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December 14, 2024

**VIA RESS AND EMAIL**

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Nancy Marconi:

**Re: Enbridge Gas Inc. (Enbridge Gas, or the Company)**
**EB-2024-0111- 2024 Rebasing and IRM**
**Response to Information Requests – Environmental Defence Motion – Updated Question #3**

In response to Environmental Defence's letter of December 4, 2024, enclosed please find the updated response to ED Motion Question #3.

Should you have any questions, please let us know.

Sincerely,

Joel Denomy

Joel Denomy
Technical Manager, Strategic Applications – Rate Rebasing

ENBRIDGE GAS INC.

Answer to Environmental Defence Motion Question

Reference:

EB-2022-0200, Hearing Transcript, Volume Two, July 14, 2023, p. 22, ln. 14.

EB-2023-0201, Exhibit I.ED-23, Page 4, Table 2.

Question:

In relation to the Customer Count Variance Account described by the Current Energy Group, provide the average revenue per customer and the average incremental cost per customer for the general service customer classes, and if those figures differ significantly from $600 in average revenue and $74.89 in incremental costs for residential customers, to explain why.

Response[1]:

The $600 in average revenue is for all general service customers, not solely residential rate classes.

Enbridge Gas notes that the average distribution revenue, excluding DSM costs, for a residential customer is approximately $500. The incremental O&M for a Rate 1 customer based on the Phase 3 2024 Cost Allocation Study[2] and the O&M costs as approved in the Phase 1 Decision is $94.12. The incremental cost of $74.89 referenced in the question was the incremental O&M cost for a residential Rate 1 customer presented as part of the Eganville Leave to Construct Application[3]. The increase in cost is a result of the harmonized cost study and the length of time and change in costs since the last approved cost studies. Please see Table 1 for a summary of the average revenue and incremental O&M cost per customer by rate class for general service customers.

[1] Enbridge Gas wishes to indicate that this answer has been prepared as fully as possible in the time available. Enbridge Gas may have further information based on better understanding of the question being asked, and on having more time to consider and respond.
[2] This cost allocation study will be filed in Phase 3 and maintains current rate zones.
[3] EB-2023-0201, Exhibit I.ED-23, p. 4, Table 2. This cost was based on the 2018 cost study escalated by PCI annually.

Table 1
Average Revenue per Customer and Incremental O&M per Customer

| Line No. | | Number of Customers | Average Revenue/ Customer ($) | Incremental O&M per Customer ($) |
|---|---|---|---|---|
| | | (a) | (b) | (c) |
| 1 | Rate 1 | 2,163,088 | 485 | 94.12 |
| 2 | Rate 6 | 172,974 | 2,167 | 228.92 |
| 3 | Rate 01 | 369,871 | 616 | 118.80 |
| 4 | Rate 10 | 2,205 | 11,641 | 1,235.38 |
| 5 | Rate M1 | 1,205,199 | 493 | 95.36 |
| 6 | Rate M2 | 8,077 | 10,182 | 928.47 |
| 7 | Total General Service | 3,921,414 | 600 | |
| 8 | Total Residential | 3,738,158 | 500 | |

The incremental costs Enbridge Gas incurs for adding a customer includes the O&M cost as shown in the table above, as well as the capital cost. The average incremental cost of adding a residential customer, determined by the revenue requirement calculation that includes both the incremental O&M and capital cost is between $491 and $610 in Enbridge Gas's rate zones. Please see line number 16, column (e) in Tables 2 to 4 which show the average revenue requirement of attaching a feasible customer. Note, the costs underpinning Tables 2 to 4 are based on the best available information today, which is the Phase 3 2024 Cost Allocation Study for current rate zones.[4] The Phase 3 2024 Cost Allocation Study is used as it is the only cost study that has been updated for the revenue requirement approved in Phase 1. The assumptions Enbridge Gas made in order to develop the cost estimates include:

a) The distribution rates used in determining the customer addition capital expenditure are based on the Phase 3 2024 Cost Allocation Study (consistent with Table 1).

b) The capital expenditure per customer attachment is calculated to be equal to Enbridge Gas earning a PI of 1.0 over 40 years (line 1 of Tables 2 to 4). This is a notional number and does not consider the actual cost to add a specific customer

[4] The Phase 3 2024 Cost Allocation Study includes the revenue requirement approved as part of the Phase 1 Interim Decision and Rate Order (EB-2022-0200), but does not include costs from the Phase 2 Settlement Proposal.

which could be higher or lower. Enbridge Gas believes this approach of estimating the incremental capital cost of adding a customer is appropriate as Enbridge Gas's portfolio must be equal to or greater than a PI of 1.0.

c) The revenue assumptions exclude projects with a SES and TCS surcharge.

d) The O&M amounts included reflect average variable O&M costs of each rate class, and do not include fixed O&M costs which can increase or decrease in a stepped fashion with material changes in the number of customers served, or due to other drivers. Please see Table 1 for the incremental O&M per customer (also see line 3 of Tables 2 to 4).

