Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2007-0731

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 Distribution Inc. for an order or orders approving the balance and clearance of the Class Action Suit Deferral Account;

AND IN THE MATTER OF an application by Enbridge Gas Distribution Inc. for an order or orders amending or varying the rates charged to customers for the sale, distribution, transmission and storage of gas commencing January 1, 2008.

BEFORE: Paul Vlahos
Presiding Member

Cynthia Chaplin
Member

DECISION

February 4, 2008

The Application

Enbridge Gas Distribution Inc. ("Enbridge" or the "Company") filed an application dated September 28, 2007 with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, 1998*, S.O.C.15, Sched. B, as amended. The application is for an order or orders of the Board approving the current balance in the 2007 Class Action Suit Deferral Account ("CASDA"), plus additional amounts to be incurred by the date of decision in this matter, and the disposition of that balance. The application also requested that the CASDA be continued in the event that the decision is not released before December 31, 2007. The balances in the CASDA are a result of the resolution of a class action lawsuit related to late payment penalties ("LPPs"), launched by Gordon Garland. Late payment penalties are charges to customers who do not pay their accounts in a timely manner. With Board approvals, all amounts recorded in CASDA since 2004 have been rolled forward into 2007 CASDA and there are no outstanding amounts in CASDA for 2004, 2005 and 2006.

The balance in the 2007 CASDA, as of August 1, 2007, was $23,537,600, along with interest totaling $682,400. In its reply argument, Enbridge reported that the balance of December 31, 2007 was $23,545,001, along with interest totaling $1,165,002.[1] Of this balance, approximately $22 million are the costs of the Court approved settlement, and the rest is Enbridge's legal expenses.

The Company proposed that the balance in the 2007 CASDA (as at the date of the decision in this proceeding) be recovered in equal amounts during each of the next eight years commencing January 1, 2008. The recovery would be accomplished by clearing portions of the 2007 CASDA each year during the 2008 to 2015 period, at the same time that other deferral and variance accounts are cleared each year, with the amounts to be allocated and recovered on the basis of customer numbers. The clearance would appear as a one-time adjustment each year to the customer's bills. The Company requested that interest continue to accrue, in the ordinary fashion, on the remaining balance in the 2007 CASDA until it is fully cleared in 2015.

[1] In its application, Enbridge indicated that there may be small additional amounts added to the 2007 CASDA related to Mr. Garland's appeal, which was to be heard in December 2007. The new balance includes approximately $8,000 related to the completion of Mr. Garland's appeals about his level of compensation.

In its prefiled evidence, the Company estimated that its proposal will result in the recovery of approximately $3.5 million per year over eight years, equating to approximately $1.90 per year per residential customer. In its reply submission the Company provided an updated estimate that its proposal will result in a recovery of approximately $3.6 million per year over eight years, equating to approximately $1.70 per customer. Given that the large majority of the Company's customers are residential customers in Rate 1, most of the recovery will come from that rate class.

The Proceeding

The Board assigned file number EB-2007-0731 to the application and issued a Notice of Application and Hearing dated October 26, 2007. The following parties intervened in the proceeding: Union Gas Limited ("Union"); the School Energy Coalition ("Schools"); the Vulnerable Energy Consumers Coalition ("VECC"); the Consumers Council of Canada ("CCC"); the Electricity Distributors Association ("EDA"); and the Industrial Gas Users Association ("IGUA").

The Board proceeded by way of a written hearing. Interrogatories were issued by intervenors and responded to by Enbridge. Submissions from intervenors and Board staff were filed by January 11, 2008 and reply submissions from the Company were received on January 25, 2008.

The full record of the proceeding is available at the Board's offices. The Board has chosen to summarize the record to the extent necessary to provide context to its findings.

Early History of the Company's LPP Charges

In 1975, as part of the Company's E.B.R.O. 302-II proceeding, the Company began charging a 5% LPP to customers whose bills were outstanding beyond a ten day grace period. This replaced the previous LPP of 10% that had applied to most customers. The decision of the Board in E.B.R.O. 302-II discussed the purpose of the LPP and referred to the LPP as "a well established and practical device in widespread use in Ontario and elsewhere to encourage prompt payment of utility bills".

