RP-2004-0188

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

AND IN THE MATTER OF the preparation of a draft handbook for electricity distribution utility rate applications

SUBMISSION OF ENBRIDGE GAS DISTRIBUTION INC.

Enbridge Gas Distribution Inc. ("Enbridge" or the "Company") respectfully submits the following comments on the second draft of the 2006 Electricity Distribution Rate Handbook (the "Handbook") which the Board issued on January 10, 2005.

Chapter 3 – Test Year and Adjustments

While historic rate making is an acceptable interim solution to regulate a broad range of utilities in a short time frame, it should not be accepted as a regular process for future rates. Basing rates on historic results that are two years old will penalize utilities that plan to expand their customer base or are exposed to significant cost increases. To offset this earnings risk, a higher rate of return would be required if the Board expects utilities to earn a fair rate of return on their invested capital. Allowing utilities to make adjustments to the general rule or to submit a forward test year will help to alleviate these concerns, but it may not be possible for all LDCs. To ensure that utilities have sufficient funds to operate their distribution systems and earn a reasonable return, the Board should base future rates on a forward test year.

The forward test year approach used over the last 30 years in the gas industry has provided an incentive for utility shareholder to manage costs and over time reduce the cost of service for gas consumers. A historic approach to rate making would remove this benefit and simply pass cost through. Accordingly, Enbridge recommends that the Board move to a forward test year for electricity rates as soon as it is practical.

Chapter 4 – Rate Base

4.7 Treatment of Capital Gains and Losses

Enbridge submits that there is no justification for the sharing of proceeds on the sale of utility assets. The assets like the utility company are owned by the utility shareholder and all proceeds should accrue to the rightful owner. Ratepayers pay for service they are not investing in the utility and therefore do not gain a proprietary right to the assets purchased and used by the shareholder in providing the service.

Chapter 5 – Cost of Capital

5.1 Maximum Return on Equity

The Handbook refers to a maximum return on common equity but does not clarify how the term will be used. In a forward test year, a maximum return would be comparable to the allowed rate of return approved by the Board. When applied to historic rate making, it could be interpreted as a limit on a utility's actual return, which would eliminate the incentives that management normally has to reduce costs and enhance revenues. In addition, unless utilities are allowed to make up an earnings short fall in subsequent years, it would penalize utilities that under earn.

Regulated utilities should be entitled to recover their invested capital and any prudently incurred costs, plus earn a fair return. In determining what constitutes a fair return on capital, the Board approves the debt-to-equity ratio and the cost of capital for utilities, including the cost of debt and a fair return on equity. Once a rate or return has been approved and incorporated into rates, like any other forecast cost, it should not be reassessed retrospectively.

Under this framework, the utility must provide service to its customers within the approved rates with the shareholder taking the risk that the return on equity will meet the approved rate of return set by the regulator. In some years the actual return will exceed the approved rate and in others it will fall short. Capping the return at the approved level would be not be appropriate unless the level was increased to account for the asymmetric downside risk of under earning.

In general, the allowed return must be sufficient to maintain the financial integrity of the utility so as not to impair its credit worthiness or its ability to attract funds on reasonable terms and continue to serve its customers in a safe and reliable manner.

Chapter 6 – Distribution Expenses

6.2.4 Employee Total Compensation

Enbridge supports the use of incentive payments as part of the total compensation package offered by a utility. Incentives help to attract and retain qualified employees and to enhance performance. Incentive programs are a common and essential compensation component in all sectors of the economy, including governments and their regulators.

Chapter 7 – Taxes / PILs

7.1.1 General Principles Underlying the 2006 Tax Calculation

Enbridge does not support the requests to adjust 2006 rates to reflect actual taxes paid. Once a utility's revenue requirement has been established and rates have been designed for full recovery, it is not practical or reasonable to true-up one cost while others are allowed to vary. True ups simply add to the administrative costs and regulatory burden for the electricity LDCs.

To eliminate this anomaly and simplify the tax calculation, income taxes should be forecast for recovery on a stand-alone basis. Taxes should be based on capital cost allowance rather than accounting depreciation. To the extent that asset sales were contemplated during the rate period, the taxes could be adjusted to reflect the tax implications of the sale.

The proposal to adjust taxes paid to reflect a cost disallowance could also result in an unfair and inappropriate impact on the utility shareholder. For example, if the cost must be incurred independent of the disallowance, there would be no tax savings to share.

Chapter 13 – Mitigation

Enbridge supports the need to manage rate impacts for customers. It would not be appropriate for the Board to limit what otherwise would be an acceptable and prudent rate increase by an efficient distributor simply because there are coincident increases in upstream costs. Quarterly commodity adjustments help to mitigate this problem in the gas industry. They also address the predictability aspect of rate shock. When customers understand why and how price increases occur, the size of the increase is not as much of a shock to them.

Rather than setting a predetermined percentage cap, rate shock should be assessed on a case by case basis to allow for a balanced review of the specific circumstances and cost drivers. When the Board determines that rate shock is possible, mitigation is required to collect the prudently incurred costs over a reasonable time frame. Rate shock in and of itself should not be considered sufficient justification to deny costs that were prudently incurred to serve the distributor's customers.

To minimize administrative costs and regulatory burden, rate impacts should be based on average use for a particular customer class rather than applying rate shock tests to individual customers or to a range of consumption levels. Overall the rates must balance ratepayer and shareholder interests in a manner that limits cost recovery to what is required to provide consumers with an acceptable

quality of service while providing shareholders with a fair rate of return on investment.

Other Matters Conservation & Demand Management ("C&DM")

General

1. As Ontario works towards the development of conservation of energy resources, it will be imperative for many stakeholders to work together. Enbridge sees a tremendous opportunity to work cooperatively with governments and electric LDCs In order to successfully maximize results and effectively promote a conservation of energy resources all parties must work in partnership. Enbridge will take a lead role in bringing together the governments and electric LDCs to achieve its and their goals for consevation.

