EB-2011-0354

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 or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2013.

BEFORE: Cynthia Chaplin
Presiding Member and Vice Chair

Paula Conboy
Member

Ellen Fry
Member

DECISION ON EQUITY RATIO AND ORDER

February 7, 2013

Background

Enbridge Gas Distribution Inc. ("Enbridge") filed an application on January 31, 2012 with the Ontario Energy Board (the "Board") under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B (the "Act") for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas commencing January 1, 2013.

The Board issued a Notice of Application dated March 2, 2012. Details on the various procedural steps which followed are available on the Board's website.

A Settlement Agreement, dated October 3, 2012, was filed which addressed all issues except the common equity ratio, a related aspect of long term debt and a matter related to the “open bill” issue. This Settlement Agreement was subsequently revised in response to concerns raised by the Board. The Board accepted the revised Settlement Agreement in its Decision on Revised Settlement Agreement and Procedural Order No. 6 dated November 2, 2012. On November 26, the Board accepted a Supplementary Settlement Agreement which addressed further matters on the “open bill” issue.

On November 19 and 20, 2012, the Board held an oral hearing concerning Issue E2: “Is the proposed change in capital structure increasing Enbridge’s deemed common equity component from 36% to 42% appropriate?” After the hearing, the Board received written submissions from Enbridge, the Building Owners and Managers Association (“BOMA”), the Consumers Council of Canada (“CCC”), Canadian Manufacturers and Exporters (“CME”), Energy Probe, School Energy Coalition (“SEC”), Vulnerable Energy Consumers Coalition (“VECC”) and Board staff.

This is the Board’s decision on Issue E2. In this decision, the proportion of capital structure comprised of deemed common equity will be referred to as the “equity ratio”.

The Board’s Cost of Capital Policy

In December 2009, after a consultative process, the Board issued its *Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities* (the “Cost of Capital Report”).[1]

In the Cost of Capital Report, the Board stated that in making determinations on the cost of capital, it is governed by the legal standard commonly referred to as the fair return standard (“FRS”). The Board adopted the following articulation of the FRS by the National Energy Board:

> A fair or reasonable return on capital should:
>
> - be comparable to the return available from the application of invested capital to other enterprises of like risk (the comparable investment standard);

[1] Report of the Board on the Cost of Capital for Ontario’s Regulated Utilities, December 11, 2009, EB-2009-0084

- enable the financial integrity of the regulated enterprise to be maintained (the financial integrity standard); and
- permit incremental capital to be attracted to the enterprise on reasonable terms and conditions (the capital attraction standard).

The Board noted that "the FRS is sufficiently broad that the regulator that applies it must still use informed judgment and apply its discretion in the determination of a rate regulated entity's cost of capital."[2]

The Cost of Capital Report indicates that the Board makes determinations on two elements in establishing the equity component of the cost of capital:

1) The deemed return on equity ("ROE"). This is a single rate of return set by the Board periodically for all utilities, considering overall market conditions; and
2) The deemed equity ratio, which is set by the Board for each utility individually, considering the circumstances of that particular utility.

The Board outlined its policy on the proportions of debt and equity in a utility's deemed capital structure as follows:

> **The Board's current policy with regard to capital structure for all regulated utilities continues to be appropriate.** As noted in the Board's draft guidelines, capital structure should be reviewed only when there is significant change in financial, business or corporate fundamentals. The Board's current policy is as follows:
>
> - The Board has determined that a split of 60% debt, 40% equity is appropriate for all electricity distributors. Capital structure was not a primary focus of the consultation and the Board notes that the comments made by participants in the consultation largely supported the continuation of the Board's existing policy.
> - For electricity transmitters, generators, and gas utilities, the deemed capital structure is determined on a case-by-case basis. The Board's draft guidelines assume that the base capital structure will remain relatively constant over time and that a full reassessment of a gas utility's capital

[2] Cost of Capital Report, p. 18

> structure will only be undertaken in the event of significant changes in the company's business and/or financial risk.[3]

All the parties agree that the Board should apply its existing policy in this proceeding. All parties take the position that the Board's policy establishes a threshold test for considering the equity ratio of gas utilities, and that this threshold test is whether there have been significant changes in the company's business and/or financial risk. They submit that the Board should conduct a full analysis of Enbridge's equity ratio only if it concludes that the threshold test has been met.