In 1978, a new form of LPP was proposed for use by Ontario utilities. The proposal was made by a task force operating under the auspices of the Ministry of Energy. The task force developed a set of voluntary guidelines that were introduced in the Ontario Legislature on November 21, 1978. These guidelines were titled "Residential Guidelines

for Credit Collection and Cut-Off Practices of Public Utility Suppliers" (the "Guidelines"). On November 21, 1978, James Auld, the then Minister of Energy, presented the Guidelines in the Ontario Legislature expressing his view that the Guidelines would provide a balanced measure of protection, not only for individual customers, but also for the broader public interest.

The Company's proposed new form of LPP, in conformance with the Guidelines, was initially reviewed and accepted by the Board as part of its April 2, 1980 decision in the Company's E.B.R.O. 369-II rate proceeding. The LPP was a one-time charge equal to 5% of the customer's current month's gas charges (exclusive of charges for other items, such as water heater rentals). In that proceeding, and in subsequent proceedings, the Board accepted the new form of LPP charges and included the forecast revenues flowing from the LLP charges to reduce the Company's revenue requirement for purposes of setting distribution rates.

The Garland Class Action Lawsuit

In April 1994, Gordon Garland launched a proposed class action proceeding against the Company alleging that some of the LPPs collected from customers may have exceeded the *Criminal Code* limit on interest rates and that, as a result, the Company must refund those LPPs. The lawsuit sought damages in excess of $112 million.

In response, the Company filed a Statement of Defence and brought a motion for summary judgment in 1994. The Ontario Court of Justice granted the Company's motion, dismissing the action in February 1995.

Gordon Garland initiated an appeal in March 1995, and in September 1996 the Ontario Court of Appeal unanimously upheld the decision by the Ontario Court of Justice and dismissed Mr. Garland's appeal.

Mr. Garland sought and was granted leave to appeal to the Supreme Court of Canada. The Supreme Court of Canada heard the appeal in March 1998. In October 1998 a majority of the Supreme Court of Canada ruled that the Company's LPP charge did constitute interest for the provision of credit. The Supreme Court of Canada returned the matter to the trial court in Ontario for disposition.

The parties to the Garland proceeding agreed that the appropriate way to proceed was by way of a new summary judgment proceeding. Both parties brought cross-motions for

summary judgment to the Ontario Superior Court. The hearing dealt with the question of whether any of the Company's remaining defenses to the action were valid.

In its April 2000 decision, the Ontario Superior Court agreed with the Company's position and dismissed the Garland class action.

Mr. Garland appealed that decision, and in December 2001 a majority of the Ontario Court of Appeal upheld the decision by the Ontario Superior Court, dismissing the action. In that decision the Ontario Court of Appeal also noted that a new LPP needs to be designed which does not result in a contravention of the law but that it was appropriate for the Board to have waited for the court to address the issues in the Garland proceeding before requiring changes to the LPP.[2]

Mr. Garland sought and was granted leave by the Supreme Court of Canada to hear an appeal of the Ontario Court of Appeal's second decision. The appeal was argued in October 2003.

In April 2004, the Supreme Court of Canada ruled in favour of Mr. Garland and held that the Company was liable to refund any LPP amounts paid by Mr. Garland in excess of the *Criminal Code* limit since April 1994, the date on which Mr. Garland initiated his action.[3] The Supreme Court of Canada returned the matter to Ontario Superior Court for disposition. What remained at issue were the LPPs related to the April 1994 to January 2002 period. In the April 2004 decision, the Supreme Court of Canada ordered the Company to pay Mr. Garland's legal costs incurred from April 1994 through the completion of the second appeal to the Supreme Court of Canada. The plaintiff brought forward its cost claim and the parties agreed to settle the costs award for the amount of $825,000.

In late 2004, Mr. Garland brought a certification motion, seeking to have the action approved as a class action.

