rate, consistent with the treatment of Union's pension burdening. Also, approximately 10% of EGD locate costs historically were capitalized and are no longer capitalized for consistency with Union's treatment of like costs. For Union, a portion of fleet depreciation related to capital work had historically been capitalized, however is longer capitalized for consistency with treatment at EGD.

b) Please see response to part a).

c) Please see Attachment 1 for Table 3 for 2020 to 2024, consistent with Exhibit 2 Tab 4 Schedule 2 paragraph 37. The calculation of capitalized overhead using prior methodologies was performed by applying the combined EGD and Union capitalization rates based on the proportion of capitalization for each department to the eligible costs. The tables in Attachment 1 are presented for the integrated utility only given that the legacy view is no longer tracked and therefore unavailable.

d) The rate in reference 1 (Exhibit 2, Tab 4, Schedule 2, Table 3, column b), is an aggregate rate calculated by taking overhead capitalization, based on EGD and Union's historical methodologies, as a proportion of 2024 gross utility O&M.

   The rates in reference 2 (EB-2018-0305, Exhibit JT1.7) represent the proportion of capitalized overheads that were allocated to ICM projects for 2019. In general, indirect overheads are allocated equally across all eligible regulated projects including both ICM and non-ICM projects .

   A direct correlation does not exist between these rates since the rate in reference 1 is a function of gross utility O&M whereas the rates in reference 2 are a function of

capital expenditures. Therefore, the rates serve distinct purposes and are unreconcilable to each other.

Table 1

Comparison of Overhead Capitalization Methodologies - 2020 Actual

Line No.	Particulars ($ millions)	Historical Method: Capitalized Amount	Historical Method: Capitalization Rate	EGI Harmonized Method: Capitalized Amount	EGI Harmonized Method: Capitalization Rate	Variance: Capitalized Amount
		(a)	*(b)*	*(c)*	*(d)*	*(c) - (a)*
1	Operations Costs	87.2	32.6%	83.0	31.0%	(4.2)
2	Business Units Costs	42.2	10.9%	36.5	9.4%	(5.7)
3	Shared Services Costs	47.4	21.7%	50.6	23.2%	3.2
4	Pension & Benefits Costs	41.9	23.9%	54.2	31.0%	12.3
5	**Total**	**218.7**	**20.9%**	**224.3**	**21.4%**	**5.7**

Table 2

Comparison of Overhead Capitalization Methodologies - 2021 Actual

Line No.	Particulars ($ millions)	Historical Method: Capitalized Amount	Historical Method: Capitalization Rate	EGI Harmonized Method: Capitalized Amount	EGI Harmonized Method: Capitalization Rate	Variance: Capitalized Amount
		(a)	*(b)*	*(c)*	*(d)*	*(c) - (a)*
1	Operations Costs	93.7	34.2%	96.1	35.1%	2.4
2	Business Units Costs	45.5	11.1%	39.9	9.8%	(5.6)
3	Shared Services Costs	46.4	20.8%	41.5	18.7%	(4.8)
4	Pension & Benefits Costs	42.5	21.2%	56.7	28.3%	14.2
5	**Total**	**228.0**	**20.6%**	**234.2**	**21.2%**	**6.2**

Table 3

Comparison of Overhead Capitalization Methodologies - 2022 Actual

Line No.	Particulars ($ millions)	Historical Method: Capitalized Amount	Historical Method: Capitalization Rate	EGI Harmonized Method: Capitalized Amount	EGI Harmonized Method: Capitalization Rate	Variance: Capitalized Amount
		(a)	*(b)*	*(c)*	*(d)*	*(c) - (a)*
1	Operations Costs	116.8	36.9%	108.8	34.4%	(7.9)
2	Business Units Costs	52.5	11.8%	43.5	9.8%	(9.0)
3	Shared Services Costs	57.7	22.2%	59.9	23.1%	2.3
4	Pension & Benefits Costs	50.6	22.8%	57.5	25.9%	6.9
5	**Total**	**277.5**	**22.4%**	**269.7**	**21.7%**	**(7.7)**

Table 4

Comparison of Overhead Capitalization Methodologies - 2023 Bridge Year

Line No.	Particulars ($ millions)	Historical Method: Capitalized Amount	Historical Method: Capitalization Rate	EGI Harmonized Method: Capitalized Amount	EGI Harmonized Method: Capitalization Rate	Variance: Capitalized Amount
		(a)	*(b)*	*(c)*	*(d)*	*(c) - (a)*
1	Operations Costs	114.8	34.7%	115.5	34.9%	0.8
2	Business Units Costs	56.0	11.0%	52.5	10.3%	(3.6)
3	Shared Services Costs	61.4	21.3%	70.0	24.3%	8.5
4	Pension & Benefits Costs	52.2	29.6%	63.2	35.8%	10.9
5	**Total**	**284.4**	**21.8%**	**301.1**	**23.1%**	**16.6**

Table 5

Comparison of Overhead Capitalization Methodologies - 2024 Test Year

Line No.	Particulars ($ millions)	Historical Method: Capitalized Amount	Historical Method: Capitalization Rate	EGI Harmonized Method: Capitalized Amount	EGI Harmonized Method: Capitalization Rate	Variance: Capitalized Amount
		(a)	*(b)*	*(c)*	*(d)*	*(c) - (a)*
1	Operations Costs	121.9	36.0%	118.2	35.0%	(3.6)
2	Business Units Costs	56.1	10.6%	54.5	10.3%	(1.6)
3	Shared Services Costs	63.8	20.5%	72.6	23.3%	8.8
4	Pension & Benefits Costs	53.2	30.0%	65.1	36.8%	11.9
5	**Total**	**295.1**	**21.8%**	**310.4**	**22.9%**	**15.4**

ENBRIDGE GAS INC.

Answer to Interrogatory from
Ontario Energy Board Staff (STAFF)

Interrogatory

Reference:

Ref 1: Exhibit 2, Tab 4, Schedule 2, p.12
Ref 2: Exhibit 2, Tab 4, Schedule 2, Attachment 1 - EY Report

Question(s):

It states that for Shared Services Costs, a single overhead capitalization rate was calculated by taking a weighted average of Operations Costs and Business Costs rates and non-capitalizable costs (groups that do not support capital activity).

a) Please explain why non-capitalizable costs are included in the calculation of the overhead capitalization rate for Shared Services Costs.

b) Please provide the capitalization rate for Shared Services costs from 2019 to 2024.

c) Please confirm that the 2020 capitalization rate for Shared Services cost per Appendix II of the EY Report is 19.5%. If not confirmed, please provide the 2020 capitalization rate for Shared Services in the EY Report.

Response:

a) The Shared Services Costs category contains groups that support overall business activities of Enbridge Gas. Therefore, to determine a weighted average overhead capitalization rate that is a fair reflection of Shared Services support of capital activity, all cost categories need to be inputs to the calculation. Excluding costs for groups not involved in capital activity would inflate the Shared Services overhead capitalization rate.

b) Table 1 provides the Capitalization Rate for Shared Services.

Table 1

Year	Rate
2019	N/A*
2020	19.5%
2021	23.5%
2022	23.2%
2023	23.8%
2024	23.8%

* Prior to the implementation of the harmonized overhead capitalization methodology, the Shared Services Category did not exist for the purposes of calculating overhead capitalization.

c) Confirmed. Please see Exhibit 2, Tab 4, Attachment 1, Page 24.

OVERHEAD CAPITALIZATION RATE

1.0 INTRODUCTION

To ensure that capital work reflects all of the costs incurred to enable assets to be placed into service and to operate for their intended use, Hydro One (a) capitalizes costs that are directly attributable to capital work, such as the purchase price for materials and equipment, and costs directly incurred to bring materials and equipment to work sites and to install and otherwise make them ready for service, and (b) capitalizes those of its common corporate costs, or 'overheads', that relate to its capital work. By including the portion of its overheads that relates to capital work in rate base, Hydro One aligns the recovery of its costs for capital-related work with the expected useful lives of the underlying assets, during which those assets are expected to provide benefits to customers.

Hydro One's Common Corporate Costs are costs that it incurs to provide shared services from centralized business operations (i.e. legal services, human resources, finance, etc.) to Hydro One and its affiliate companies. Those overheads are allocated to Transmission and Distribution, as well as affiliates, through the methodology described in Exhibit E-04-08. For each of Transmission and Distribution, capitalized overhead costs represent the portion of their allocated Common Corporate Costs that have been incurred to support capital expenditures and which are therefore capitalized along with the costs directly attributable to capital work.

This Exhibit describes the methodology that Hydro One uses to allocate its overhead costs to capital work, for the Transmission business and the Distribution business (the Overhead Capitalization Methodology). Generally, these costs are allocated through the application of an overhead capitalization rate, which is a calculated percentage representing the amount of overhead costs that are required to support capital projects in a given year. A distinct overhead capitalization rate applies to each of Transmission and Distribution as a result of applying the proposed Overhead Capitalization Methodology. In addition, this Exhibit describes the detailed

review and benchmarking of Hydro One's approach to overhead capitalization that has been performed in response to prior directives from the OEB.

2.0 OVERHEAD CAPITALIZATION METHODOLOGY

The Overhead Capitalization Methodology was developed for Hydro One by Black & Veatch (B&V, formerly RJ Rudden Associates). It was first presented in the report "Distribution Overhead Capitalization Rate Method" dated May 20, 2005 in the Distribution application for 2006 Distribution Rates and accepted by the OEB.[1] In subsequent applications, the OEB has continued to accept the recommended methodology for both Transmission and Distribution.[2] The methodology was most recently accepted by the OEB in the application for Distribution Rates for 2018 to 2022 (EB-2017-0049), as well as in the application for Transmission revenue requirement for 2020-2022 (EB-2019-0082).

In its most recent Transmission and Distribution decisions, the OEB signalled its intention to undertake detailed reviews of certain allocation methodologies used by Hydro One, including the Overhead Capitalization Methodology.[3] Hydro One therefore undertook a competitive RFP process to select an appropriate expert to undertake detailed assessments of its Common Corporate Cost Allocation Methodology, Overhead Capitalization Methodology, and methodology for allocating Shared Assets. Though open to engaging a new expert, after evaluating multiple proposals, Hydro One selected Black & Veatch (B&V) once again for this

[1] RP-2005-0020/EB-2005-0378

[2] Refer to Appendix 'A', Table 13 of Black & Veatch's Report on Corporate Cost Allocation review, which is provided in Exhibit E-04-08, Attachment 1.

[3] In EB-2017-0049 the OEB directed Hydro One to file a report as part of its next rebasing application that compares Hydro One's capitalization of common corporate costs with those of other utilities in Ontario, Canada and North America, and specified that this should include utilities both under US GAAP and those using International Financial Reporting Standard (IFRS). In EB-2019-0082 the OEB directed Hydro One to provide a report comparing capitalization of common corporate costs with those of other utilities in Ontario, Canada, and North America (both under USGAAP and IFRS), and ordered that a detailed review of Hydro One's methodology regarding overhead capitalization be filed in its next rebasing application, including the revenue requirement impact and risk analysis associated with transitioning from US GAAP to MIFRS.

engagement. However, B&V was selected with a new lead expert for the study, and a mandate to take a fresh, detailed and critical look at the methodologies and to refine them where appropriate on the basis of best practises (2020 B&V Study). The Common Corporate Cost Allocation Methodology is addressed in Exhibit E-04-08. The methodology for allocating Shared Assets is addressed in Exhibit C-03-01. The Overhead Capitalization Methodology is discussed in the current exhibit.