Board Findings

The Board notes that one of Enbridge's expert witnesses, Mr. Coyne of Concentric Energy Advisors ("Concentric"), has expressed a view that differs from Enbridge's position. Mr. Coyne expressed the view that the Board's analysis, even at the threshold stage, should be a comprehensive FRS analysis, even if there has been no significant change in risk. Concentric conducted a comprehensive quantitative analysis of Enbridge's cost of capital against the FRS, including comparability to other utilities. Mr. Coyne expressed his view as follows:

> Concentric believes that it is consistent with Board policy that a reassessment of a utility's capital structure should be undertaken whenever there is a reasonable doubt that its capital structure, in conjunction with its allowed return, fails to meet the fair return standard.[4]

He further stated that in his view capital structure is an "unfinished element" of the Board's cost of capital policy.

> We felt as though the Board laid out its overarching framework and its adherence to the fair return standard, rendered a decision on ROE, and left the equity ratio as an element of its policy to be decided down the road…that is one of the reasons we're sitting here is that there is an element of unfinished business associated with that work.[5]

[3] Cost of Capital Report, pp. 49-50
[4] Tr2, p 10
[5] Tr2, p91

This interpretation of the Board's policy is incorrect. The Board states explicitly in the Cost of Capital Report that the current policy on capital structure continues to be appropriate and that capital structure will only be reviewed if there is a significant change in risk for the specific company. This does not entail a full cost of capital analysis and assessment against the FRS unless there has been a significant change in risk. The Board has structured its policy in a way that applies the FRS while promoting regulatory efficiency and predictability. The Board's policy does not require a full FRS analysis in each rate case. However, it ensures that the Board will perform a full review of capital structure in instances where a significant change in risk indicates that a change may be needed in order to continue to meet the FRS. The Board considers that where there has not been a significant change in risk, the FRS continues to be met. The Board notes that another Enbridge witness, Mr. Lister, expressed this as Enbridge's understanding as well: "It is our position that if the Board found that there was no change in business risk, then by definition the Board would be saying that the fair return standard has been met."[6]

In applying the threshold test in this proceeding, the Board will therefore consider the evidence and argument concerning risk, and will not conduct a broader FRS analysis. If the Board concludes that the threshold test has been met (i.e. that there has been a significant change in Enbridge's business and/or financial risk), it will perform a full analysis based on the principles of the FRS to determine the appropriate equity ratio for Enbridge. If the Board concludes that there has not been a significant change in risk, it will not need to perform any further analysis.

Time Parameters

The Board considered what past point of reference it should use in determining whether there have been significant changes in Enbridge's business and/or financial risk. It also considered what prospective timeframe it should use in assessing risks of future events. Enbridge took the position that the Board should be taking a long term view, both historically and prospectively. Enbridge submitted that even though the Board made a decision on Enbridge's equity ratio in 2007 (EB-2006-0034), it should be considering changes in risk since 1993. Enbridge did not propose a specific timeframe for considering long term prospective risk.

[6] Tr1, p. 92

Enbridge submitted that

> It is important that changes in Enbridge's business and financial risk be viewed over the long term. Enbridge's equity ratio should be commensurate with its long-term business risk, which can only be assessed through a long-term view. That is why Enbridge has presented business risk evidence showing changes over the past 20 years. While it is true that Enbridge's equity ratio was considered in a 2006 proceeding, the fact is that there is now additional information available that was not considered at that time. This additional information adds to the conclusion that Enbridge's business and financial risks have increased, over both the long term and the more immediate term. To confine the examination of changes in Enbridge's business risks to consider only changes since 2006 would result in an incomplete examination and evaluation.[7]

The intervenors that made submissions on the past point of reference took the position that the Board should only consider changes in risk since EB-2006-0034. Concerning future risks, CCC submitted that

> ...the change in business and/or financial risk must be within some proximate timeframe. If evidence of a change in business and/or financial risk is of circumstances that may or may not occur at some indeterminate time in the future, then the evidence doesn't satisfy the Board's test. In the case of [Enbridge], the Board must be satisfied not only that there is evidence of a significant change in business and/or financial risk, but that the change will affect [Enbridge] in 2013 or in the near term beyond that.[8]

Board Findings

In 2007 the Board made a decision in EB-2006-0034 concerning the appropriate level for Enbridge's equity ratio. In that proceeding, Enbridge had a full opportunity to present evidence and argument in support of its position.