[2]Following a Board initiative and letter of direction on October 1, 2001, in its Decision and Interim Order in the RP-2001-0032 rate case, dated January 31, 2002, the Board accepted a Company proposal to reduce the LPP charge from 5% to 2%, effective February 1, 2002.
[3]Similar class action proceedings starting in 1994 have been brought against Union Gas, as well as Toronto Hydro and other electricity distributors in Ontario.

Settlement of the Class Action Lawsuit

In June 2006, a settlement was reached between the parties as to the basic monetary terms of settlement, involving payment of $22 million. The outstanding non-monetary issues were settled between the parties in July 2006 and were proposed to the Ontario Superior Court.

On September 25, 2006, the Ontario Superior Court indicated that it was not yet prepared to approve the proposed settlement without providing the Court with more discretion in certain matters. The parties agreed to the amendments requested by the Court and on December 8, 2006 the Court approved the settlement reached by the parties.

The total amount paid by the Company in connection with the settlement is $22 million, which includes the $825,000 already paid to the plaintiff's counsel following the April 2004 decision of the Supreme Court of Canada. A payment of $2 million was made on account of the plaintiff's costs in July 2006 after the settlement was reached. A further payment of $19.175 million was made after the settlement was approved by the Court.

The settlement funds were largely allocated to fees, legal costs and an endowment to the Winter Warmth Fund, as follows:

***Cy Pres* distribution to Winter Warmth Fund**	**$ 9,000,000**
Class Proceedings Fund levy	**$ 1,917,500**
Repayment of disbursements to Class Proceedings Fund	**$ 311,825**
Disbursements and GST not paid by Class Proceedings Fund	**$ 31,051**
Counsel Fees (including costs and compensation for the representative plaintiff)	**$10,130,469**
GST	**$ 609,155**
Total	**$22,000,000**

In July 2006, the Company informed the Board of the settlement reached and sought the Board's guidance as to how to proceed to apply for clearance of the CASDA.

By letter dated August 17, 2006, the Board stated that the final costs should be booked in the CASDA and recorded once the Ontario Superior Court approved the settlement (which occurred in December 2006). The Board further stated that the most efficient way to proceed would be by way of application by the Company to the Board (this application).

History of the CASDA

The Board first approved the CASDA in February 1995, in response to a request from the Company after Mr. Garland commenced his action. At the time, the account was intended to record the costs arising from the Company's defence of the class action, net of any award of costs by the Ontario Court of Justice in favour of the Company.

In E.B.R.O. 490 (fiscal 1996 rates case), the Board accepted the settlement proposal which included the continuation of the CASDA. In E.B.R.O. 492 (fiscal 1997 rates case), the Board again accepted the settlement proposal which included the continuation of the CASDA. The Board allowed the Company to clear amounts that had accrued in the 1996 CASDA (which included carry-forward amounts from 1995), stating that the amounts in the account had been prudently incurred.

In E.B.R.O. 495 (fiscal 1998 rates case), the Board accepted the settlement proposal which included the continuation of the CASDA. In E.B.R.O. 497 (fiscal 1999 rates case), the Board considered whether the amounts in the CASDA should be cleared to rates, but decided not to and continued the CASDA.

In the subsequent five separate rate cases covering the Company's fiscal years 2000 to 2004, the Board accepted the settlement proposals by parties to clear the CASDA balances to rates as well as authorizing the continuation of CASDA.

After the Supreme Court of Canada's second Garland decision, where the plaintiff brought forward its cost claim and the parties agreed to settle the costs award for the amount of $825,000, the Company applied to the Board, as part of its fiscal 2005 rate case, to expand the scope of CASDA to include the plaintiff's legal costs. The Board approved the Company's request but noted that any decision as to the recovery of such amounts in the CASDA would be made in a subsequent proceeding.

In EB-2005-0001 (fiscal 2006 rates case), the Board accepted the settlement proposal which included that all amounts recorded in the 2005 CASDA at December 31, 2005 would be transferred to 2006 CASDA, which would also include any further amounts attributable to the litigation and the judgment.