Table 2

Estimate of Incremental Revenue Requirement of Attaching Feasible Rate 1 Customers

| Line No. | Particulars ($) | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|---|
| | | (a) | (b) | (c) | (d) | (e) |
| | Rate Base Investment | | | | | |
| 1 | Capital Expenditures | 4,548 | 4,548 | 4,548 | 4,548 | 4,548 |
| 2 | Average Investment | 4,304 | 8,667 | 12,899 | 17,001 | 20,972 |
| | Revenue Requirement Calculation: | | | | | |
| | Operating Expenses: | | | | | |
| 3 | Operating and Maintenance Expenses | 94 | 188 | 282 | 376 | 471 |
| 4 | Depreciation Expense | 120 | 250 | 381 | 511 | 642 |
| 5 | Property Taxes | 14 | 27 | 41 | 55 | 68 |
| 6 | Total Operating Expenses | 227 | 466 | 704 | 942 | 1,181 |
| | Required Return (1) | | | | | |
| 7 | Interest Expense | 132 | 265 | 395 | 521 | 642 |
| 8 | Return on Equity | 151 | 303 | 451 | 595 | 734 |
| 9 | Required Return | 282 | 569 | 847 | 1,116 | 1,376 |
| 10 | Total Operating Expense and Return | 510 | 1,034 | 1,550 | 2,058 | 2,557 |
| | Income Taxes | | | | | |
| 11 | Income Taxes - Equity Return (2) | 54 | 109 | 163 | 215 | 265 |
| 12 | Income Taxes - Utility Timing Differences(3) | (55) | (101) | (141) | (175) | (156) |
| 13 | Total Income Taxes | (1) | 9 | 22 | 39 | 109 |
| 14 | Total Revenue Requirement | 509 | 1,043 | 1,573 | 2,097 | 2,666 |
| 15 | Number of Customers | 1 | 2 | 3 | 4 | 5 |
| 16 | Average Revenue Requirement per Customer | 509 | 522 | 524 | 524 | 533 |

Notes:

(1) The required return assumes a capital structure of 62% debt at 4.94% and 38% common equity at the 2024 Board Formula return of 9.21%. The annual required return is as follows: Average Investment (row 2) * 62% * 4.94% plus Average Investment (row 2) * 38% * 9.21%

(2) Taxes related to the equity component of the return at a tax rate of 26.5%.

(3) Taxes related to utility timing differences are negative as the capital cost allowance deduction in arriving at taxable income exceeds the provision of book depreciation in the year.

Table 3
Estimate of Incremental Revenue Requirement of Attaching Feasible Rate 01 Customers

| Line No. | Particulars ($) | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|---|
| | | (a) | (b) | (c) | (d) | (e) |
| | Rate Base Investment | | | | | |
| 1 | Capital Expenditures | 4,912 | 4,912 | 4,912 | 4,912 | 4,912 |
| 2 | Average Investment | 4,642 | 9,353 | 13,923 | 18,352 | 22,640 |
| | Revenue Requirement Calculation: | | | | | |
| | Operating Expenses: | | | | | |
| 3 | Operating and Maintenance Expenses | 119 | 238 | 356 | 475 | 594 |
| 4 | Depreciation Expense | 129 | 270 | 411 | 552 | 693 |
| 5 | Property Taxes | 32 | 64 | 96 | 128 | 160 |
| 6 | Total Operating Expenses | 280 | 572 | 863 | 1,155 | 1,447 |
| | Required Return (1) | | | | | |
| 7 | Interest Expense | 142 | 286 | 426 | 562 | 693 |
| 8 | Return on Equity | 162 | 327 | 487 | 642 | 792 |
| 9 | Required Return | 305 | 614 | 914 | 1,204 | 1,486 |
| 10 | Total Operating Expense and Return | 585 | 1,185 | 1,777 | 2,359 | 2,933 |
| | Income Taxes | | | | | |
| 11 | Income Taxes - Equity Return (2) | 59 | 118 | 176 | 232 | 286 |
| 12 | Income Taxes - Utility Timing Differences(3) | (60) | (109) | (152) | (189) | (168) |
| 13 | Total Income Taxes | (1) | 9 | 24 | 42 | 117 |
| 14 | Total Revenue Requirement | 584 | 1,195 | 1,801 | 2,402 | 3,050 |
| 15 | Number of Customers | 1 | 2 | 3 | 4 | 5 |
| 16 | Average Revenue Requirement per Customer | 584 | 597 | 600 | 600 | 610 |

Notes:

(1) The required return assumes a capital structure of 62% debt at 4.94% and 38% common equity at the 2024 Board Formula return of 9.21%. The annual required return is as follows:

Average Investment (row 2) * 62% * 4.94% plus Average Investment (row 2) * 38% * 9.21%

(2) Taxes related to the equity component of the return at a tax rate of 26.5%.