In arguing that the Board should now consider evidence for a period starting in 1993, as indicated in the extracts of its argument reproduced above, Enbridge is in effect arguing

[7] Enbridge Argument in Chief, p. 5
[8] CCC Argument, p. 3

that the Board should reconsider the basis for its decision in EB-2006-0034. Enbridge had the right to seek a review of that decision, but did not do so. Parties and ratepayers are entitled to rely on the results of Board proceedings, subject to the established legal review mechanisms.

In EB-2006-0034, the Board performed an assessment of the change in Enbridge's risk and determined the appropriate equity ratio for Enbridge at that time. In this proceeding, the Board's task in assessing the change in risk is to examine how risk has changed from the time the issue was previously decided in EB-2006-0034. To extend the analysis to a date before the Board's last consideration of the issue would inappropriately revisit the basis for the Board's risk assessment in EB-2006-0034, which was embodied in the approved equity ratio at that time. If there is now information available which was not known when the equity ratio was previously set, this will inform the analysis of change in risk only to the extent it is relevant to the change in risk since the equity ratio was last set.

Accordingly, the Board will determine whether there has been a significant change in Enbridge's risk since the Board rendered its decision in EB-2006-0034 in 2007.

Regarding the risk of future events, the Board agrees with CCC that the relevant future risks are those that are likely to affect Enbridge in the near term. Any risks that may materialize over the longer term can be taken into account in subsequent proceedings. In considering the risk of future events, the Board will take into account the fact that, generally, the more distant the potential event, the more speculative is any conclusion on the likelihood that the risk will materialize.

Assessment of Change in Risk

Although Enbridge has presented evidence and argument concerning changes in its risk since 1993, its position is also that it has experienced a significant increase in its business and financial risk since 2007. Intervenors take the position that this is not the case. Although the intervenors' expert witness, Dr. Booth, expressed the view that risk has decreased since 2007, the intervenors do not focus on arguing this position. No party argued that the risk had declined sufficiently to warrant a decrease in the common equity ratio. The Board has therefore focused only on the question of whether the risk has increased significantly.

Business Risk

Enbridge submits that its business risk has increased since 2007 in three ways:

1) Volumetric demand profile;
2) System size and complexity; and
3) Environmental and technological advancement.

In assessing the change in risk associated with each of these three factors, the Board will consider both the impact of each factor on Enbridge's business operations and the extent to which regulatory mechanisms mitigate this impact.

Volumetric Demand Profile

Enbridge submits that average use of natural gas by its customers has declined, causing upward pressure on distribution rates as distribution costs are apportioned over lower volumes. It submits that ultimately this can cause customers to fuel-switch or further decrease consumption. Enbridge points out that the decline in average use has occurred despite low gas prices. It submits that gas prices are likely to increase, thereby increasing the risk. Enbridge submits that an increase in its number of customers does not mitigate this risk. In its view, this is because most new customers are customers who are subject to volatility in consumption due to weather conditions.

Intervenors submit that there is no evidence that gas prices will increase in the near term. They also submit that demand for gas is likely to increase in the near term because of increased use of gas for power generation. They submit that the competitive position for gas remains strong.

Intervenors also submit that an increase in the number of Enbridge customers mitigates the impact of declining average use. They point out that any customers considering fuel-switching from gas to electricity would need to be prepared to pay higher prices. Intervenors submit that demand side management ("DSM") initiatives have been a cause of decreased average use, but that Enbridge is protected against this decrease by the Lost Revenue Adjustment Mechanism ("LRAM") account. Intervenors submit that since 2007 Enbridge's risk has also been decreased by its increased proportion of fixed charges and the creation of the Average Use True-Up Variance Account ("AUTUVA").