C&DM Process & Procedures
Stakeholder input to C&DM Plans

2. The consultative process at Enbridge has evolved over the past decade. This process can function well, but can also present difficulties if its purpose becomes unclear. It is clear, based on the experience of Enbridge, that the following principles must be applied.

   (a) Consultation is recommended but should be voluntary.
   (b) The LDC is accountable for all aspects of its programs including consultation
   (c) Stakeholders must:
       Participate in good faith
       Bring value to the discussion
       Work towards a reasonable consensus

Audit Requirements

3. It is expected that LDCs will continue to have reporting requirements similar to those issued as a condition of their C&DM Plans. However, a specific audit of these results should only be required in cases where clearance of LRAM and/or an incentive is being requested. The purpose of the audit should be limited to verifying the actual results of the program against the protocol in place at the time the program was delivered. Any recommendations from the audit should be considered for implementation in future years, but not applied retroactively.

4. DCs are ultimately accountable for the results of their programs and LDCs must be accountable for completion of the audit as set out by the Board.

The Board should provide clear direction on the scope and depth of the audit and provide information outlining clear deliverables. Such direction will limit the likelihood of disputes and uncertainty.

C&DM Revenue Requirement
Spending Envelope

5. A prescriptive spending envelope for LDCs, subject to predefined rules would be recommended as it is simple and straightforward. Previous evidence filed on behalf of Enbridge during prior rate cases showed that demand side management programs of comparable utilities in North American had budgets in the range of 0.2 percent to 2 percent of gross revenues. An average of about 1 percent was presented as being appropriate. However, evidence during the 2006 EDR proceeding suggests that the pre-approved spending limit should be closer to 3 percent of gross revenues. Enbridge supports a higher spending limit given that the additional funds will generate greater TRC benefits to ratepayers while considering the rate impacts on customers.

Incentive Mechanism

6. Enbridge takes the position that an incentive mechanism is necessary and that TRC is the appropriate metric for gauging conservation benefits. Maximizing these TRC benefits is a key goal. It was also indicated that using 5 percent of net TRC benefits as proposed by Pollution Probe is consistent with the shared savings mechanisms as they have been applied around North America. This methodology will result in lower costs to ratepayers as they will enjoy 95 percent of the additional benefits generated by these programs. According to expert witness Mr. Chernick, the incentive was described as a price worth paying if it generates more TRC

7. It is important to remember that where net TRC benefits are used as the basis for calculating an incentive payment, an incentive is only available should the benefits achieved exceed the costs of the program. This creates a natural incentive for LDCs to minimize program administrative costs. It is also important to understand that while an incentive mechanism may have a short term impact on rates; this impact is dwarfed by the TRC benefits which ratepayers enjoy, hence reducing their overall energy costs. Accordingly, it is appropriate to award a successful program operator on the first and last dollar of net TRC benefits generated. Positive results along the entire TRC spectrum should not be viewed as "insipid" as the first dollar of TRC benefits is just as valuable to ratepayers as the last dollar. Conservation needs to become an important part of the LDC business model and not simply viewed as a regulatory requirement.

8. It is also important to acknowledge that C & DM programs are a different form of business activity when compared to distributing electricity. Little

time and effort need be expended convincing customers to connect to the electricity grid. Much time and effort is required to convince customers to change behaviors and/or purchase more efficient appliances. An incentive based on sharing benefits from the first dollar of net TRC will serve to maximize benefits for customers, regardless of the size or position of an LDC.

9. In its partial decision of the 2003 Company Rate Case (RP-2003-0203) the OEB accepted the following four principles related to incentive mechanisms.

   1. The rewards should encourage the company to continue to expand its DSM programs.
   2. The incentive should be based on results achieved for ratepayers, not just effort expended.
   3. Risks and rewards should not be too high.
   4. The incentive mechanism should be transparent and straightforward.

It is also recommended that the following principles be endorsed by the Board.

The reward should vary with the results

10. The reward should increase with achievement of higher performance levels. This further supports the first two principles, since it encourages the Company to expand DSM as a business activity. Moreover, the returns are based on results achieved and not just efforts expended. A straight percent of actual net TRC provides both an incentive to ensure cost effective programs (that benefits exceed the costs) and that benefits are maximized regardless of the heterogeneity across LDCs. LDCs would know that they benefits from C&DM activities in direct proportion to the success of their programs. An incentive mechanism as described would be straight forward and simple to administer.

Reduce the complexity associated with the TRC calculation

11. This can be achieved through using a percent of net actual TRC as the basis for the incentive rather than adding the additional level of complexity tested in previous Enbridge's DSM incentive mechanisms. It is unnecessarily complex to base the incentive on a percentage of the difference between a forecast budget and actual TRC benefits. This "Delta" TRC framework is far more complicated than a straight percent of net TRC benefits generated model. Additional conditions on this model are neither necessary nor recommended.

LRAM

12. Implementation of an LRAM is a fundamental business requirement for an LDC to pursue C&DM. LDCs must be kept whole where its C&DM programs reduce load and hence revenues. The mechanism can vary as long as the results are the same. It is Enbridge's experience that the most effective LRAM is one based on the inclusion of forecast results in the budget, with a future adjustment to reflect actual results after verification. If it is not possible to develop a reasonable forecast for 2006 for C&DM programs, the LRAM may have to be claimed after actual results have been verified. However, this is not preferable as this defers, until the LRAM is cleared, the LDC's recovery of all of its lost revenues rather than the much smaller difference between actual and forecast results.

All of which is respectfully submitted on February 14, 2005, by

[original signed]

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