In EB-2006-0034 (fiscal 2007 rates case), the Board accepted the settlement proposal which stipulated that the 2005 CASDA amount and the 2006 CASDA amount would be included in the 2007 CASDA, to be addressed in a future proceeding (the subject of this proceeding).

Board Findings

For the reasons set out below, the Board finds that all costs (Enbridge's own legal costs, settlement costs and interest) in the CASDA are recoverable from ratepayers.

There is no dispute among the parties regarding whether Enbridge's own legal costs should be recoverable from ratepayers. These costs have been cleared through the CASDA historically and recovered in rates, primarily as part of settlement agreements among the parties.

The Board will not require supporting documentation for these legal expenses, as has been suggested by VECC in its argument. It was open to parties to request such information through the interrogatory process; none did so. During prior dispositions of this account there has been no suggestion that Enbridge's own legal expenses were unreasonable or inappropriate; there is no reason to conclude differently now. The Board will also not require an independent audit of these amounts as suggested by VECC. The Board does not think that the additional expense involved would be warranted. They are actual expenses incurred and, as observed above, there has been no suggestion in the past that the legal expenses were unreasonable or inappropriate.

What is at issue is whether the $22 million settlement costs, and associated interest expense, should be recovered from ratepayers.

The Board notes that the $22 million settlement was approved by the Ontario Superior Court following two hearings. Following the first hearing, the Court stated on September 25, 2006 that "the total benefits provided by the settlement represent a fair and reasonable compromise of the issues between the parties, and it is in the interests

of class members that they should be approved." The Court indicated that it wished more information on certain matters supporting the settlement. Having received that information, following the second hearing the Court approved the $22 million settlement amount on December 8, 2006. Enbridge has already paid this amount and there is no issue in the Board's view of the reasonableness of the amounts paid by Enbridge.

The issue for the Board is whether the Court-approved amount is recoverable from the ratepayers.

The following issues were raised in argument:

- Were the costs prudently incurred?
- Are the costs a form of forecast variance?
- Would recovery of these costs be retroactive ratemaking?
- Should any adjustments be made to the amount?
- What is the appropriate disposition (allocation and recovery period) of the account?

Were the Costs Prudently Incurred?

Enbridge argued that the costs are recoverable from ratepayers because they are the result of defending late payment penalties which were established by Board orders. In Enbridge's view, the costs were prudently incurred. CCC argued that Enbridge should bear the risk of imprudent decisions, but not where it acts pursuant to a Board order. CCC agreed that these costs should be borne by ratepayers.

Union and Enbridge also argued that the LPPs were for the benefit of ratepayers. The LPP charges were designed to recover the costs associated with late payments (collection costs and working capital requirements) and served to lower the rates that all customers would have otherwise paid. They noted that judicial precedents support the recovery of all litigation expenses (whether or not the litigation was successful) where the activity was reasonably undertaken for the benefit of ratepayers. They also noted that no party disputed that the LPP operated to the benefit of ratepayers and that in its absence the rates would have been higher.

Union further argued that "…having defined the late payment penalties to be in the public interest – as being, in other words, just and reasonable – and having required the utilities to charge them, it would be patently unreasonable for the OEB to deny recovery

of LPP litigation costs which arose solely and exclusively on account of those OEB ordered penalties."

VECC argued that the fact that the Board ordered the recovery of LPPs is irrelevant to whether Enbridge should be able to collect the settlement costs. Enbridge argued before the Supreme Court that it should not be liable for damages because the LPP charges arose through a Board order. According to VECC, the Supreme Court accepted this defence only for the period up until 1994 when the Garland claim was first made. In VECC's view: "for the period after 1994, the SCC [Supreme Court of Canada] held that EGDI [Enbridge] could not rely on Board orders as an excuse to retain revenue collected on the basis of a LPP because the claim, once filed in 1994, changed the legitimate expectation of the parties." Schools argued essentially the same position.