Enbridge responds that in its view available regulatory tools do not fully manage the impact of declining average use, because deferral and variance accounts do not cover all customer groups and do not ameliorate all short-term volume risk. Enbridge submits that the AUTUVA only remedies in-year forecast error for consumption. Enbridge also responds that its increased proportion of fixed charges does not ameliorate its volumetric risk.

Board Findings

There is no dispute that average use has declined and continues to do so. Enbridge data and forecasts show a decline of 1.2% per year in average weather normalized residential consumption from 2006 to 2013. The Board notes that average use was also declining in 2007. However, the issue in this proceeding is not whether average use has declined; it is whether the declining average use presents a larger risk than in 2007.

As submitted by the intervenors, one cause of declining average use is the explicit regulatory policy goal of greater conservation and energy efficiency. As part of its normal business, embedded in the rate setting process, Enbridge operates Board approved DSM programs to further this policy through reduced gas consumption. An important component of the DSM programs is the Board approved incentive paid to Enbridge for achievement of specific goals. Declining average use may require the spreading of fixed distribution costs over a smaller volume, but it also reduces a customer’s exposure to commodity costs. Hence, DSM can serve to enhance the competitive position of gas, and the impact of DSM on Enbridge’s revenues has been explicitly addressed.

Enbridge has added customers each year since 2007, an overall increase of 11% from 2007 to its forecast for 2013. The Board notes that although Enbridge has expressed concern about the fact that most new customers are weather-sensitive, its evidence indicates that weather risk has not increased since 2007.

The evidence also shows that in terms of price the competitive position of natural gas compared to oil and electricity is stronger than it was in 2007. Shale gas is a significant new development since the last risk assessment. This, among other factors, has led to lower prices. An Enbridge witness expressed the view that environmental issues make shale gas supply uncertain, but the evidence does not demonstrate that this uncertainly is likely to have a detrimental effect over the near term.

Currently, gas maintains a significant price advantage over oil and electricity. The evidence does not indicate whether gas prices are likely to increase over the near term, or how the price of gas is likely to compare to that of other fuel sources in that timeframe. Enbridge's expert, Mr. Coyne, did not express the view that prices are likely to increase. Mr. Coyne testified that gas prices are volatile and uncertain, and that his considerable experience in forecasting gas prices leads him to conclude that gas is a very difficult commodity to forecast.

Historical experience also indicates that higher gas prices would not necessarily eliminate the significant differentials between the prices of gas and other fuels. For example, in 2006, when gas prices were significantly higher, they were still significantly lower than alternative energy sources other than heavy fuel oil for industrial use. This means that any increase in gas prices in the near term would not necessarily be likely to cause significant fuel-switching.

The volatility of gas prices has been a risk factor in the past and continues to be a risk factor currently. The question is whether price volatility is a greater risk when prices are low, as they are currently, than when prices are higher, as they were in 2007. The evidence does not demonstrate that this is the case.

Regulatory mechanisms, including rate design and special accounts, also operate to protect Enbridge's revenues.

Enbridge now collects a greater portion of its revenues from fixed charges than in 2007. Enbridge does not consider that this reduces risk. An Enbridge witness indicated that this change was made for purposes of reflecting cost causality more accurately. However, the Board agrees with the intervenors that this change also helps to mitigate risk. Distribution costs are largely fixed. If more of the costs are recovered through fixed charges, there is less revenue volatility related to volume changes, and less uncertainty that the fixed costs will be recovered. This mitigation is greater now than it was in 2007, since Enbridge's forecast for 2013 shows 51% of revenues collected through fixed charges, a significant increase over 33% in 2007. In addition, Enbridge has benefited from a growing customer base over which to recover its fixed costs. This means that Enbridge's revenues are now less dependent on volume than in 2007.

Mr. Coyne expressed the view, however, that increasing the proportion of fixed costs "sets the stage for the so-called, quote-unquote death spiral"[9] by decreasing customers' opportunity to economize by decreasing consumption. In his view, this could cause significant fuel-switching. The Board considers that this does not take account of the fact that if average use declines, the customer's commodity costs will decline. Given that 49% of distribution revenues are still collected through variable charges, this means that the customer's overall bill will also decline. The evidence does not indicate that a "death spiral" situation will likely arise in the near term.