(3) Taxes related to utility timing differences are negative as the capital cost allowance deduction in arriving at taxable income exceeds the provision of book depreciation in the year.

Table 4
Estimate of Incremental Revenue Requirement of Attaching Feasible Rate M1 Customers

| Line No. | Particulars ($) | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
|---|---|---|---|---|---|---|
| | | (a) | (b) | (c) | (d) | (e) |
| | Rate Base Investment | | | | | |
| 1 | Capital Expenditures | 3,955 | 3,955 | 3,955 | 3,955 | 3,955 |
| 2 | Average Investment | 3,738 | 7,531 | 11,210 | 14,777 | 18,229 |
| | Revenue Requirement Calculation: | | | | | |
| | Operating Expenses: | | | | | |
| 3 | Operating and Maintenance Expenses | 95 | 191 | 286 | 381 | 477 |
| 4 | Depreciation Expense | 104 | 218 | 331 | 445 | 558 |
| 5 | Property Taxes | 26 | 51 | 77 | 103 | 129 |
| 6 | Total Operating Expenses | 225 | 460 | 694 | 929 | 1,163 |
| | Required Return (1) | | | | | |
| 7 | Interest Expense | 114 | 231 | 343 | 453 | 558 |
| 8 | Return on Equity | 131 | 264 | 392 | 517 | 638 |
| 9 | Required Return | 245 | 494 | 736 | 970 | 1,196 |
| 10 | Total Operating Expense and Return | 470 | 954 | 1,430 | 1,899 | 2,360 |
| | Income Taxes | | | | | |
| 11 | Income Taxes - Equity Return (2) | 47 | 95 | 141 | 186 | 230 |
| 12 | Income Taxes - Utility Timing Differences(3) | (48) | (88) | (122) | (152) | (135) |
| 13 | Total Income Taxes | (1) | 7 | 19 | 34 | 95 |
| 14 | Total Revenue Requirement | 470 | 961 | 1,449 | 1,933 | 2,454 |
| 15 | Number of Customers | 1 | 2 | 3 | 4 | 5 |
| 16 | Average Revenue Requirement per Customer | 470 | 481 | 483 | 483 | 491 |

Notes:

(1) The required return assumes a capital structure of 62% debt at 4.94% and 38% common equity at the 2024 Board Formula return of 9.21%. The annual required return is as follows:

Average Investment (row 2) * 62% * 4.94% plus Average Investment (row 2) * 38% * 9.21%

(2) Taxes related to the equity component of the return at a tax rate of 26.5%.

(3) Taxes related to utility timing differences are negative as the capital cost allowance deduction in arriving at taxable income exceeds the provision of book depreciation in the year.

Updated Response: /u

By letter dated December 4, 2024, ED requested Enbridge Gas to update its response to motion question #3 to indicate “the cost of an additional customer incremental to the costs already covered by base rates.” The Company confirms that it believes its original response remains appropriate. The Company agrees that base rates can support a certain level of capital spending, in total. However, base rates and the annual escalation of those rates under a price cap rate setting mechanism during an incentive regulation (“IR”) term are not allocated to a specific type of capital expenditure recovered within rates. Generally, revenue growth through price cap escalation alone is insufficient to fully fund the cost associated with capital required to add customers and maintain safe and reliable service during the IR term. Growth and efficiencies are required to make up the difference and to earn allowed ROE under incentive regulation. What is clear is that there are incremental capital and operating costs associated with adding customers, that would not otherwise be incurred in the absence of doing so.

As part of the regulatory compact, the Company is obligated to serve new customers in return for the revenues generated from them. The obligation to serve is not compatible with the decoupling mechanisms proposed by ED, which are contrary to the OEB’s established rate setting mechanisms. The incremental revenues from customer growth are required to fund the necessary capital investments which enable the Company to add customers.

Further, when viewed in isolation, the cost of adding a customer typically outweighs the incremental revenues received from that customer in the first number of years. This is because the carrying costs of the associated capital costs are highest in the early years, but slowly decrease over time as the cost of assets are recovered through depreciation, whereas rates/revenues reflect an average carrying cost of assets (due to the varied mix of assets at all ages reflected in rate base). As a result, in the near term, where rates are set through a price cap mechanism, not cost of service, the addition of customers actually creates a drag on earnings, not a windfall.