The Board does not agree that the Supreme Court's rejection of Enbridge's defence is applicable to the issue before the Board. The Court was addressing the question of whether Enbridge could rely on the Board's orders as a defence against a claim that the charges were illegal. We are concerned with a different question: whether Enbridge can rely upon the Board's orders as a justification for recovering costs which arise from defending Board approved charges which are ultimately found to be invalid.

IGUA argued that the ratepayers are not responsible for the wrongful acts and that the legal responsibility for committing the wrongful acts rests with the utilities, the Board and/or the province of Ontario. IGUA submitted that if legal responsibility is the guiding principle then only Enbridge's own legal costs should be recoverable from ratepayers. Enbridge responded that the ratepayer groups were also responsible in that they did not object to the implementation of the LPP – and in fact supported it.

The Board does not agree with IGUA that legal responsibility for the act in these circumstances is the determinative principle upon which to base its decision as to the disposition of the settlement costs. The issue before the Board isn't who is responsible for the wrongful acts; the issue is: are the costs recoverable from ratepayers?

CCC in fact submitted that under this line of reasoning Enbridge would have had to assume that the essential argument of Garland was correct and immediately changed the LPP accordingly. In CCC's view, if the Board finds Enbridge to have been imprudent, it would effectively preclude a utility from defending any future action.

From a ratemaking perspective, the costs can only be found imprudent if, in the circumstances at the time, Enbridge should have acted differently, thereby mitigating or eliminating the costs. The Board agrees with CCC that it was reasonable for Enbridge to defend the Garland action and notes that the associated legal costs incurred by Enbridge have been allowed in rates over the years.

Also, the LPP remained essentially unchanged for some time. As Union noted, after the Supreme Court's 1998 determination, the Board considered whether it should re-examine LPP and decided to await the Court's resolution of the Garland proceeding. Earlier court decisions found the charges valid, and there was no decision that the charges were invalid until the Supreme Court's second decision was issued in April 2004. VECC argued that EGD could have sought an alternative structure in 1994 when it was put on notice that the LPP might be criminal in nature. The Board agrees that Enbridge could have proposed a different approach, but that would be a conclusion reached by the application of hindsight – and hindsight cannot be applied in assessing whether these costs are prudent. The Board finds that Enbridge did not act imprudently in not seeking to change the LPP earlier than it did.

The Board concludes that the costs were prudently incurred.

Are the costs a form of forecast variance?

Schools and VECC argued that the settlement costs are essentially variances from forecast, and that they are therefore appropriately borne by shareholders because the return on equity provides compensation for these types of risks. In CCC's view, the circumstances in this case cannot be characterized as forecast error. CCC submitted that the issue before the courts was not the accuracy of the forecasts, but rather whether the formula was legal. The Board agrees with CCC and Enbridge: the costs are not related to the forecast of the LPP revenues being inaccurate; the costs are current costs of resolving litigation once the Supreme Court found the LPP charges to be illegal.

IGUA argued that the recovery of this "uninsured litigation risk" would essentially treat the return on equity as a guaranteed return. IGUA submitted that the Board should determine what portion of the equity risk premium is attributable to "uninsured litigation losses" and use that amount to determine what level of costs should be borne by shareholders. IGUA suggested an amount of 100 basis points and used that as the basis for its estimated $13.7 million disallowance.

The Board does not agree with IGUA. It may be that there are "uninsured litigation losses" which are appropriately borne by the shareholder, but in this case the costs arise directly from defending rates and charges which were set by Board order and which were subsequently found to be invalid. The Board does not accept that the equity risk premium compensates shareholders for the risk that they may not be able to recover costs arising from Board orders being found invalid. Rather, the Board agrees with CCC that the equity risk premium would have to be higher if shareholders were required to bear the risk that a Board order would turn out to be invalid. Or as Enbridge stated: "…no one would ever have thought that one aspect of legitimate regulatory risk would be the risk of non-recovery of a cost that was incurred as a result of the good faith compliance with Board orders implemented by the utility for the benefit of ratepayers."

The Board concludes that these costs do not represent a forecast error or forecast variance to be borne by shareholders.

Would recovery of these costs be retroactive ratemaking?