Other regulatory mechanisms also operate to help mitigate the impact of Enbridge's volumetric risk. Forecast average use is a factor that the Board takes into account in its rate setting framework. As pointed out by the intervenors, the AUTUVA compensates for variance between forecast and actual volume and the LRAM compensates for volume reductions due to DSM programs.

Enbridge is correct in stating that the available regulatory mechanisms do not fully protect Enbridge from the potential impact of volumetric risks. However, the Board notes that current regulatory mechanisms address Enbridge's potential volumetric risks more comprehensively than the mechanisms that were in place in 2007. For example, since 2007 the AUTUVA has been put into place and as indicated above, Enbridge's approved proportion of fixed costs has increased.

In addition, the Board notes that Enbridge has not provided quantitative evidence concerning the potential financial impact of the aspects of its risk not covered by regulatory mechanisms, or of how this has changed since 2007. Given the comprehensive extent of the regulatory mechanisms and the limited extent of Enbridge's likely volumetric risk as discussed above, the Board considers that the financial impact of the amount of risk not covered by the regulatory mechanisms is likely to be small.

[9] Tr2, p.206

Accordingly, as discussed above, the Board concludes that Enbridge has not experienced a significant increase in risk since 2007 relating to its volumetric demand profile.

System Size and Complexity

Enbridge submits that there has been a significant increase in the complexity of managing its gas distribution system due to increased system size, increasing peak demands and higher pipeline integrity standards. It submits that its first Asset Plan, prepared in 2012 and filed in this proceeding, demonstrates a need for higher and growing capital expenditures and that asset condition is an area of considerable uncertainty. Enbridge also identified a number of specific risk factors, relating to system size and complexity, which it considers have increased since 2007.

Enbridge has provided quantitative data on the increase since 1993 in its system size, number of employees, capital budget and operations & maintenance ("O&M") budget and on the increase since 1995 in its major projects. It has not provided data to indicate what part of this increase has occurred since 2007. Enbridge has also provided information on pipeline integrity rules introduced in 2001 and 2006. Enbridge submits that pipeline safety regulatory requirements are becoming more prescriptive as a result of events such as the San Bruno explosion in 2010.

BOMA submits that the size of Enbridge's system has not increased appreciably since 2007. It reaches this conclusion based on its calculation of Enbridge's average annual increase in employees and capital and O&M budgets since 2003. CCC submits that Enbridge's capital expenditure requirements are dealt with adequately in its rate applications. Several intervenors submit that higher safety standards decrease Enbridge's risk rather than increasing it. Board staff submits that many of the specific risk factors listed by Enbridge are simply routine matters of utility business operations rather than risks.

Board Findings

The Board accepts Enbridge's position that system size and complexity have increased since 2007, although as pointed out by BOMA, Enbridge has not provided quantitative information on the magnitude of these increases. The Board also accepts that there has been heightened attention to safety standards since 2007, as a result of incidents in North America that have raised safety concerns. However, the issue the Board must consider is not whether system size and complexity, including related safety standards, has increased; it is whether the increase in size and complexity results in higher risk.

As Enbridge's system grows and becomes more complex, Enbridge adds more assets and employees and does more work. The result may be a higher number of adverse events. However, system growth also brings benefits such as greater economies of scale, greater customer and geographical diversity, more advanced systems and greater employee expertise. As a result, increased size and complexity does not necessarily mean that Enbridge's risk will increase. Its risk will increase only if the increase in adverse events (or probability or severity of adverse events) is greater than the rate of system growth. The evidence does not indicate that this is the situation for Enbridge.

The Board agrees with the intervenor submissions that higher safety standards are more likely to reduce, rather than increase risk. Higher safety standards are designed to decrease the risk of safety-related incidents, which can involve a high financial and reputational cost.

Similarly, the Board considers that Enbridge's Asset Plan reduces risk, rather than increases it, because it provides better information concerning the uncertainties and required expenditures for capital assets.