Based on its detailed review of Hydro One's Overhead Capitalization Methodology, B&V has concluded that Hydro One's existing Overhead Capitalization Methodology continues to be appropriate because it is accurate and transparent, fairly attributes to and recovers appropriate overhead costs from capital work, and ascertains which activities have a causal link between overhead costs and capital activity. B&V also incorporated several enhancements to the methodology, including an expanded review of activities performed by all Shared Service groups, which has allowed for the direct assignment of all Shared Service activities across all Shared Service groups rather than only for Shared Services relating to customer relations, asset management and operations.

A consolidated report from B&V, addressing all aspects of its review, including with respect to the Overhead Capitalization Methodology, is provided in Exhibit E-04-08, Attachment 1.

In summary, B&V describes the Overhead Capitalization Methodology as follows:

> *The general methodology employed is first to review Shared Service activities to ascertain if the activity directly supports OM&A, directly supports capital, or supports both capital and OM&A. Second, to split the costs that support both capital and OM&A between (a) costs that remain OM&A, and (b) costs that will be included in the Overhead Capitalization Rate calculation and thereby capitalized (by applying a 50/50 weighting of the Labour Content-Capital Ratio and the Total Spending-Capital Ratio). Third, to calculate the total Capitalized Shared Service Costs by adding (1) the portion of overhead costs directly relating to capital and (2) the Shared Service activities relating to capital, the total of*

> *which is then divided by the total Capital Expenditures to determine the Overhead Capitalization Rate.*[4]

Using the established methodology, Hydro One reviews its overhead capitalization rates on a monthly basis to determine if the rates need to be updated to reflect in-year changes in capital spending and the associated support costs. At year-end, capitalized overheads are trued-up to reflect actuals. This results in a better alignment of overhead costs with the capital work that those costs support. Although the actual overhead capitalization rates may fluctuate from month to month, the methodology that is applied each month remains consistent with that which has been accepted by the OEB in the relevant prior rate proceeding.

The Overhead Capitalization Methodology, as reviewed and set out in the 2020 B&V Study for purposes of the current application, presents a reasonable and appropriate method for allocating overhead costs to capital work for each of the Transmission and Distribution businesses. Hydro One has applied the Overhead Capitalization Methodology as recommended by the 2020 B&V Study in calculating its requested revenue requirement in this application.

Table 1, below, summarizes the overhead capitalization rates and amounts for each of the Transmission and Distribution businesses, as calculated using the methodology that has been recommended by B&V. Attachment 1 to Exhibit E-04-08 presents further details of the 2020 B&V Study.[5]

[4] B&V Report, p. [8].
[5] Sections 6 of the B&V Report – Overhead Capitalization Rate Methodology and Appendix C – Overhead Capitalization Rate Calculation

Table 1 - Overhead Capitalization Rates and Amounts for Transmission and Distribution

Overhead Cost Category	Test Years (%)					Test Years ($M)				
	2023	2024	2025	2026	2027	2023	2024	2025	2026	2027
Transmission	8.0%	8.0%	9.0%	9.0%	9.0%	118.1	119.7	121.0	122.3	123.9
Distribution	9.0%	9.0%	9.0%	9.0%	9.0%	89.9	91.0	94.9	94.2	95.7

In general, the updates to the methodology employed in the 2020 B&V Study resulted in a decrease in the total Common Corporate Costs being recovered through the Overhead Capitalization Rate. This was a result of directly assigning more costs to OM&A only rather than excluding those costs that were within the historical Time Study groups. This, however, does not necessarily result in a lower Overhead Capitalization Rate given there are different levels of capital expenditures from which to recover these overhead costs. The capitalization rates are consistent with the previous Transmission study (EB-2019-0082), while the capitalization rates are down relative to the previous Distribution study (EB-2017-0049).

3.0 OEB DIRECTIVES

In its decisions in EB-2017-0049 and EB-2019-0082, the OEB expressed concerns with Hydro One's overhead capitalization levels and directed Hydro One to provide a report that benchmarks its capitalization of overhead costs against other utilities in Ontario, Canada, and North America, both under US GAAP and IFRS. The OEB also ordered that a detailed review of Hydro One's approach to overhead capitalization be carried out.

Therefore, in addition to engaging B&V to perform a detailed review of the Overhead Capitalization Methodology, Hydro One undertook a competitive RFP process through which it selected PricewaterhouseCoopers LLP (PwC) to undertake the required benchmarking of its overhead capitalization costs, as well as to assess the reasonableness of Hydro One's approach to overhead capitalization relative to applicable regulatory and accounting guidance under both US GAAP and IFRS. These aspects of PwC's analysis are discussed below, and a copy of PwC's report, entitled *Hydro One Capitalization of Common Corporate Costs Review* (PwC Report on Capitalization of Common Corporate Costs), is provided as Attachment 2 to this Exhibit. An

Hydro One

Capitalization of Common Corporate Costs Review

June 17, 2021

pwc

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Purpose, scope and limitations of this report

At the request of Torys LLP, as counsel to Hydro One Networks Inc. ("Hydro One", "the Company"), we have prepared this report to (i) comment on the process used by Hydro One for the capitalization of common corporate costs and (ii) compare Hydro One's capitalization of common corporate costs with other utilities in Ontario, Canada and North America.

We understand that the purpose of this report is to assist Hydro One with its planned 2023-2027 combined Distribution and Transmission rate application (the "Application") to be filed with the Ontario Energy Board ("OEB") in 2021.

This report includes:

- A comparison of the percentage of common corporate costs capitalized by Hydro One to the percentage of such costs capitalized by other regulated utilities,
- An overview of the process and methodology developed for the Company by Black & Veatch that will be used by Hydro One to allocate and capitalize common corporate costs,
- PwC's findings as to the reasonableness of the approach that Hydro One will use to capitalize common corporate costs based on the results of procedures outlined in this report, and
- A comparison of the Hydro One common corporate cost capitalization methods outlined in the Company's Application to the guidance provided by the OEB and Federal Energy Regulatory Commission ("FERC") as well as to the accounting guidance prescribed by the Financial Accounting Standards Board ("FASB") for Generally Accepted Accounting Principles in the United States of America ("US GAAP") and International Financial Reporting Standards as issued by the International Accounting Standards Board ("IFRS").

Limitations

This report refers to the methodology outlined by Black & Veatch in its *Report on Corporate Cost Allocation Review* dated June 9, 2021 (the "B&V Report") as filed in Hydro One's Application for the calendar years 2023-2027, inclusive. Specifically, the report refers to the methodology for capitalizing corporate costs for the Tx and Dx businesses as described in Section 6 of that report.

Our work was limited to the procedures and analysis described herein. Our work was performed on the basis that information included in the B&V Report and other information provided to us by Hydro One was accurate and complete. Unless otherwise noted, all references in this report to Hydro One processes, methods and methodologies refer to the proposed methodology summarized in the B&V Report and not to methods that Hydro One may have used in the past. We did not review Hydro One's revenue requirement calculations and application for the calendar years 2023-2027 nor audit, verify nor otherwise validate any data nor explanations, except as specifically noted by us in this report. Our engagement cannot be relied upon to disclose errors, irregularities or illegal acts, including fraud or defalcations that may exist. Further, this evaluation does not constitute an audit, accounting opinion, tax opinion, attest opinion nor any other form of assurance.

This report is intended solely for use by Torys LLP and Hydro One Networks Inc. under the terms of our agreement dated June 1, 2020 and is not intended or authorized for any other use or party. If any unauthorized party uses this report, in whole or in part, it is their sole responsibility and their sole and exclusive risk, that they may not rely on the report, that they do not acquire any rights as a result of such access and that PricewaterhouseCoopers LLP does not assume any duty, obligation, responsibility or liability to them.

Executive summary

In order for capital work to reflect all costs incurred to bring the assets to be capable of operating for their intended use, utility regulators permit regulated entities, such as Hydro One, to capitalize common corporate costs that relate to capital work. A widely accepted principle used to assign common corporate costs to capital work is that a reasonable causal link or an association with capital activity exists to support the assignment. Under cost of service-based regulation, regulated entities are permitted to recover their capital costs (through depreciation expense) and earn a return on the capital costs that are included in their rate base (subject to any adjustments that may apply under a related incentive regulation framework). By including these costs in rate base and recognizing and permitting recovery of depreciation expense, the capitalization of common corporate costs aligns the recovery of those common corporate costs associated with capital activity with the estimated useful life of the underlying fixed assets. Consequently, the capitalization of such common corporate costs aligns their recovery with the period of time during which customers are expected to benefit from the use of those assets, consistent with the regulatory principle of intergenerational equity.

We were engaged to identify a group of peer utilities and compare Hydro One's capitalization of common corporate costs to this group. We were also engaged to understand Hydro One's proposed methodology for the capitalization of common corporate costs allocated to Hydro One's Distribution and Transmission businesses and to compare the methodology with guidance issued by the OEB and FERC as well as the accounting guidance under US GAAP and IFRS. Black & Veatch ("B&V") has developed this methodology for the capitalization of Hydro One's common corporate costs. Hydro One's proposed overhead capitalization methodology set out in the B&V Report is based on the principle, noted above, that common corporate costs should be allocated to capital where there is a reasonable causal link to capital activity.

In our comparison of common corporate costs capitalized at Hydro One to those that are capitalized by other regulated utilities, we observed that the Company fell within the range of its Canadian peers. When compared to US utilities, while Hydro One's capitalization percentage was at the upper end of the peer group, there was a large range of results which can be attributable to factors such as company size, size of the construction program, different definitions of the costs to be considered and involvement of third-party contractors. These differing factors make a comparison between Hydro One and other utilities difficult as many are not comparable. Of particular significance is that Hydro One self-constructs most of their capital work. In our experience, this is in contrast to many of its peers which generally perform more construction activity through the use of third parties. Such third-party suppliers incur their own common corporate-type costs and include such costs in their billings to the utilities, and those billings are in turn capitalized as direct costs by the utility. In either a self-constructed or outsourced situation, common corporate-type costs are incurred and included in the capital work, but there is a difference in the source of the charges (either capitalized by the utility or capitalized through the direct charging of third-party billings to capital work) and that difference has a significant impact on the utility's common corporate cost capitalization rate. There are many other factors that, in our view, may have contributed to differences within the peer group and made comparisons difficult, including limitations on publicly available information, a lack of common definitions of key terms, differences in methodologies and each utility's environment and operating models.

Given the aforementioned challenges in making direct comparisons to peers, we performed additional work to understand Hydro One's process to capitalize common corporate costs and compared its process with the relevant guidance issued by the OEB and FERC and the accounting guidance under US GAAP and IFRS.

Our process for completing this evaluation included the following steps:

- Obtaining and reviewing process and policy documentation provided by management,
- Interviewing and conducting walkthroughs with Hydro One personnel responsible for the cost capitalization processes to understand how common corporate costs will be capitalized in the Application,
- Discussing the methodology with Black & Veatch, who were engaged by Torys LLP as counsel to Hydro One to develop the methodology for the allocation and capitalization of common corporate costs,
- Obtaining and reading the B&V Report which provides details on Hydro One's proposed methodology for allocating and capitalizing common corporate costs, and
- Comparing Hydro One's proposed method of capitalizing common corporate costs against guidance from OEB and FERC and accounting guidance, specifically US GAAP and IFRS.