IGUA also submitted that changing current rates to adjust for over or under collection from prior periods is inappropriate retroactive ratemaking. Schools objected to the recovery on the grounds of intergenerational equity because the customers who benefited from the LPP are not the same customers who will be paying for recovery of the settlement costs. Enbridge argued that the costs are current costs; while the cause of action may be in the past, the costs of defending the proceeding and ultimately settling the matter are current costs.

The Board does not agree that recovery of the costs would result in retroactive ratemaking. Enbridge is not seeking to recover past costs or to change prior rates; it is seeking to recover costs arising from settling a dispute related to a finding that past Board orders were legally invalid, and it is seeking to do so at the first practical opportunity after the costs were incurred.

Should any adjustments be made to the account?

No party took issue with the amount of the settlement, but some parties argued that adjustments should be made to this amount. CCC argued that that the amount to be recovered should be adjusted if actual LPP revenue exceeded forecast. The Board concludes that this adjustment is not appropriate. Such an adjustment would require an

examination of all the related costs and revenues, because if the LPP revenues were higher than forecast, it is likely the collection costs and working capital requirements were higher as well. More importantly, though, the Board believes that those variations from forecast appropriately remain the risk of Enbridge.

IGUA submitted that if the costs were to be recovered, then account should also be taken of prior cost estimates which were in excess of actual costs, and those amounts should be returned to ratepayers as well. IGUA asserted that these excess earnings would be greater than the settlement costs. VECC also argued that EGD over-earned in the relevant years on a weather normalized basis and that "to isolate the forecast risk assumed by EGDI with respect to LPP revenue and shift it entirely to ratepayers retroactively, when clearly other forecasted cost/revenue items have benefited EGDI is self-evidently unfair."

Enbridge and its shareholders do bear the risks related to the cost and revenue forecasts underpinning the rates. The Board has already determined that the settlement costs do not represent a forecast risk and that the recovery of the settlement costs does not represent retroactive ratemaking. Therefore there is no justification for the adjustment proposed; such an adjustment would be retroactive ratemaking.

What is the appropriate disposition (allocation and recovery period) of the account?
No party objected to the proposed allocation on the basis of customer numbers. VECC however did argue that implementation issues should be determined after the Board determines the amount to be recovered. The Board believes that such an approach would cause an unnecessary delay; all the necessary information is available at this time. The Board accepts the proposed allocation method. This allocation method reflects the allocation of the LPP revenues and is therefore appropriate.

Enbridge proposed an eight year recovery period, with the amount collected as a one-time bill adjustment each year. CCC suggested the amounts should be recovered over the period of the incentive regulation mechanism, and Enbridge supported this approach as well in its reply submission. The Board agrees with that suggestion and will adopt it. The estimated impact for a five year recovery period would be about $2.70/year for a residential customer. The method of recovery is consistent with the way in which late payment revenues were collected from customers. The Board finds there is no significant ratepayer benefit in terms of reduced impact to extending the period of recovery to as long as eight years, and that there are benefits in terms of simplicity and

efficiency to aligning the recovery to the period of the incentive rate mechanism as well as reduced interest expense for the ratepayers.

For administrative ease, the Board leaves it to the Company to consider the commencement of the first charge and seek the appropriate order or orders when it has done so. The Board approves the continuance of the CASDA so that it will continue to be the mechanism to record the outstanding balance in the CASDA account until it is fully drawn down. The Board expects the Company to propose the same equal one-time recovery amount per customer per rate class.

A separate decision on cost awards for eligible intervenors will be issued once the steps set out below are completed.

1. Eligible intervenors shall file with the Board and serve Enbridge their cost claims within 15 days from the date of this Decision.

2. Enbridge may file with the Board and serve cost claimants any objections to the claimed costs within 30 days from the date of this Decision.

3. Intervenors may file with the Board and serve Enbridge any response to any objections for their cost claims within 45 days from the date of this Decision.

DATED at Toronto, February 4, 2008.

Original Signed By

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Paul Vlahos
Presiding Member

Original Signed By

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Cynthia Chaplin
Member