The Board also considered the specific risk elements listed by Enbridge as being related to system size and complexity. Enbridge has not made specific submissions on a number of the elements on the list: price of materials, interest rates or utility credit spreads, cost of labour, insurance costs, cost of litigation, cost of bad debts, ability to generate other revenues as forecast, aging workforce, technical safety or compliance standards, operational risks associated with underground facilities, third party damages and employee health and safety. Most of these elements are direct costs to the utility which are forecast and addressed directly through rate setting. The evidence does not demonstrate that these elements have resulted in a significant increase in business risk.

Accordingly, the Board concludes that Enbridge has not experienced a significant increase in risk since 2007 relating to its system size and complexity.

Environmental and Technological Advancement

Enbridge submits that changes in policy and laws to further environmental objectives create uncertainty for the gas distribution business. Enbridge provides examples of such changes that include the Ontario *Green Energy Act, 2009,* proposed amendments to the Ontario *Environmental Protection Act* and several policy reports prepared by the National Round Table on the Environment and the Economy (NRTEE).[10]

Enbridge submits that

> There is a clear long-term risk that demand for natural gas will decline, as new technologies and energy saving practices take further hold. The current impact of items such as replacement of less efficient appliances and new *Building Code* standards is described in Enbridge's Gas Volume Budget evidence. These impacts will cumulate over time. Even if the magnitude of impacts cannot be known with certainty, it is a fair concern that these items will negatively impact natural gas demand in the future.[11]

In Enbridge's list of specific risk elements, it categorizes two elements as "Environment and Technology" risks: "price of fuel oil or other energy alternatives"; and "advancement of other technologies".[12] It assesses the risk since 2007 relating to "advancement of other technologies" as "neutral" rather than increasing. The risk element "price of fuel oil or other energy alternatives" covers the possibility that gas prices will increase, which is addressed above under Volumetric Demand Profile.

Several intervenors submit that gas distributors such as Enbridge benefit from the movement from coal fired to natural gas fired electricity generation.

CCC and BOMA submit that Enbridge's position on the risks due to environmental policies and laws is largely speculative. CCC submits that the *Green Energy Act* is the one such initiative with tangible results to date and that Enbridge has not provided evidence to substantiate the impact on its business.

[10] The NRTEE is a body established by federal statute to identify, promote and explain practices and principles of sustainable development.
[11] Enbridge Reply, p. 13
[12] Exhibit J1.3 p.2

Board Findings

The evidence does not indicate that since 2007 environmental policy and laws which have been implemented have had the effect of making the price of gas less attractive than that of other fuels. Gas prices have decreased since 2007 and the differential between the price of gas and other fuels has increased. As discussed above, the evidence also does not demonstrate that this pricing situation is likely to change significantly over the near term. In addition, as indicated above, to the extent that there is an increase in gas prices in this timeframe, this is not necessarily likely to cause significant fuel-switching.

The evidence does not demonstrate a tangible risk that new environmental policy and laws in relation to gas distribution will be implemented over the near term, or if implemented, will be likely to have a detrimental effect on Enbridge in terms of volume over the near term. The Board agrees with intervenors that, to the contrary, the policy commitment to cease all coal-fired electricity generation in Ontario is likely to result in more gas-fired electricity generation, which is a benefit to Enbridge. In addition, as discussed under Volumetric Demand Profile, to the extent that DSM initiatives decrease Enbridge's volume, this risk is addressed by the LRAM account. Also, as discussed above, increasing energy efficiency has the effect of strengthening the ongoing competitive position of gas compared to other fuels.

Accordingly, the Board concludes that Enbridge has not experienced a significant increase in risk since 2007 relating to environmental and technological advancement.

Financial Risk

Enbridge submits that although it is not inhibited in accessing debt markets, it has greater financial risk than other Canadian and American regulated natural gas distribution businesses with comparable profiles. It submits that this is because it has a lower equity ratio than comparable utilities, which causes unfair competition for investment capital. Enbridge submits that the view taken by the markets in relation to debt issuance is evidence that Enbridge's financial risk has increased since 2007.