Based on completing these procedures and analyses, we determined Hydro One's proposed methodology for capturing common corporate costs and allocating such costs to capital activities is reasonable, supportable and consistent with the principle that the assignment of such costs to capital work should be based on a causal link. Further, the methodology follows the guidance promulgated historically by the OEB and FERC and is consistent with the practice of other utilities that apply rate regulated accounting guidance under US GAAP and IFRS.

Comparison to other utilities

Overview and Summary

We selected a group of US and Canadian peer companies to compare to Hydro One. As it relates to the capitalization of common corporate costs, comparisons with other utilities are challenging because:

- The term "common corporate costs" is not a defined term and utilities often include different costs in their comparable measures;
- Few utilities disclose information about their costs in a way that facilitates comparison to Hydro One's common corporate costs because disclosure of an entity's indirect costs and overhead accounting practices is not required by either US GAAP or IFRS;
- The nature of utility activities and operations, including processes to direct charge costs to capital or OM&A and/or allocate indirect costs to capital often differ;
- The types of activities included in the pool of indirect costs to be allocated to capital often differ; and
- Utilities who use third-party contractors to perform more of their capital work will have more common corporate-type costs embedded in their direct charges from third-party contractors and consequently will have less costs in their pool of common corporate costs.

We identified a group of peer companies who report under both US GAAP and IFRS and compared the percent of common corporate cost equivalents capitalized. In addition, where possible based on information available, we also compared Hydro One's process to this peer group. We observed that the Company fell within the range of its Canadian peers. When compared to US utilities, while Hydro One's capitalization percentage was at the upper end of the peer group, there was a large range of results which can be attributable to factors such as company size, size of the construction program, different definitions of the costs to be considered and involvement of third-party contractors. Further, the Company's higher proportion of self-constructed capital work relative to the peer group companies likely contributes to this result. In particular, we note that third-party contractors that are hired by a company to perform capital work will embed their overheads and their other indirect costs in their charges to the company. To the extent that the third-party contractors hired by a company are working on capital work, the total third-party contractor cost, inclusive of these overheads and indirect costs, are also capitalized as part of the capital work. Therefore, in the case of a company who uses third-party contractors more heavily than Hydro One, it is reasonable to expect that a higher proportion of their indirect costs would be directed towards activities which are done internally which may be not capital in nature. As a result, such companies would likely have a lower capitalization rate than Hydro One.

Analysis

In the following section, we describe the approach we took to identify comparable/peer companies to Hydro One and explain how Hydro One's capitalization percentage based on the 2023 test year compares to the Canadian and US peers selected. We also considered additional information that was available from publicly available FERC forms for US utilities.

Hydro One 2023 comparative figures

In order to benchmark Hydro One's common corporate cost capitalization percentages to other utilities, the following percentages of common corporate costs to be capitalized were provided for the 2023 test year by Hydro One and we agreed them to the B&V Report:

Table 1

Total common corporate costs capitalized within Tx and Dx as a percentage of total Tx & Dx OM&A expenses	Total common corporate costs capitalized within Tx and Dx as a percentage of total common corporate costs allocated to Tx & Dx
18%	**48%**

Approach

Comparable companies

Identifying comparable companies is challenging and an imperfect exercise as utility companies differ in many ways. Differences include, but are not limited to:

- Size (Size can be measured in many ways including number of customers, kilometres of distribution and/or transmission lines, revenue, total assets, etc.);
- Geographic region (urban, rural, terrain etc.);
- Proportion of the business that includes distribution, transmission, generation or unregulated non-utility activities;
- Number of subsidiaries under a corporate parent (including whether subsidiaries are regulated or unregulated);
- Basis of accounting (US GAAP, IFRS, other);
- Regulatory environment;
- Proportional use of third-party contractors and employees for capital construction related activities; and
- Size and nature of the company's capital program.

Further, not all companies disclose data regarding indirect costs and/or the capitalization of these costs in public filings. For example, we originally identified 13 comparable companies to include in our comparison analysis. However, based on our research, few of these original selections provided the necessary comparable capital cost allocation data in financial statements, rate case filings or other public disclosures (other than the FERC forms discussed below). As a result, we expanded our selection to choose some utilities that were less comparable, but provided more of the data necessary for this analysis. The below table details all of the companies considered in our analysis including our original selection of comparable peers and the additional utilities subsequently added based on those that disclosed relevant data.

Table 2

	Company name	Country	Basis of accounting
Original Peer Companies Identified with Relevant Quantitative Data Available			
1	Toronto Hydro	Canada	IFRS (incl. IFRS 14)
2	BC Hydro and Power Authority	Canada	IFRS (incl. IFRS 14)
3	Fortis BC	Canada	US GAAP
4	Enbridge Gas Inc.	Canada	US GAAP
5	Evergy Metro (Kansas City Power & Light)	US	US GAAP
Additional Companies Identified Based on Availability of Relevant Quantitative Data*			
6	Enmax Power Corporation	Canada	IFRS (incl. IFRS 14)
7	Southern California Edison	US	US GAAP
8	San Diego Gas and Electric Company	US	US GAAP
9	Pacific Gas & Electric Company	US	US GAAP
Original Peer Companies Identified with only Qualitative Data Available (excluded from quantitative comparison, but qualitative data is included in Appendix B)			
10	Alectra Incorporated	Canada	IFRS
11	CenterPoint Energy Houston Electric	US	US GAAP
12	Consumers Energy	US	US GAAP
13	DTE Electric Company	US	US GAAP
Original Peer Companies Identified with no Relevant Data Available (excluded from our analysis, except where specified)			
14	Hydro Québec	Canada	US GAAP
15	Wisconsin Electric Power Company	US	US GAAP
16	Arizona Public Service	US	US GAAP
17	Public Service Enterprise Group	US	US GAAP

*These four companies were not originally identified as comparable peer companies based on their size and other factors considered; however, the applicable data was available for these companies and were therefore added to our peer group.

Data comparability

The comparison analysis is further complicated by the fact that the term “common corporate costs” is not defined by IFRS, US GAAP, FERC or the OEB. When performing our research, we found that no other utility used the term “common corporate costs”. To perform the comparison to other utilities, we had to analyze the data and compile costs that, in our judgment, based on publicly available information, appeared to be most comparable to “common corporate costs” as defined by Hydro One. There is no way in which to be certain that our compilations and assessments of the most comparable cost measures are accurate. As a result, in this report when we refer to common corporate costs of utilities other than Hydro One we are referring to the pool of costs that we thought best approximates Hydro One’s definition of these costs.

Although FERC, the OEB and other regulators require disclosure of components of administrative and general costs or operating maintenance and administrative costs that are capitalized, the presentation, groupings and functions presented are not consistent and often lack sufficient detail of what is included in the amount to draw a direct comparison to Hydro One’s categorization.

Observations

Metrics utilized

We obtained data from publicly available sources to approximate the costs reported by other utilities that are most comparable to what Hydro One defines as common corporate costs. Based on this data, we identified comparable cost pools and noted that a different metric would be appropriate for Canadian peers and US peers.

In our view, the best measure for the Canadian peers is common corporate costs capitalized as a percentage of total OM&A expenses **(Canadian company metric).** We believe this to be an appropriate metric for these companies, as it is common in the capitalization process for Canadian utilities to first charge expenses to OM&A. Subsequently, an analysis is performed to assess which of these overhead costs within OM&A can be allocated to capital.

For US companies, it is common practice to capitalize a portion of their total common corporate cost pool (often referred to as an Administrative & General cost (A&G) pool), rather than capitalizing a portion of total OM&A. This is largely driven by the FERC Uniform System of Accounts Prescribed for Public Utilities and Licensees Subject to the Provisions of the Federal Power Act in Part 101 of Title 18 of the Code of Federal Regulations ("USoA") which provides specific accounts to record A&G costs and an account to reclassify certain of these costs to capital. As such, for US comparable companies, we have considered common corporate costs capitalized as a percentage of what we observed to be most equivalent to total common corporate costs as the measure to compare US utilities to Hydro One **(US company metric)**.

Neither of these metrics are defined in any guidance issued by a regulatory or accounting standards body. However, these metrics in the tables below have been calculated consistent with the metrics for Hydro One in the above table to the extent possible.

Results of our research

As noted in the table above, based on publicly available information, for certain companies we were able to obtain only qualitative data such as how "common corporate costs" were allocated by each company to capital and what types of costs were included as "common corporate costs". For others, qualitative and quantitative data were either both available or neither was available. Refer to the tables below for the quantitative data found.

Appendix B provides further information on how we used judgement in determining the appropriate metric to compare to Hydro One as well as the qualitative data identified.

Table 3

US companies

Utility name	Regulator	Basis of accounting	Common corporate cost equivalents capitalized as a % of total common corporate cost equivalents
Southern California Edison (SCE)	California Public Utilities Commission (CPUC)	US GAAP	24.05%
San Diego Gas & Electric Company (SDG&E)	California Public Utilities Commission (CPUC)	US GAAP	8.57%
Pacific Gas & Electric Company (PG&E)	California Public Utilities Commission (CPUC)	US GAAP	12.23%
Evergy (Kansas City Power & Light Company)	Kansas Corporation Commission	US GAAP	16.69%
Hydro One	Ontario Energy Board (OEB)	US GAAP	48%

From our research of US companies where quantitative information was available, our estimates suggest a wide range of capitalization rates between 8.57% and 24.05% compared to Hydro One's capitalization rate of 48%. In our experience, most US utilities use third-parties to construct capital work which is in contrast to Hydro One that primarily self-constructs their capital work. As we previously noted, this is one reasonable reason for the disparity noted.

We describe additional research performed over the US peer group below. (See discussion of FERC data analyzed)

Table 4

Canadian companies

Utility name	Regulator	Basis of accounting	Common corporate cost equivalents capitalized as a % of equivalent OM&A
FortisBC Inc.	British Columbia Utilities Commission (BCUC)	US GAAP	15%*
Enbridge Gas Inc.	Ontario Energy Board (OEB)	US GAAP	22% (*Enbridge Gas Distribution Inc. pre-amalgamation - indirect overhead as a percentage of designated overhead) 14.4% (Union Gas Limited pre-amalgamation)
Toronto Hydro Corporation	Ontario Energy Board (OEB)	IFRS	32%
Enmax Power Corporation	Alberta Utilities Commission (AUC)	IFRS	7%*
BC Hydro and Power Authority	British Columbia Utilities Commission (BCUC)	IFRS	4%*
Hydro One	Ontario Energy Board (OEB)	US GAAP	18%

*Derived – Refer to Appendix B for details

From our research of Canadian companies where quantitative information was available, we noted a wide range of capitalization rates from 4% to 32%. Splitting the comparative company results between those that report under US GAAP, the range was from 15% to 22% and those that report under IFRS the range was between 4% and 32% – compared to Hydro One's rate of 18%.

It should be noted that the types of costs included in the peer companies' methodologies (US and Canadian) are generally similar to the type of costs included in Hydro One's pool of costs to be included in the capitalization process. However, the makeup of certain cost types as described varies from company to company and therefore it is not possible to know with certainty if the activities or costs described by one company are comparable to the activities or costs described by Hydro One or any other peer to develop a meaningful comparison.

Please refer to Appendix B for additional details on these results including qualitative information about the companies identified.

Additional FERC Research Performed

In addition to looking at rate case data for the US companies in the peer group list, we reviewed each US Company's 2019 FERC Form 1, specifically looking at the allocation of A&G costs to construction accounts in accordance with the FERC USoA. In our experience, these A&G costs are similar to what Hydro One defines as common corporate costs. A&G labor and office supplies amounts are accumulated in FERC accounts 920 – Administrative and general salaries and 921 – Office supplies and expenses. FERC account 922 – Administrative expenses transferred – Credit is then used to reclassify a certain amount of these costs to construction costs. Refer to the FERC Account descriptions below:

920 Administrative and General salaries.

a. This account shall include the compensation (salaries, bonuses, and other consideration for services, but not including directors' fees) of officers, executives, and other employees of the utility properly chargeable to utility operations and not chargeable directly to a particular operating function

b. This account may be subdivided in accordance with a classification appropriate to the departmental or other functional organization of the utility

921 Office supplies and expenses.

a. This account shall include office supplies and expenses incurred in connection with the general administration of the utility's operations which are assignable to specific administrative or general departments and are not specifically provided for in other accounts. This includes the expenses of the various administrative and general departments, the salaries and wages of which are includible in account 920

b. This account may be subdivided in accordance with a classification appropriate to the departmental or other functional organization of the utility

A portion of the total balance in FERC accounts 920 and 921 is then transferred from A&G expense and allocated to construction accounts through FERC account 922 - Administrative expenses transferred - Credit. The account 922 description is below:

922 Administrative expenses transferred - Credit.

This account shall be credited with administrative expenses recorded in accounts 920 and 921 which are transferred to construction costs or to nonutility accounts. (See electric plant instruction 4.)

Of the seven US companies included in the original list of peer companies, four have comparable data in their FERC Form 1 (Consumers Energy, DTE, Evergy Metro/Kansas City Power & Light and Arizona Public Service). Three companies included in the original list of peer companies (Wisconsin Electric Company, CenterPoint Energy Houston Electric and Public Service Electric & Gas Company) did not have comparable data in their FERC Form 1 as Account 922 was either negative or not utilized by these companies. Explanations as to why the use of these accounts can vary across companies is described below. Additionally, we included the FERC data for the three additional companies we added to our original list of peer companies (Southern California Edison (SCE), San Diego Gas & Electric (SDG&E) and Pacific Gas & Electric (PG&E)) for a total of seven companies. Below is an example of the FERC Form data for Consumers Energy. As indicated in the highlighted lines below, the total A&G pool is $54,710,134 (sum of amounts in FERC accounts 920 and 921) and the amount transferred out of those accounts and into construction (i.e., capitalized) in FERC account 922 is $19,182,696.

Exhibit 1

Name of Respondent 20200401-8001 FERC PDF (Unofficial) 03/03/2020 Consumers Energy Company	This Report Is: (1) [X] An Original (2) [ ] A Resubmission	Date of Report (Mo, Da, Yr) / /	Year/Period of Report End of 2019/Q4

ELECTRIC OPERATION AND MAINTENANCE EXPENSES (Continued)

If the amount for previous year is not derived from previously reported figures, explain in footnote.

Line No.	Account (a)	Amount for Current Year (b)	Amount for Previous Year (c)
165	6. CUSTOMER SERVICE AND INFORMATIONAL EXPENSES		
166	Operation		
167	(907) Supervision	5,891,247	3,436,425
168	(908) Customer Assistance Expenses	157,377,172	156,669,571
169	(909) Informational and Instructional Expenses	840,614	556,107
170	(910) Miscellaneous Customer Service and Informational Expenses		
171	TOTAL Customer Service and Information Expenses (Total 167 thru 170)	164,109,033	160,662,103
172	7. SALES EXPENSES		
173	Operation		
174	(911) Supervision		
175	(912) Demonstrating and Selling Expenses	76,777	365,144
176	(913) Advertising Expenses		
177	(916) Miscellaneous Sales Expenses		
178	TOTAL Sales Expenses (Enter Total of lines 174 thru 177)	76,777	365,144
179	8. ADMINISTRATIVE AND GENERAL EXPENSES		
180	Operation		
181	(920) Administrative and General Salaries	43,323,913	43,115,738
182	(921) Office Supplies and Expenses	11,386,221	13,886,497
183	(Less) (922) Administrative Expenses Transferred-Credit	19,182,696	19,238,560
184	(923) Outside Services Employed	28,339,550	31,539,992
185	(924) Property Insurance	3,113,930	672,467
186	(925) Injuries and Damages	10,071,322	11,667,830
187	(926) Employee Pensions and Benefits	6,760,213	8,610,967
188	(927) Franchise Requirements		
189	(928) Regulatory Commission Expenses	572,500	646,798
190	(929) (Less) Duplicate Charges-Cr.		
191	(930.1) General Advertising Expenses		
192	(930.2) Miscellaneous General Expenses	13,037,141	19,512,040
193	(931) Rents	166,781	-37,435
194	TOTAL Operation (Enter Total of lines 181 thru 193)	97,588,875	110,376,334
195	Maintenance		
196	(935) Maintenance of General Plant	4,577,531	5,887,963
197	TOTAL Administrative & General Expenses (Total of lines 194 and 196)	102,166,406	116,264,297
198	TOTAL Elec Op and Maint Expns (Total 80,112,131,156,164,171,178,197)	2,672,803,758	2,809,445,278

We obtained the same FERC Form 1 data for the seven companies noted above. The data below shows the cumulative amounts in FERC accounts 920 and 921 and the amounts capitalized in FERC account 922 for each company, as well as the average percent of capitalized A&G across all seven companies, which was approximately 34%.

Table 5

Number	Utility name	A&G capitalized (FERC account 922)	Total A&G expenses – Capitalization base (Sum of FERC accounts 920 and 921)	% of total A&G capitalized
1	Southern California Edison Company	225,318,190	664,084,735	34%
2	Consumers Energy	19,182,696	54,710,134	35%
3	Pacific Gas & Electric Company	103,181,563	472,370,054	22%
4	San Diego Gas & Electric Company	13,569,700	47,785,405	28%
5	DTE Electric Company	53,923,636	193,880,305	28%
6	Evergy Metro Inc. (Kansas City Power & Light)	30,551,805	42,460,525	72%
7	Arizona Public Service	21,226,138	110,801,217	19%
	Company Average			34%
	Hydro One common corporate costs capitalized as a % of OM&A			48%

The percentages from the 2019 FERC forms noted above will differ from the percentages in the rate case filings for a variety of factors. The first is that the FERC data above is based on actual 2019 amounts while the data in a company's rate case filings is based on historical test years from years prior to 2019 or on forecasted 2019 amounts. The second is that the rate case filings may give additional information on what amounts are included in a company's A&G pool subject to capitalization, and these amounts can include more than just A&G salaries and office supplies and expenses, which are captured in FERC accounts 920 and 921. For example, SDG&E's most recent rate case uses 2016 historical test year data and specifies that 'Costs subject to capitalization include FERC Accounts 920, 921 and 923. FERC Account 923 – Outside services employed includes "the expenses of professional consultants and others for general services which are not applicable to a particular operating function or to other accounts". Capitalization of amounts from Account 923 should not be included in Account 922.

Additionally, as indicated in both the rate case data and the FERC data, the amount and percentage of A&G capitalized differs across companies. This can be due to several reasons, including, but not limited to:

- The size of the company
- How much of A&G is directly charged to capital work at each company as opposed to how much is charged to account 920/921 and then allocated to capital
- What costs are charged to A&G and how different capitalization factors are applied at each company
- How much construction is performed by company personnel vs. third-party contractors, which may impact the capitalization percentage
- The nature and volume of functions outsourced to third parties at each company (FERC Account 923), which is not included in the data above

We further note that while the FERC USoA is designed to create consistency between filers, how these three FERC accounts are used in practice can vary considerably. There are some companies who do not use account 922 at all to reclassify A&G costs to capital as noted by the account equaling zero for certain companies. We assume that these companies either do not allocate any of these costs to capital, which we believe is unlikely, or report the amounts in FERC accounts 920 and 921 net of amounts capitalized. Conversely, we observe that some filers allocate more than 100% of FERC accounts 920 and 921 to capital via account 922, which may indicate they are using account 922 to allocate more than just accounts 920 and 921 costs to capital (e.g., account 923 costs). That is not to say that non-account 920 and 921 type costs should not be allocated to capital, but only that the instructions for account 922 state that this account should only reflect the amount of accounts 920 and 921 costs that have been capitalized. Further, the page in the FERC Form 1 that captures this data is not subject to external audit, which may drive some of this inconsistency.

In addition to analyzing the FERC data for the seven companies included in our comparison to other utilities, we obtained the same data for all FERC Form 1 filers in the U.S. There were a total of 198 US companies that filed a FERC Form 1 in 2019. 93 of these companies had what we considered to be 'account 922 outliers' as discussed above (i.e., the companies did not use account 922 or the balance in the account was less than zero or more than 100% of FERC accounts 920 and 921); therefore, we excluded the data for these 93 companies in our comparisons. We looked at the percentage of A&G capitalized for the remaining 105 companies and found that capitalization percentages ranged from 1% to 83% with an average across the 105 companies of 22% and a median of 19%. As discussed above, these US companies as a general rule, do not self construct their capital work while Hydro One generally does self construct. This consideration is important to the evaluation of this data.

Our observations and conclusions

- Components of common corporate cost - the types of costs included in the peer companies' comparable measures, are similar to the types of costs included in Hydro One's cost pools included in the capitalization process. However, the description of cost varies from company to company and consequently it is not possible to know how comparable the results are. Please see Appendix B for further detail on this observation.

- Construction strategy - in our experience, most utilities use third-party contractors for their significant capital work. From our discussions with management, we understand that, historically, the vast majority of Tx and Dx capital work at Hydro One has been self-constructed, and not contracted to third parties. Consequently, it is reasonable to expect that Hydro One's capital program requires significantly more support from all areas of the company, including finance, management, administration and other resources, than other utility companies that use third-party contractors. As a result, one would expect that Hydro One's percentage of common corporate costs capitalized would be higher than many of its peers as it would require more support from various elements of the organization to complete its capital work. In addition, if such capital work was outsourced to a third party, many of these indirect costs and general and administrative overheads would be embedded in the construction costs charged by the third-party contractor, included in their billings to the Company, and capitalized as a direct cost of construction under US GAAP and IFRS. It is reasonable that utilities that perform more capital work internally will have higher percentages of indirect costs allocated to capital than those that use third-party contractors. If a utility who self-constructs a significant portion of its capital work was to not capitalize similar costs that are inherently capitalized when third-party contractors are used, it would create intergenerational inequity by having current customers pay for these costs that ultimately benefit current and future customers simply due to differences in the source of the party (the Company or third-party contractor) performing the construction activity.

Overview of process and methodology for capitalizing common corporate costs

Overview and summary

We reviewed and obtained an understanding of Hydro One's proposed method for capitalizing common corporate costs in its Application and compared this with guidance issued by the OEB and FERC as well as accounting guidance under US GAAP and IFRS. We met with the responsible individuals at Hydro One and with Black & Veatch ("B&V"), who have been engaged on behalf of Hydro One to develop its process. B&V performed a detailed activity level analysis to determine those activities that have a relationship to capital work and the method for allocating the costs for those activities to either capital or to OM&A.

Based on the methodology described to us by Hydro One and B&V and the procedures we performed, we believe that the proposed method to capitalize common corporate costs is reasonable and is consistent with the principle that any assignment of indirect costs to capital work should be based on a reasonable causal link.

Our understanding

Overview

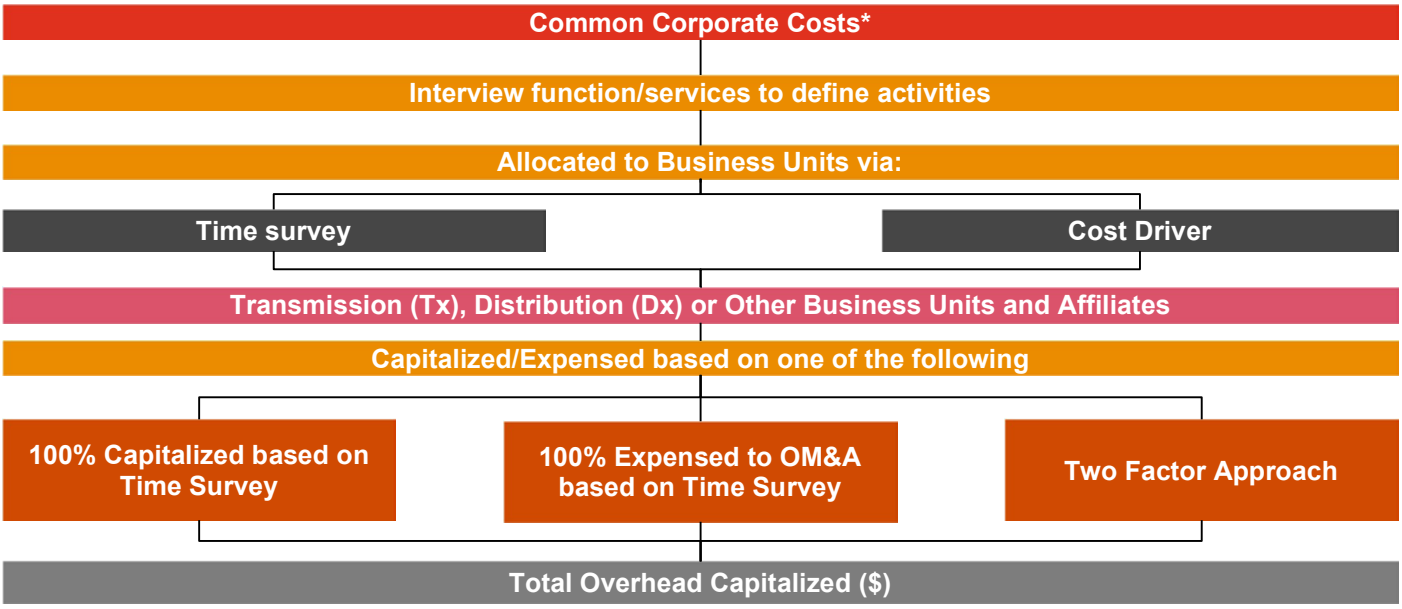
Hydro One has identified certain cost centres (e.g., Human Resources, Legal, etc.) that provide common services to multiple companies or business units within the Hydro One group. These are the costs that are referred to as common corporate costs by Hydro One. Where practical, Hydro One direct charges common corporate costs to capital or OM&A work directly depending on the nature of work being performed. However, certain cost centres may work on multiple programs/projects concurrently and/or support the business as a whole and cannot be directly charged to capital or OM&A. As a result, a method to allocate these remaining costs to the underlying business units and capital or OM&A is necessary. Within each cost centre, major activities were identified and costs for each major activity are classified as either a labour or non-labour cost, both of which follow a similar process. These activities were identified by the Company and B&V by interviewing individuals responsible for each of the cost centres.

B&V then determined how the costs of each activity should be allocated across the Company's Transmission (Tx) and Distribution (Dx) business units, as well as other business units and affiliates ("business units") that are outside the scope of this report. These costs are allocated to these business units based on the results of a time survey or a cost driver. An example of a cost driver for a given activity is the number of employees for a certain business unit compared to total employees for all business units that benefit from the given activity. This is an important step as it increases the likelihood that costs which should not be borne by Tx or Dx customers are removed from the pool of costs to be capitalized.

Once the costs have been allocated to the business units (including Tx and Dx), certain activities which are deemed to be 100% related to OM&A or 100% related to capital based on the time surveys performed by B&V are allocated accordingly. For activities which are not deemed to be 100% attributable to capital or OM&A, a two-factor general allocator, discussed below, is used to determine the costs to be allocated to capital.

The following exhibit illustrates this process.

Exhibit 2



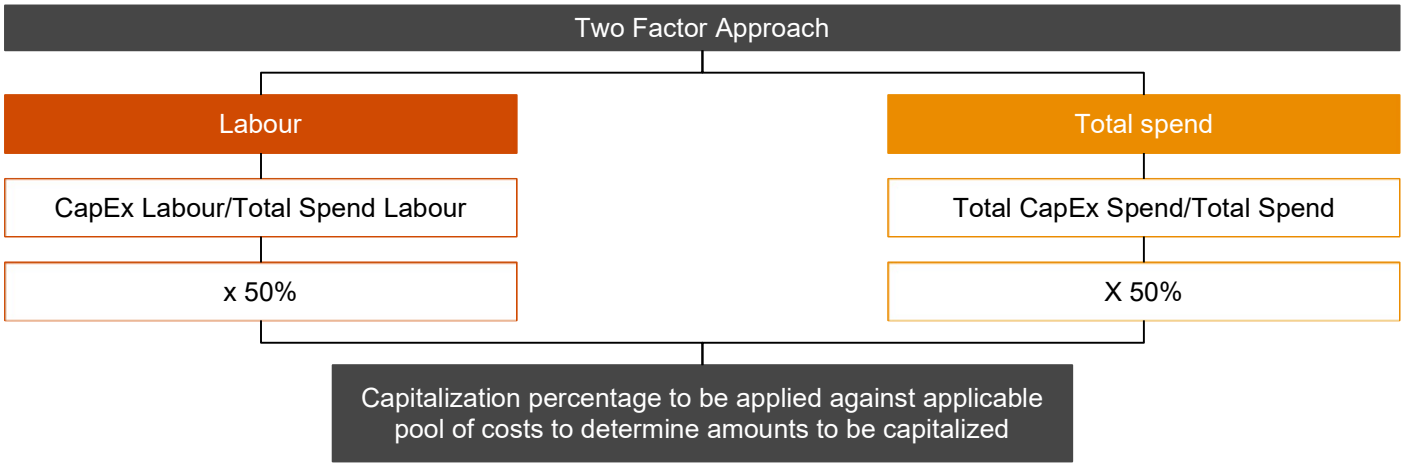
Two-factor approach

For the costs that are not allocated 100% to capital or OM&A, a two-factor approach is applied.

The two-factor approach equally weights the percentage determined using factors developed using the following methods

1. Labour content method – labour dollars capitalized as a percentage of total labour dollars within the Tx or Dx business unit; and
2. Total spend method – total capital spend dollars (including labour, materials, etc.) as a percentage of total spend dollars (capital expenditures plus OM&A expenditures) within the Tx or Dx business unit.

Exhibit 3



Based on our discussions with management, applicable common corporate costs are causally related to both labour content and total spending and both approaches produce percentages that relate to construction activities. In B&V's opinion, there is no evidence that either method is meaningfully more appropriate, thus, a 50%–50% weighting is applied.

Total common corporate cost capitalization rate

We reviewed documents provided to us, including process documents, calculations, and source transactions that result in the total overhead costs that relate to each of the cost centres/activities that comprise common corporate costs.

As shown in Exhibits 2 and 3 above, once the common corporate costs are determined for the Tx and Dx areas, the costs are then classified as either 100% capital or OM&A (based on time surveys or through the use of the two-factor allocator at the activity level). For any given period, the actual costs are multiplied by these percentages to determine a total capitalized amount.

The following table shows the common corporate costs capitalized based on the 2023 forecast. Please note that we have defined this capitalization percentage in two ways as further discussed above in our discussion of comparison to other utilities.

Table 6

	Projected 2023 capitalization % and amounts capitalized ($ Millions CAD)
Metric 1: Corporate common costs capitalized as a % of total corporate common costs	
Overhead costs capitalized	$208.0
Total common corporate costs	$432.4
Metric 1 Capitalization rate (US Metric)	**48%**
Metric 2: Corporate common costs capitalized as a % of OM&A	
Overhead costs capitalized	$208.0
Total OM&A	$1,131.0
Metric 2 Capitalization rate (Canadian Metric)	**18%**

The total common corporate costs were capitalized at a rate of 48% when compared to total common corporate costs and 18% when compared to total OM&A. Both of these metrics are for the combined Tx and Dx businesses. Please note that the denominator in Metric 1 excludes common corporate costs which are direct charged and removed from the allocation cost pool.

Our observations and conclusions

As PwC did not attend the interviews with B&V nor perform the time surveys, we cannot comment on the percentage of time these activities relate to capital. However, we reviewed the nature of the activities in general as well as the description of these activities provided to us by management and B&V and observed a relation to capital for those activities which had some portion allocated to capital.

Based on the methodology described to us by Hydro One and B&V, in our opinion the proposed method to capitalize common corporate costs is reasonable and is consistent with the principle that any assignment of indirect costs to a capital work should be based on a reasonable causal link.

Comparison to regulatory and accounting guidance

Overview and summary

There is no regulatory guideline, statement or source that is universally accepted by utilities and regulators as the definitive statement, definition or standard that prescribes what types of indirect costs should be considered for capitalization nor how such costs are allocated to capital. Canadian utility regulators and FERC have historically accepted that indirect activities support capital work and, to the extent that there is a causal link to the capital activities, have allowed the associated costs to be allocated to capital. US GAAP and IFRS allow for the capitalization of costs by rate-regulated entities to the extent that it is probable that those costs will be recovered in future rates.

Based on our understanding we believe Hydro One's process and methodology for the capitalization of common corporate costs is reasonable based on the guidance issued by the OEB and FERC for entities that follow US GAAP and IFRS.

Comparison to OEB guidance

As part of our procedures, we reviewed the guidance issued by the OEB and compared this to the process and methodology to be used by Hydro One for allocating common corporate costs to capital.

Excerpt from Ontario Energy Board Accounting Procedures Handbook for Electric Distribution Utilities

"Overhead Charged to Construction includes engineering, supervision, administrative salaries and expenses, construction engineering and supervision, legal expenses, taxes and other similar items. The assignment of overhead costs to particular jobs or units shall be on the basis of a reasonable allocation of actual costs. The records supporting the entries for overhead charged to construction costs shall be maintained so as to show the total amount for each element of overhead for the year and the basis of allocation."

Our observations

The above guidance was obtained from Appendix A of the Ontario Energy Board Accounting Procedures Handbook for Electric Distribution Utilities ("2007 Handbook") and has been applicable to Hydro One since the adoption of US GAAP on January 1, 2012. Hydro One's fillings with the OEB on adoption of US GAAP noted that US GAAP effectively continued the accounting practices previously applied under legacy Canadian GAAP pursuant to Part V of the Handbook of the Canadian Institute of Chartered Accountants and there were no accounting policy changes arising from the transition from Canadian to US GAAP that impacted Hydro One Distribution's rate base or revenue requirement (EB-2013-0416, Exhibit A, Tab 15, Schedule 2).

Consistent with the guidance described above, overhead charged to construction at Hydro One, including common corporate costs, are first direct charged to the related business unit and capital or OM&A work order when reasonably possible. Common corporate costs that cannot be directly charged are accumulated and then capitalized based on the approach discussed previously.

Consistent with the guidance as mentioned above, the common corporate cost allocations and rates determined are held within SAP, Hydro One's system of record. The common corporate cost capitalization rates are based on business plan numbers and other estimates, and both the planned and actual amounts can be automatically calculated in SAP. At year-end, capitalized overheads are trued-up to reflect actual results. The records kept supporting the methodology appear to be appropriate.

Based on the guidance described above, and our review of the Company's process and methodology for demonstrating a causal link between the cost incurred and the capital program, it is reasonable that the Company is capitalizing an allocation of such costs to capital work. We also note that this methodology is consistent with our experience with other regulated utilities that report under US GAAP in Canada and the United States.

Comparison to FERC guidance

As part of our procedures, we reviewed the FERC guidance regarding capitalization of costs and compared this to the process and methodology employed by Hydro One. While Hydro One is not required to follow the FERC guidance, it is helpful to understand how other large regulators in North America, and the utilities that they regulate, view these types of costs. FERC's accounting rules for jurisdictional electric utilities are detailed in its USoA.

Excerpts from FERC electric plant instruction number 4, overhead construction costs to its Uniform System of Accounts

a. "All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired."

b. "As far as practicable, the determination of payroll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to the construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted."

c. "For Major utilities, the records supporting the entries for overhead construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each electric plant account, and the bases of distribution of such costs."

Our observations

The FERC guidelines outline that charges to plant accounts consist of direct costs and construction overheads and that construction costs should be supportable and based on cost causation.

Consistent with paragraph A of the FERC guidance, overhead costs at Hydro One, including common corporate costs, are first direct charged to the related business unit and capital or OM&A work order when reasonably possible. Common corporate costs that cannot be directly charged are accumulated and then capitalized based on the approach discussed previously.

Consistent with paragraph B of the FERC guidance, payroll charges at Hydro One are first direct charged to the related projects/programs when possible. Hydro One uses time surveys, where practicable, to allocate payroll to capital or OM&A in cases where an activity is 100% allocable to one or the other and allocates the remaining payroll charges based on the two-factor approach discussed previously.

Consistent with paragraph C of the FERC guidance as mentioned above, the common corporate cost allocations and rates determined are held within SAP, Hydro One's system of record. The common corporate cost capitalization rates are based on business plan numbers and other estimates, and both the planned and actual amounts can be automatically calculated in SAP. Hydro One reviews the overhead capitalization rate on a monthly basis (at a minimum) to determine if the overhead rate needs to be updated to reflect any changes in capital spending and associated costs. At year-end, capitalized overheads are trued-up to reflect actual results. The records kept supporting the methodology appear to be consistent with the support we observe at other utilities.

Additionally, in line with Electric Plant Instruction Number 4 of the FERC USoA, utilities generally capitalize a portion of the administrative expenses that have been recorded in FERC Accounts 920 - Administrative and general salaries and 921 - Office supplies and expenses, and record the transfer to construction costs in FERC Account 922 - Administrative expenses transferred - Credit. This process is described later in this report. These instructions further support FERC's guidance to capitalize certain administrative and general costs.

Comparison to US GAAP

We reviewed relevant US GAAP guidance, as defined by the Accounting Standards Codification ("ASC") of the Financial Accounting Standards Board ("FASB") regarding capitalization of costs and compared this to the process and methodology employed by Hydro One.

Excerpts from US GAAP Guidance

1. **FASB's ASC 360 – Property, plant and equipment**

   ASC 360–10: "Property, plant and equipment should be recorded at historical cost, which includes the costs incurred for activities to bring them to the condition and location necessary for their intended use. Interest costs incurred during the period the assets are brought to that condition and location are also included in the historical cost of acquiring the asset, if material."

2. **FASB's ASC 980 – Regulated operations**

   ASC 980-340: "25-1 Rate actions of a regulator can provide reasonable assurance of the existence of an asset. An entity shall capitalize all or part of an incurred cost that would otherwise be charged to expense if both of the following criteria are met:

   a. It is probable (as defined in Topic 450) that future revenue in an amount at least equal to the capitalized cost will result from inclusion of that cost in allowable costs for rate-making purposes.

   b. Based on available evidence, the future revenue will be provided to permit recovery of the previously incurred cost rather than to provide for expected levels of similar future costs. If the revenue will be provided through an automatic rate-adjustment clause, this criterion requires that the regulator's intent clearly be to permit recovery of the previously incurred cost."

Our observations

Based on the US GAAP sections noted above, costs incurred for activities to bring the property, plant or equipment to the condition and location necessary for their intended use should be recorded as capital assets. ASC 980 provides further guidance on the capitalization of overhead costs that are probable of future recoveries through rate base.

According to PwC's Power and Utilities Guide (Section 17.1):

> "A regulated utility should comply with U.S. GAAP applicable to entities in general with regard to its accounting and financial reporting. If it is also subject to ASC 980, the applicable provisions within that standard are applied as an adjustment to or in lieu of other U.S. GAAP (when specifically required by ASC 980)."

A regulated utility may have unique considerations in developing capitalization policies because regulators often permit recovery of costs as part of capital work that may otherwise be charged to expense in the period they are incurred. Only those costs that are probable of recovery through future rates should be capitalized as part of the utility plant.

As a result, costs that are allowed to be included in rate base by a utility's regulator are generally capitalized by utilities that use US GAAP.

As outlined in the guidance above, a company subject to the requirements of ASC 980 must first apply the accounting guidance applicable to all entities (i.e., in this case ASC 360). However, under ASC 980, the actions of the regulator often impact the accounting for certain activities.

ASC 980 provides guidance that allows for costs that may otherwise be expensed to be capitalized if it is both, 1) probable that future revenue will result from the inclusion of that cost in allowable costs for rate-making purposes and 2) the future revenue will permit the recovery of the previously incurred costs.

Consequently, the utility regulator has a direct impact on how certain costs are accounted for under US GAAP. If a cost supports underlying capital work, but may not be capitalized under US GAAP before the application of ASC 980, the regulator must decide if that cost should be borne by customers over the life of the underlying capital asset to match its use and the period during which customers will derive a benefit from it (i.e., capitalized) or expensed as a period cost and borne only by current period customers. It is typical for regulators to allow for costs that relate to and support capital work to be charged to capital to better match the benefit received to the cost in accordance with the regulatory principle of matching costs and benefits and producing intergenerational equity.

Comparison to IFRS

We reviewed relevant International Financial Report Standards (IFRS) as defined by the International Accounting Standards Board (IASB) regarding capitalization of costs and compared this to the process and methodology employed by Hydro One.

Excerpts from IAS 16 – Property, plant and equipment

Recognition

1. The cost of an item of property, plant and equipment comprises:
   a. its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
   b. any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
   c. the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
2. Examples of directly attributable costs are:
   a. Costs of employee benefits (as defined in IAS 19 Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
   b. Costs of site preparation;
   c. Initial delivery and handling costs;
   d. Installation and assembly costs;
   e. Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
   f. Professional fees.
3. Examples of costs that are not costs of an item of property, plant and equipment are:
   a. Costs of opening a new facility;
   b. Costs of introducing a new product or service (including costs of advertising and promotional activities);
   c. Costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
   d. Administration and other general overhead costs.

Excerpts from IFRS 14 – Regulatory deferral accounts

IFRS 14.5 An entity is permitted to apply the requirements of this Standard in its first IFRS financial statements if and only if it:

   a. Conducts rate-regulated activities; and
   b. Recognized amounts that qualify as regulatory deferral account balances in its financial statements in accordance with its previous GAAP.

IFRS 14.B3 For the purposes of this Standard, a regulatory deferral account balance is defined as the balance of any expense (or income) account that would not be recognized as an asset or a liability in accordance with other Standards, but that qualifies for deferral because it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers. Some items of expense (income) may be outside the regulated rate(s) because, for example, the amounts are not expected to be accepted by the rate regulator or because they are not within the scope of the rate regulation. Consequently, such an item is recognized as income or expense as incurred, unless another Standard permits or requires it to be included in the carrying amount of an asset or liability.

IFRS 14.B5 – The following are examples of the types of costs that rate regulators might allow in rate-setting decisions and that an entity might, therefore, recognise in regulatory deferral account balances:

i. Volume or purchase price variances;

ii. Costs of approved 'green energy' initiatives (in excess of amounts that are capitalised as part of the cost of property, plant and equipment in accordance with IAS 16 Property, Plant and Equipment);

iii. Non-directly-attributable overhead costs that are treated as capital costs for rate regulation purposes (but are not permitted, in accordance with IAS 16, to be included in the cost of an item of property, plant and equipment); (emphasis added)

iv. Project cancellation costs;

v. Storm damage costs; and

vi. Deemed interest (including amounts allowed for funds that are used during construction that provide the entity with a return on the owner's equity capital as well as borrowings).

Our observations

Based on the IFRS sections noted above, directly attributable costs incurred for activities to bring the property, plant or equipment to the condition and location necessary for it to be capable of operating in the manner intended by management may be capitalized. Further administrative and other general overhead costs are explicitly not permitted to be capitalized. IAS 16 does not define what types of costs are considered “administrative and other general overhead costs”. While the FASB guidance under ASC 360 previously described is not as exhaustive as IAS 16 paragraph 19, the interpretation in practice in this area is largely consistent between the two frameworks and outside the application of ASC 980, administrative and other general overhead costs are not capitalized under US GAAP.

However, as we note below, in instances where IFRS 14 is applicable, when such administrative and other general overhead costs are allowed to be capitalized by a utility’s regulator, such costs would also be capitalized under IFRS, but with different presentation. A company who has adopted IFRS 14 must first apply the accounting guidance applicable to all entities (i.e., in this case IAS 16). However, under IFRS 14, the actions of the regulator impact the accounting for certain activities.

IFRS 14 provides guidance that allows any expense (or income) that would not be recognized as an asset or a liability in accordance with other Standards, to qualify for deferral if it is included, or is expected to be included, by the rate regulator in establishing the rate(s) that can be charged to customers in the future.

Consistent with the guidance in ASC 980 under US GAAP, the regulator has a direct impact on how certain costs are accounted for. If a cost supports an underlying capital program, but may not be capitalized under IFRS before the application of IFRS 14, the regulator must decide if that cost should be borne by customers over the life of the underlying capital work to match its use and the period during which customers will derive a benefit from it (i.e., capitalized) or expensed as a period cost and borne only by current period customers.

Where IFRS 14 is applied for administrative and other general overhead costs, deferrals permitted by the regulator would be treated as a regulatory asset under IFRS whereas under US GAAP, these amounts would generally be capitalized directly to Property, Plant and Equipment (PP&E). This results in a difference in geographical presentation on the balance sheet and income statement. Absent the application of IFRS 14, such costs that do not qualify for capitalization to PP&E would generally be recorded as expense in the period they are incurred.

The Regulatory Assets and Regulatory Liabilities, Exposure Draft, that was issued by the IASB on January 28, 2021 is subject to a comment period ending on June 30, 2021. The date for a final standard to be issued is uncertain and will likely depend on the significance of the comments received by the IASB. Tentatively, it has been decided that the effective date would be 18-24 months after publication of a final standard.

Our observations and conclusions

Based on our understanding we believe Hydro One’s process and methodology for the capitalization of common corporate costs is reasonable based on the guidance issued by the OEB and FERC and consistent with the principles of US GAAP and IFRS.

Appendix A – Qualifications

Eric Clarke

Eric is a utilities specialist partner with over 25 years working with utility clients in Canada, the US, UK and Europe. He joined PricewaterhouseCoopers in Edmonton, Alberta in 1993 after graduating from the University of Saskatchewan with a Bachelor of Commerce degree. On obtaining his Chartered Accountant qualification in 1996, he transferred to PricewaterhouseCoopers in London, England where he worked in PwC's energy & utilities practice from 1996 to 2003. During this period, Eric also spent one year working in Paris leading an engagement with a Fortune 500 multinational energy company. He returned to Canada in 2003 to join PricewaterhouseCoopers' utility practice in Toronto.

Eric oversees audit and advisory services to several Canadian utilities. He has a wide range of international experience in leading large and complex internal and external audit assignments, regulatory matters, IFRS and US GAAP conversion projects, due diligence and transaction services, stock exchange listings and other risk management and advisory services.

Eric is a regular instructor at the Directors Education Program of the Institute of Corporate Directors and a presenter at the Canadian Electricity Association Finance & Accounting Committee. He is a board member and Chair of the Finance Committee for the Safehaven Project for Community Living.

Eric is a Partner of PricewaterhouseCoopers LLP, based in our Toronto office whose address is 18 York Street, Suite 2600 Toronto, Ontario, M5J 0B2.

Eric Clarke as well as other PwC personnel working under his supervision and direction, have read and analyzed supporting documentation and information relevant to the issues on this engagement. He has been assisted by several other PwC professionals, including Philip Hagel and Al Felsenthal, each with applicable regulated utility knowledge and experience.

Appendix B – Results of comparison to other utilities

US Comparable Companies (Quantitative Data Available)

The table below summarizes benchmarking results of peer companies in the United States where quantitative data is available:

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of Total Corp. Common (A&G) Costs	Additional Factors	Reference
Southern California Edison (SCE), California Public Utilities Commission (CPUC). US GAAP	Administrative and General ("A&G") overhead costs are based on study approved by the regulator. SCE performs an A&G Effort Study to determine A&G capitalization rate for costs that are not already directly recorded to capital work orders. Each department that incurred expenses charged to accounts 920 and 921 estimated their A&G costs that support construction activities. Estimates were developed by reviewing employees' time and expenses related to construction activities and by reviewing the relationship between departmental functions and activities and construction activities. Overheads allocated based on cost drivers/time study and include cost of corporate functions and services like human resource, IT, corporate finance and risk assessment and strategy.	Corporate Cost – Audit, Controllers, Corporate Communications, Customer Service, Human Resources, Law, Treasurer. Strategy – General Functions and Information Technology. Operations Support – Training, Environmental, Health and Safety.	24.05%	2019 Capital Expenditures: $3.9 billion USD. Total assets = $64 billion USD at December 31, 2019 Distribution, transmission, and generation company	SCE 2018 GRC A16-09 SCE08 Volume 03, Book A Workpapers EIX 2019 10K

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of Total Corp. Common (A&G) Costs	Additional Factors	Reference
San Diego Gas & Electric Company (SDG&E), California Public Utilities Commission (CPUC). US GAAP	SDG&E and SoCalGas charge most of their operating costs directly to either capital or O&M. However, some of the A&G expenses, labor overheads (e.g. pension and benefits, injuries and damages), and clearing account costs support construction efforts.	A&G costs represent corporate services and include the following: • A&G salaries, • shared services • office supplies • expenses and outside services employed.	8.57%	2019 Capital Expenditures: 1,522 million USD Total assets = $19,225 million USD at December 31, 2019 Distribution, transmission, and generation company	SDG&E 2019 GRC A.17-10-008 Revised Workpapers SDG&E 2018 10K
Pacific Gas & Electric Company (PG&E), California Public Utilities Commission (CPUC). US GAAP	Overhead allocation is based on detailed review by Corporate Service departments to calculate the appropriate administrative and general (A&G) capital allocation. A&G costs are assigned to each operational line of business using an allocation method. Pensions and benefits are also capitalized.	A&G Department costs include costs related to the Finance Organization, Regulatory Affairs, Corporate Affairs and Executive Offices and Corporate Secretary A&G Company Wide expenses include costs related to general liability insurance, directors' and officers' insurance, non-nuclear and nuclear property insurance, and Director fees and expenses	12.23%	2019 Capital Expenditures: $6,313 million USD Total assets = $84,614 million USD at December 31, 2019 Distribution, transmission, and generation company	PG&E D.17.05.013 GRC Rev Req 2017-2019 PG&E 2019 10K
"Evergy (Kansas City Power & Light Company)" Kansas Corporation Commission	A&G expenses are allocated using a number of methods depending on the cause of the cost. (i.e. cost drivers). The indirect allocation of A&G payroll to construction activity follows the FERC USoA guidance	Indirect A&G costs include corporate services costs, executive salaries and indirect labour.	16.69%	2019 Capital Expenditures: $1,210 million USD Total assets = $25,976 million USD at December 31, 2019 Distribution, transmission, and generation company	Rate App. S20180501162757 Evergy 2019 10K
US GAAP Summary	For the peer companies observed, the common corporate costs capitalized as a percentage of total common corporate costs ranged from **8.57%-24.05%**.				

US Comparable Companies (Qualitative Information Only)

The table below summarizes benchmarking results of peer companies in the United States where only qualitative information is available:

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of Total Corp. Common (A&G) Costs	Additional Factors	Reference
CenterPoint Energy Houston Electric (CEHE), Public Utility Commission of Texas US GAAP	A&G costs are directly assigned. Allocated costs are directly assigned and based on functionalization factors. The three primary policies that determine how project costs are to be either capitalized or expensed include: various Federal Energy Regulatory Commission ("FERC") guidelines relating to capitalization and expenses; CenterPoint Energy's (CNP's) Capitalization Policy (which was developed consistent with the FERC guidelines); and CNP's Capitalization of Computer Software Policy (also developed consistent with FERC guidelines).	A&G expenses include, but are not limited to, salaries and wages, office supplies, outside services, regulatory commission expenses, rents and general maintenance. Allocated Expenses include functions such as Audit, Business & Operations Support, Communications, Executive Management, Finance, Government Affairs. Human Resources, Legal Regulatory, Technology Operations.	Capitalization rate information is not available	2019 Capital Expenditures: $1,033 million USD Total Assets = $11,262 million USD at December 31, 2019 Distribution and transmission company	2019 CenterPoint Energy Houston Electric Rate Case WP V1-L.1 Page 1 of 1 (Page 7101) CenterPoint Energy 2019 Form 10-K
Consumers Energy, Michigan Public Service Commission US GAAP	Common Corporate Service Costs are an aggregation of expenses that are not attributable to any one department but are incurred on behalf of the Company as a whole. Examples include: Corporate labor and expenses, capitalized credits to O&M, billing credits for A&G labor expenses and outside services as part of a full-cost loading adder, Senior management time and expenses and board of director costs	Capital overhead costs include those costs related to the following: •Administrative and General (A&G): Portion of Corporate Service Salary and Business Expenses •Pension/Defined Company Contribution Plan •Other Post-Employment Benefits (OPEB): Retiree Health and Life •Other Capitalized Costs (OCC): Active Health and Life,	Capitalization rate information is not available	2019 Capital Expenditures: $2,085 million USD Total assets = $23,699 million USD at December 31, 2019 Distribution and generation company	2018 Rate Case Docket U-20134-0007, Consumers Energy Testimony Consumers Energy 2019 Form 10-K

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of Total Corp. Common (A&G) Costs	Additional Factors	Reference
		Workers Comp, Injuries and Damages, 401k Savings Match and Payroll Taxes -Engineering and Supervision (E&S): portion of Distribution cost centers that support capital work; i.e. planning, design, and field supervision			
DTE Electric Company Michigan Public Service Commission US GAAP	Corporate Staff Group (CSG) is a shared services organization, DTE Energy Corporate Services LLC, which includes corporate staff functions. Corporate staff group costs are first incurred and accumulated at the DTE Energy Corporate Services LLC. Each department within a corporate staff organization identifies products and services it expects to provide to legal entities and/or business units based on the corporate staff organization's scope of work. These products and services are measured based on the most appropriate cost driver.	The organizations within the Corporate Staff Group (CSG) provide a variety of Administrative and General (A&G) type services to the Company. These include: Audit Services, Accounting and Planning, Tax, Finance and Treasury, Corporate and Governmental Affairs, Communications, Corporate Offices Supply Chain, Corporate Fleet and Facilities, Human Resources, Information Technology, Legal, Regulatory Affairs, Environmental Management and Major Enterprise Projects	Capitalization rate information is not available	2019 Capital Expenditures: $2,368 million USD Total assets = $24,588 million USD at December 31, 2019. Distribution and generation company	2019 Rate Case U-20561 Direct Testimony (TMU39-40) DTE Electric Company 2019 Form 10-K

US Comparable Companies (Data Not Available)

Data was not available for the following peer companies in the United States:

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of Total Corp. Common (A&G) Costs	Additional Factors	Reference
Wisconsin Electric Power Company, Public Service Commission of Wisconsin US GAAP	Detailed information is not available		Capitalization rate information is not available	N/A	
Arizona Public Service, Arizona Corporation Commission US GAAP	Detailed information is not available		Capitalization rate information is not available	N/A	
Public Service Enterprise Group, New Jersey Board of Public Utilities US GAAP	Detailed information is not available		Capitalization rate information is not available	N/A	

Canadian Comparable Companies (Quantitative Data Available)

The table below summarizes benchmarking results of peer companies in Canada where quantitative data is available:

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of OM&A (in millions)	Additional Factors	Reference
FortisBC Inc., British Columbia Utilities Commission US GAAP	Capitalized overheads are determined through applying a capitalization rate to gross O&M expenses. The capitalization overhead rates are assigned to regulated capital and certain other major projects. Direct costs are charged to projects and capitalized directly. Direct overhead loading costs are allocated through the estimated time to be charged to capital projects on an employee or individual cost basis. Indirect costs - net of direct costs and direct overhead loading costs and allocated through a capitalization rate determined through a survey based model to calculate the cost allocation to labour and non-labour.	Major categories of capitalized OM&A are: (1) Labour and (2) Non-labour including engineering, external relations, information systems, regulatory, legal, human resources and finance.	15% (percentage is derived)	2019 Capital expenditures = $106 million CAD Total assets = $2,326 million CAD at December 31, 2019 Distribution and transmission company	FEI-FBC 2020-2014 MRP Application Appendix D6-2 FBC OVERHEAD CAPITALIZATION METHODOLOGY REVIEW, KPMG fortisbc.com
Enbridge Gas Inc., Ontario Energy Board US GAAP	Capitalized overheads are allocated through two streams: direct and indirect. Indirect cost allocations to capital are determined based on four methods: i) time analysis, ii) work plan (allocation of time and expenses), iii) cost drivers and iv) composite ratio (corporate average or HR composite ratios). Major cost components include (i) indirect overhead allocations, (ii) Alliance partner overheads, (iii) district contract pre-work costs and (iv) administration and general overheads.	Corporate costs - Human Resources (including Pension and OPEB, Employee training, Salary wages and Benefits), Finance, IT, Legal, Executive, Supply chain, Regulatory, Direct capital support, Information service costs, Utility costs, Advertising, Insurance, Donations, Regulatory and Recovery.	22% (Enbridge Gas Distribution Inc. pre-amalgamation - indirect overhead as a percentage of designated overhead) 14.4% (Union Gas Limited pre-amalgamation)	2019 Capital expenditures = $1,109 million CAD Total assets = $24,681 million CAD at December 31, 2019 Distribution and transportation company	EB-2019-0105 EB-2019-07-17 EB-2018-0305 Exhibit I. STAFF.32 EBRO 497 EB-2011-0008-Exhibit B, Tab 4, Schedule 2 Union Gas: Overhead Capitalization Study 2017 Enbridge Gas Inc. December 31, 2019 MDA