Table 5 illustrates the forecast impact of customer additions over the IRM term. The forecast costs are shown at line 15 and reflect the cumulative revenue requirement of customer connection capital plus incremental operating costs per customer addition. Customer addition revenues, which are shown on line 18, reflect the revenue requirement associated with 2024 customer connection capital which is embedded in base rates and subject to annual PCI escalation, plus the cumulative gross margin associated with customer additions. Finally, line 19 provides the variance between customer addition costs and revenues, which shows the costs of customer connections outweigh the associated revenues. Of course, this issue would be amplified if the Company were not permitted to retain incremental revenues from new customer additions during the IRM term.

Table 5
Revenue Shortfall in IRM Term for Illustration

| Line No. | Particulars | 2024 | 2025 | 2026 | 2027 | 2028 |
|---|---|---|---|---|---|---|
| | | (a) | (b) | (c) | (d) | (e) |
| 1 | PCI (%) | | 3.3% | 1.7% | 1.7% | 1.7% |
| 2 | Customer Adds ($) (1) | | 40,533 | 38,879 | 37,000 | 35,200 |
| 3 | Revenue/ Customer($) (2) | 600 | 620 | 631 | 641 | 652 |
| 4 | O&M/ customer ($) (3) | 94 | 97 | 99 | 100 | 102 |
| 5 | Property Tax /Customer ($) (3) | 14 | 14 | 15 | 15 | 15 |
| 6 | Capital Expenditures ($Millions) (4) | 224 | 286 | 256 | 230 | 208 |
| | Revenue Requirement ($Millions) | | | | | |
| 7 | RR- 2024 Customer Adds | (5) | 21 | 21 | 21 | 20 |
| 8 | RR- 2025 Customer Adds | - | (5) | 27 | 26 | 26 |
| 9 | RR- 2026 Customer Adds | - | - | (2) | 24 | 23 |
| 10 | RR- 2027 Customer Adds | - | - | - | (1) | 21 |
| 11 | RR- 2028 Customer Adds | - | - | - | - | 3 |
| 12 | Total RR Capital Related (sum of lines 7 to 11) | (5) | 17 | 45 | 70 | 94 |
| 13 | O&M (line 2 x line 4) | | 4 | 8 | 11 | 15 |
| 14 | Property Tax (line 2 x line 5) | | 1 | 1 | 2 | 2 |
| 15 | Total Cost (sum of lines 12 to 14) | | 21 | 54 | 83 | 111 |
| 16 | Base Revenue Escalated @ PCI | (5) | (5) | (5) | (5) | (6) |
| 17 | Customer Growth-Revenue (line 2 x line 3) | | 25 | 50 | 73 | 96 |
| 18 | Total Revenue- Customer Adds | | 20 | 44 | 68 | 91 |
| 19 | Revenue Shortfall (line 15 - line 18) | | 1 | 10 | 15 | 20 |

Notes:

(1) Customer additions based on AMP filed Nov 8, 2024.
(2) $600 per customer is the average for all general service customers, provided in Table 1, escalated for PCI in line 1.
(3) O&M and property tax based on Table 2, line 3, column (a).
(4) 2024 Customer Growth based on Phase 1 Rate order, and 2025-2028 based on AMP filed November 8, 2024.

The Company also notes that rate base growth and the associated carrying costs (i.e. cost of capital and depreciation expense and taxes), which has resulted from the level of capital expenditures required to maintain the safe operation of the system (i.e. through replacement of long lived assets, being replaced in current dollars) and meet growth requirements, has exceeded the revenue growth that is attributable to solely PCI escalation of base rates. Revenue growth due solely to PCI escalation is not sufficient to support the costs associated with capital requirements.

Revenues associated with PCI, growth, and cost efficiencies have been leveraged under the Price Cap rate setting mechanism to accommodate capital requirements. As rates are not tied to costs under a price cap mechanism, the ability to offset cost pressures in one area through efficiencies or revenue growth (i.e. scale economies) is a key attribute to the mechanism. The revenues achieved through the Price Cap mechanism should be treated as a whole (not segregated). This allows a utility to allocate funds across a variety of cost categories including O&M, capital and cost of capital. Isolating revenues by specific cost categories, such as growth capital contradicts the principles of Performance Based Regulation (PBR) and restricts the utility's operational flexibility.

The expectation that incremental revenues from the growth capital enables the funding of additional capital is reflected by the inclusion of the growth (g) factor in the ICM formula. The purpose of the g-factor is to account for the incremental capital funding that is notionally expected to be funded through existing rates resulting from revenues achieved from growth. By incorporating the g-factor, the ICM formula ensures that the incremental revenues generated from customer growth are recognized before incremental capital funding is awarded.

Finally, the imposition of either of the proposed decoupling mechanisms would impede the Company's ability to earn its allowed rate of return and a fair return, in any circumstance where more revenues are being returned to customers as compared to the cost offsets recognized. This impact is additive over an incentive regulation term.

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