CME submits that the capital markets perceive Enbridge's financial risk to be if anything lower than in 2006, considering Enbridge's consistent earnings in excess of allowed returns, its improved interest coverage ratios, its financing costs in comparison to utilities with higher equity ratios, its ability to obtain loans with terms as long as 40 years and its consistent A credit rating. CME submits that Enbridge's lower equity ratio in relation to other comparable utilities would only be relevant if it adversely affected Enbridge's ability to obtain capital on reasonable terms. VECC put forward a similar position.

Board Findings

In assessing whether Enbridge has experienced an increase in financial risk since 2007, the essential question to consider is how the market would view Enbridge as a potential investment.

Enbridge argues that its financial risk has increased since 2007 because other comparable utilities have increased their equity ratios, whereas Enbridge's equity ratio has remained constant. An Enbridge witness characterized a comparison of equity ratios among comparable utilities as an indicator of Enbridge's relative risk. The Board agrees with the submissions of intervenors that the equity ratios of other utilities, including Ontario gas and electricity distributors, and the changes in those equity ratios relative to Enbridge, are not necessarily an indicator of a change in Enbridge's financial risk. The Board considers that in assessing whether Enbridge's financial risk has increased since 2007, the appropriate indicators are the key elements of Enbridge's market circumstances: access to capital, interest coverage ratios, credit ratings, debt terms, and financial results.

<u>Access to Capital</u>

Enbridge states that it is not currently inhibited in accessing debt markets. Enbridge's most recent debt financing was a bond issued in 2011 that was a reopening of a bond issued in 2010. The fact that this bond has a 40 year term confirms that Enbridge has not been inhibited in its access to capital. The evidence also does not lead to the conclusion that Enbridge's access to capital is more difficult currently than in 2007.

<u>Interest Coverage Ratios</u>

Enbridge's trust indenture requires it to have an interest coverage ratio of 2.0. Enbridge's interest coverage ratio was 2.5 for 2011, the same ratio as in 2007. The forecast interest coverage ratios for 2012 and 2013 are lower than the actual ratio for 2011 but still exceed the required ratio of 2.0.

Accordingly, the Board does not consider that Enbridge has experienced a significant decrease in its interest coverage ratio since 2007.

Credit Ratings

Given that debt investors rely on credit ratings, changes in credit ratings would normally indicate a change in financial risk. Enbridge is currently rated by Standard & Poor's as A-/Stable and by DBRS as R-1 low. One of Enbridge's witnesses, Mr. Yaworsky, confirmed that Enbridge's rating has remained the same since 2007, except for a period when there was an issue concerning Enbridge's parent company.

Mr. Yaworsky testified that Standard & Poor's and DBRS are currently reviewing Enbridge's ratings. He expressed the view that there is an increasing risk of lower ratings as a result of an increased spread between Enbridge's bonds and government bonds (as discussed below). However, Dr. Booth testified that the availability of capital to invest in government debt has recently increased the spread between government and corporate bonds generally. It is not clear to what extent the ratings agencies would take this factor into account. Furthermore, Mr. Yaworksy testified that he cannot predict the outcome of the credit ratings review, because "most of the agencies' risk identification is qualitative."[13]

Accordingly, the evidence does not lead to the conclusion that any decrease in Enbridge's credit rating is likely over the near term.

Debt Terms

Mr. Yaworksy testified that in comparing the terms of Enbridge's debt instruments over time, it is important to consider the spread between the yields of Enbridge's and comparable Government of Canada bonds. In his view, a larger spread indicates greater financial risk. Dr. Booth testified that another factor to take into account is that recently an influx of capital seeking to invest in Canadian and American government debt has increased the spread in the market generally. Dr. Booth also pointed out that overall changes in the spread between government and corporate bonds are addressed through the operation of the Board's return on equity formula.

[13] Tr1, p. 169

Enbridge provided listings of the bonds it has issued since 2007 and its estimated bond pricing for a hypothetical 10-year Enbridge bond issued in 2013. The estimated spread for the hypothetical 2013 10-year bond is 110 basis points. This the same as the spread for the 10-year Enbridge bond issued in 2007. This comparison does not indicate an increase in financial risk since 2007.