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of OM&A (in millions)	Additional Factors	Reference
	The current method of estimating the proportion of costs that are capable of being capitalized and transferring those costs to a holding account ('blanket') that contains costs relating to capital projects. These costs are then allocated on a proportionate basis using total Capital Work in Progress (CWIP) as the driver, where the most relevant allocation driver is CWIP.				Enbridge Gas Inc. June 30, 2020 MDA EB-2011-0354 Exhibit D2 Tab 7 Schedule 1
Toronto Hydro Corporation, Ontario Energy Board (OEB) IFRS	Capitalized overheads are allocated based on cost drivers and include corporate functions and services, and employee benefits. Major cost categories include: (1) Labour (including pension and OPEB), (2) Vehicle and (3) Material handling on cost.	Corporate costs include - Finance, Payroll, Information Technology, Legal, Human Resources, Procurement, Facilities, Senior Management	32%	2019 Capital expenditures = $571 million CAD Total assets = $5,613 million CAD at December 31, 2019 Distribution company	EB-2018-0165 2017, 2018, 2019 Annual Reports 2019 Annual Financial Report
Enmax Power Corporation Alberta Utilities Commission IFRS	Capitalized overheads are determined through a combination of time studies (including estimated work effort, total headcount, vehicle count, workstation count, square footage, insurance asset value and executive head count), cost drivers and direct charges. A universal cost allocator is used for those costs that cannot be allocated reasonably using a single cost driver. Amount of annual capitalized overheads the company is permitted to capitalize is currently based on a 19% rate approved by AUC to a cap of $16M and $4M for Distribution and Transmission, respectively, in 2007, escalated by 3% annually.	Corporate costs include accounting, finance, human resources, information technology, treasury and legal services.	7% (Derived*)	2019 Capital expenditures = $444 million CAD Total assets = $6,744 million CAD at December 31, 2019 Distribution and transmission company	AUC Decision 2012-246 2007-2016 Formula Based Ratemaking March 25, 2009 23752-D01-2020

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of OM&A (in millions)	Additional Factors	Reference
BC Hydro and Power Authority, British Columbia Utilities Commission IFRS	Overheads are allocated to four main OM&A cost categories (1) Generation, (2) Transmission, (3) Distribution, (4) Customer Care, and (5) Corporate Services, using a bottom up functionalization approach. Under IFRS, the company has $67 million of planned additions to the IFRS PPE Regulatory Account for smoothing the rate impact of overhead costs not eligible for capitalization under IFRS, as they are not considered directly attributable to the construction of capital assets.	Capitalized costs consist of overhead costs directly attributable to capital expenditures that are transferred from OM&A to PPE. Major categories of capitalized OM&A are: (1) Generation, (2) Transmission, (3) Distribution, (4) Customer Care, and (5) Corporate Services	4% (Derived*)	2020 Capital expenditures = $2,782 million CAD Total assets = $30,730 million CAD at March 31, 2019 Distribution, transmission, and generation company	Cost of Service Study 2019 2018/19 ANNUAL SERVICE PLAN REPORT
Summary	For the peer companies observed, the common corporate costs capitalized as a percentage of total OM&A ranged from **4%-32%**.				

*Amounts noted as derived above, have been calculated as follows:

- FortisBC Inc. - amounts have been derived from “Appendix D6-2 FBC Overhead Capitalization Methodology Review, KPMG” dated March 8, 2019 (page 21), normalized for Hydro One comparable departments: Capital related costs (excluding Engineering) of $8.0 million, as a percentage of Total O&M Costs (excluding Engineering) of $53.2 million.

- Enmax Power Corporation - amounts have been derived from “AUC Decision 2012-246, Implementation of International Financial Reporting Standards”, dated September 14, 2012 (Page 15): 2012 Administrative overheads forecasted to be capitalized under IFRS of $9.1 million, as a percentage of total 2012 forecasted Administrative overheads. Total administrative overheads have been calculated based on 2012 CGAAP Capitalized administrative overheads of $23.2 million capitalized at 19%, resulting in an estimated total forecast of administrative overheads total of $122.0 million.

- BC Hydro and Power Authority - amounts have been derived from “British Columbia Hydro and Power Authority, 2019/2020 Annual Service Plan Report”, dated June 4, 2020 (pages 26, 41, 62), normalized for Hydro One comparable operating expenses: Capitalized costs of $72 million, as a percentage of Total operating expenses (excluding Electricity and gas purchases, Water rentals, Transmission charges and Amortization and depreciation) of $1,626.0 million.

Canadian Comparable Companies (Qualitative Information Only)

The table below summarizes benchmarking results of peer companies in the Canada where only qualitative information were available:

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of OM&A (in millions)	Additional Factors	Reference
Alectra Incorporated, Ontario Energy Board IFRS	New capitalization policy implemented in 2019 to align with IFRS and track through deferral accounts.	Major categories of capitalized OM&A are: (1) Direct labour costs, (2) Benefit costs, (3) Material handling costs, and (4) Fleet costs.	Capitalization rate information is not available	2019 Capital expenditures = $380 million CAD Total assets = $5,056 million CAD at December 31, 2019 Distribution company	EB-2018-0016 EB-2019-0018 December 31, 2018 MDA

Canadian Comparable Companies (Data Not Available)

Data was not available for the following peer companies in Canada:

Utility Name, Regulator and Basis of Accounting	Analysis	Overhead Cost Components	Corp Common Costs capitalized as a % of OM&A (in millions)	Additional Factors	Reference
Hydro-Québec, Government of Quebec US GAAP	Detailed information is not available		Capitalization rate information is not available	N/A	

ENBRIDGE GAS INC.

Answer to Undertaking from
Ontario Energy Board Staff (STAFF)

Undertaking

Tr: 8

To advise what type of changes to capitalization would require OEB approval under ASC 980

Response:

Enbridge Gas interprets the undertaking to ask what types of changes to the overhead capitalization methodology would require OEB approval under ASC 980.

Enbridge Gas believes that any changes to the indirect overhead capitalization methodology are subject to OEB approval. It is the Company's intent to follow the proposed harmonized indirect overhead capitalization methodology which has been included in evidence. This methodology is based upon the principles enunciated in Section 3.1 of Exhibit 2, Tab 4, Schedule 2. Accordingly, changes would only be undertaken for the purpose of enhancing those principles (e.g. increased transparency, accuracy, etc.). If required, any changes made during the incentive rate period will be communicated to the OEB during annual Earnings Sharing proceedings and, where appropriate, approval would be sought.

PARTIAL SETTLEMENT PROPOSAL

Enbridge Gas Inc. Application for approval of 2024 Rates

June 28, 2023

(Updated July 12, 2023)

overspend on the WAMS project and 25% of the overspend on the Enbridge Gas Distribution GTA Reinforcement Project from opening 2024 rate base.

While the overall level of rate base additions from 2023 capital expenditures is not settled, Parties agree that Enbridge Gas will not include any amounts in 2024 opening rate base for the Dawn to Corunna project (approved in EB-2022-0086). Instead, the determination of the amount to be included in rate base for the Dawn to Corunna project will be made in Phase 2 of this proceeding. Phase 2 will include the issue of how much (if any) of the value of the project should be allocated to Enbridge Gas's non-utility operations. The full-year impact of the approved Dawn to Corunna project rate base amount will be recoverable from ratepayers.

No items related to 2024 capital budget and associated rate base were settled. In relation to the capitalized overhead part of the 2024 capital budget, there is no agreement as to methodology or amount.

b) Volumes & Revenues

For the sole purpose of setting rates for 2024, Parties agree to Enbridge Gas's as-filed volumes forecast and revenues at existing rates, revenue forecasts for storage and transportation (S&T), upstream transportation revenue, optimization revenue and other revenues, subject to three exceptions. These exceptions relate to: (i) an agreed adjustment to the 2024 customer forecast; (ii) an unsettled issue about the appropriateness of the requested Volume Variance Account; and (iii) how amounts related to proceeds from Enbridge Gas dispositions of property should be included in other revenue forecast or otherwise credited to ratepayers.

The agreement on volumes and revenues is expressly made for the sole purpose of setting rates for 2024. Parties have agreed upon the 2024 Test Year results from the forecasting methodologies, not the broader issue of whether the methodologies are generally appropriate (e.g., for capital planning). Parties agree that a determination on the methodologies is not necessary in order to set the volume forecast underpinning 2024 rates.

c) O&M

Parties agree that the 2024 as-filed O&M budget, net of overhead capitalization and exclusive of DSM costs set and approved in the EB-2022-0002 DSM Framework proceeding, will be reduced by $50 million to $821 million. Applying Enbridge Gas's proposed overhead capitalization methodology, capitalized overhead is consequently reduced to $292 million, which represents a $18 million reduction from the as-filed amount. These adjustments result in a gross O&M budget of $1,113 million, exclusive of DSM-related amounts. The net O&M budget, after $292 million of overhead capitalization, is $821 million.

Parties agree that this gross O&M budget is reasonable in the context of a proposed capital budget (before updates) of $1,491 million. It will be open for Parties to argue that a different capitalized overhead amount would be appropriate if a different overhead capitalization methodology is approved and/or if a different capital budget is approved. In the event that the OEB approves a capitalized overhead amount that is different from $292 million, all Parties agree that any resulting adjustment of the O&M budget envelope to account for the reduced/increased portion of gross O&M being recovered as capitalized overhead is an item for Parties to argue and the OEB to consider.

In connection with the agreement on the O&M budget envelope, Parties have agreed to variance account treatment for two aspects of the O&M budget – (i) Distribution Integrity Management Program (DIMP) and Enhanced Distribution Integrity Management Program (EDIMP) costs; and (ii) pension and other post-employment benefits (OPEB) costs.

Parties accept Enbridge Gas's proposed methodology for determining 2024 income and property taxes. Final forecast 2024 income and property taxes cannot be determined until other unresolved issues are determined.

d) Gas Costs and related issues

Parties agree to the as-filed 2024 gas supply cost, subject to issues to be determined in Phase 2 of this proceeding related to costs for load balancing including storage. Parties further agree that the issues related to a common reference price methodology and operational contingency space are storage related cost allocation issues appropriately determined in Phase 2 of this proceeding.

For the purposes of determining gas supply costs, Parties agree to a modified version of the Enbridge Gas proposal for design day and design hour with a number of limitations and provisos as indicated below.

Parties agree to a modified approach from the Enbridge Gas filing for unaccounted-for gas (UFG) costs. The amount in rates will be based on the average actual UFG volumes for 2018-2020. UFG variance accounts will be created where: (i) Enbridge Gas and ratepayers will share, on a 50/50 basis, the cost/credit of variances in UFG volumes included in rates and the actual UFG volumes at the applicable gas supply reference price, up to a maximum volume of 400,000 10^3m^3; and (ii) Enbridge Gas will recover/credit the full cost implications of the variance between the actual price of Enbridge Gas's gas supply purchases and the applicable gas supply reference price, applied to all actual experienced UFG volumes. Enbridge Gas has agreed to determine and report on an appropriate way to identify, measure and mitigate fugitive emissions.