Enbridge also provided a listing of the spreads for bonds issued by several potentially comparable utilities. However, none of these utilities issued bonds with terms and timeframes comparable to Enbridge's 10-year bonds.[14]

Financial Results

The Board also examined Enbridge's financial performance since 2007. From 2007 to 2011, Enbridge exceeded its Board allowed return on equity. The financial information provided by Enbridge shows a net revenue sufficiency in the range of $21 to $40 million each year in relation to total revenue of approximately $1 billion. Enbridge's forecast for 2012 shows that it does not expect to reach its Board allowed return; however the amount of the forecasted shortfall is only $4 million in relation to forecast total revenue of approximately $1 billion.[15] Therefore Enbridge has not experienced a significant deterioration in financial results since 2007.

Accordingly, as discussed above, the Board concludes that Enbridge's market circumstances have not deteriorated significantly since 2007 in terms of access to capital, interest coverage ratio, credit ratings, debt terms or financial results, and that consequently Enbridge has not experienced a significant increase in financial risk since 2007.

Decision of the Board on Equity Ratio

The Board concludes that there has been no significant increase in Enbridge's business and/or financial risk since 2007. Accordingly, the Board finds that Enbridge's equity ratio shall remain at 36% and that a full FRS analysis is not required.

Settlement on Cost of Debt

Issue E1 in this proceeding is as follows:

[14] Accordingly it was not necessary for the Board to consider the extent to which these utilities are comparable to Enbridge.
[15] Figures in this paragraph have been rounded.

Is the forecast of the cost of debt for the Test Year, including the mix of short and long term debt and preference shares, and the rates and calculation methodologies for each, appropriate?

In the Settlement Agreement for this proceeding, the parties agreed on how Issue E1 would be settled if Enbridge's equity ratio remains at 36%. Since the Board has now determined that Enbridge's equity ratio remains at 36%, this provision of the Settlement Agreement finalizes Issue E1.

Rate Implementation

The rates currently approved by the Board for Enbridge are interim rates. A Rate Order is required to incorporate the return on equity that was published by the Board on November 15, 2012 in accordance with the Board's policy.

Cost Awards

In determining the amount of cost awards in this proceeding, the Board will apply the principles in section 5 of the Board's *Practice Direction on Cost Awards* and the maximum hourly rates in the Board's Cost Awards Tariff.

THE BOARD ORDERS THAT:

1. Enbridge shall file with the Board and serve on the intervenors a draft Rate Order within 7 days of the date of this Decision.

2. Intervenors shall file with the Board and serve on Enbridge, within 7 days of the date of the draft Rate Order, any comments on the draft Rate Order.

3. Enbridge shall file with the Board and serve on the intervenors any reply to intervenor comments within 7 days of the receipt of the intervenor comments.

4. Parties eligible for cost awards shall file their cost claims with the Board, and serve them on Enbridge, by February 28, 2013. Cost claims must be prepared in accordance with the Board's *Practice Direction on Cost Awards*.

5. Enbridge shall file with the Board any objection to a cost claim, and serve it on the party that made the claim, by March 7, 2013.

6. Any party whose cost claim was objected to shall file any reply submission with the Board, and serve it on Enbridge, by March 14, 2013.

All filings with the Board must quote file number **EB-2011-0354**, be made through the Board's web portal at www.pes.ontarioenergyboard.ca/eservice/, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address, telephone number, fax number and e-mail address.

All filings shall use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca. If the web portal is not available the document may be emailed to BoardSec@ontarioenergyboard.ca. Persons who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Persons who do not have computer access are required to file seven paper copies. If a document has been submitted through the Board's web portal an e-mail is not required. For all electronic correspondence and materials related to this proceeding, parties must include in their distribution the Case Manager, Colin Schuch at colin.schuch@ontarioenergyboard.ca and Senior Legal Counsel, Kristi Sebalj at kristi.sebalj@ontarioenergyboard.ca.

All communications should be directed to the attention of the Board Secretary and be received no later than 4:45 p.m. on the required date.

DATED at Toronto, February 7, 2013

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary