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Regulatory Partnerships

Remarks to
CAMPUT 2004 Conference
Halifax, Nova Scotia
May 11, 2004

Introduction

- Good morning. It is a pleasure to be in Halifax, and once again address the annual CAMPUT conference.
- I last attended this gathering in 2001 in Toronto when I spoke about incentive regulation. Since that conference, CAMPUT has very appropriately broadened the conference focus to a North American perspective. And of course, Enbridge has broadened to be more North American since then too, so it is a pleasure to be able to address the national energy regulators of Canada, the U.S., Mexico and the Canadian provincial regulators all in one room.
- The interdependency of our energy systems and the importance of regulatory coordination were dramatically emphasized this past year with the eastern electricity grid failure, which started in Ohio, but quickly spread through Ontario and eight U.S. states. Moreover, this outage cascaded through our crude oil pipeline system and had lines shut down from Ontario and Michigan all the way back to Edmonton. This has clearly illustrated that even different energy infrastructures are inter-dependent.
- My comments today address how improved regulatory partnerships can contribute to innovations in ratemaking and to the regulatory approval processes so that infrastructure is built and operated in a timely and responsible manner.
- First, just a few words to establish Enbridge's North American credentials. Our core businesses of crude oil pipelines, natural gas pipelines and natural gas distribution are operated across the Canada-U.S. border and in 20 states, 6 provinces and the Canadian North.
- Enbridge and its affiliates own and operate:
 - the world's longest crude oil pipeline system,
 - Canada's largest natural gas distributor, serving 1.7 million customers in eastern and New York State, and
 - more than 15,000 kilometres of natural gas transmission and gathering pipelines in the U.S Midcontinent and Gulf Coast regions.

- Enbridge and its affiliates also hold major ownership interests in two large-diameter, cross-border natural gas transmission systems – the Alliance and Vector pipelines.
- Constructive relationships in regulatory forums are critical to reliable and expanded infrastructure so vital to North America’s energy future. We need regulatory certainty, streamlining and regional cooperation in building new infrastructure. And we need to ensure that commercial oversight from various jurisdictions provides incentives for the massive private investment needed to maintain reliability and meet growing demand.
- Industry, regulators and stakeholders all work to ensure that consumers have secure supplies of appropriately priced energy. I suggest that the consumer will be better served the more that these parties exercise their responsibilities as “partners” in the challenge of energy delivery, rather than as adversaries.
- Whether it is for pipeline routes, environmental reviews or rate approvals, the regulatory model must work constructively. In some venues we have found an adversarial environment. Evidence is presented and critiqued. Lawyers find fault by cross-examining witnesses. Regulators adjudicate and issue orders. “Adversaries” worry about information asymmetry (or disclosure issues); they fight battles, they celebrate victories.
- And when the matter is finally determined (sometimes after Court appeals), I wonder if the best interests of energy consumers really were served.
- We seem to be trying to prove that the win/lose model is better than the win/win model. It’s archaic.
- In other venues we have seen the benefit of working together as partners with an eye toward our common objective of delivering secure energy. Partners negotiate deals. They can’t afford to entrench on positions and so drive towards a common ground. Partners seek to overcome obstacles rather than hold them up as reasons to maintain the status quo. When the deal is reached, partners can be relied upon to deliver on the contract, since their reputation, and therefore the next deal relies upon it.

The Role of the Regulator

- So I’d like to pose the question to you today: What is the role of the regulator? Is it to be a “policeman”, watching companies to see if there is any wrongdoing. Supervising and enforcing. Or should the regulator be more of a

visionary, working with all parties to find innovative solutions to ensure lowest-cost energy and security of supply?

- I know that most definitions of “regulation” do contain “policeman-like” references. Webster’s, for example, defines “regulate” as “to control, direct or govern according to a rule, principle, or system.”
- But I prefer the approach taken by economics professor Charles F. Phillips in his 1993 book “The Regulation of Public Utilities”. He wrote that, “Regulation is concerned with rates, service, safety, and to a growing extent the efficiency of management.” He stated that regulators have five basic objectives. Three of them were to prevent excessive profits and unreasonable price discrimination; ensure public safety, and expand the service to as many as possible. But the other two objectives were to ensure adequate earnings (to allow system expansion), and to promote the development of industry.
- I fully understand the need for due diligence and ensuring adherence to rules and regulations. But I also think it can be too easy to miss seeing the forest for the trees. It can be too easy to pass on valuable ideas such as incentive tolling because there’s a fear that it enables companies to profit.
- I sometimes think that regulators are afraid to allow pipeline companies to do well, because they might be accused of not protecting the customer enough. In fact, incentive tolling can benefit all parties – if all parties work together to share the vision and make it happen.
- In the future, I hope that all regulators will be seen as facilitators, offering incentives, removing barriers, working in partnership with industry and stakeholders towards secure and economic energy supply.
- I believe that a regulatory model based on opportunity, incentives and performance-sharing drives very different behaviours than one based just on rulemaking, enforcement and penalties. One frees creativity and innovation while the other stifles it. So, can we not relax more rules, remove more barriers?
- There are positive signs in North America.
- In Canada, the NEB and CEAA have efficient regulatory processes and a number of positive steps have been taken to coordinate regulatory approvals for an anticipated filing for a Mackenzie Valley natural gas pipeline.

- I also applaud the efforts in the United States to develop a more proactive process to natural gas pipeline siting. Proponents and FERC worked together to devise a more constructive and flexible approach to public consultation for certification of new projects. Hopefully, this will lead toward a less adversarial environment between industry, regulators and the affected public.
- However, while progress has been made in both countries, the issue of regional coordination among provinces or states affected by new projects still presents significant challenges.

Access to New Supply

- Energy security and supply is a multi-jurisdictional issue, and nowhere is this more apparent than with northern natural gas pipelines.
- Enbridge recently announced an interest in participating in the Alaska Highway Pipeline Project and filed an application to the State of Alaska about 10 days ago.
- This project will require a partnership approach because of the scope of the project, the many jurisdictions and because of the need to align a number of key stakeholders, including indigenous communities. Resource owners and shippers are key.
- All of us recognize that the project depends on common goals and shared risks. We have to improve multiple jurisdictional review of such pipeline proposals. Otherwise, it will be the Achilles heel of northern gas development.

Ratemaking Alternatives

- Let me turn now to the topic of ratemaking.
- Enbridge has welcomed the evolution of rate regulation away from the traditional cost of service approach; a process that has typically been adversarial, costly and complex. Lighter handed forms of rate regulation that recognize the role of incentives are now well established.
- Within the Enbridge family of assets, we have:
 - competitive rates with the backstop of price caps in place on FERC regulated pipelines;
 - an incentive tolling agreement on our crude oil mainline in Canada; and

- we experimented with a three-year revenue cap on the O&M expenses of our gas distribution system in Ontario.

- We have had notable successes in these areas, and we have learned some lessons.
- The value of the partnership model is well demonstrated by the incentive tolling agreement for our crude oil mainline in Canada. The agreement, negotiated with shippers for the period 1995 to 1999, was a first for a Canadian pipeline. The agreement was based upon our commitment to operate our infrastructure as efficiently as possible and to share any realized savings with customers.
- We renegotiated the agreement for a second term five-year term, to the end of 2004, and we are now negotiating a renewal that we hope will be in place before year-end.
- From the inception of incentive tolling arrangements in 1995 to the end of 2003, the performance sharing mechanism of the agreements resulted in after-tax benefits of \$96.8 million; almost half of that amount (47%) was shared with customers.
- The tolling agreement has strengthened our relationship with shippers with the result that the Company has a greater customer service orientation. Spending our time working for our customers instead of preparing for rate cases!
- We have also had some success in the negotiation of regulatory issues for our gas distribution system in Ontario. Within a three-year PBR plan on our distribution O&M costs, from 2000 to 2002, we were able to negotiate all issues without a hearing in 2001, and all of the rate-making issues in 2002 (policy issues were taken to a hearing).
- We learned some lessons from the first generation O&M PBR plan. The OEB and stakeholders criticized us for our outsourcing strategy, affiliate relationships and disclosure within the plan. We have learned that we need to work together to provide appropriate disclosure, ensure that there are no surprises and build trust. A partnership model requires it.
- We firmly believe that lighter handed regulation is a win/win for all. Let me give you an example. For the 2004 rate year, we found ourselves unable to get a cost of service rate application through the process in time to avoid retroactive rate setting.

- With the support of the OEB and most stakeholders, we made the simple proposal that 2004 rates be set by escalating 2003 rates by an amount equal to 90% of the forecast rate of inflation. Our application was 44 pages long. After a two day public hearing, the Board accepted the application, with the proviso that an earnings sharing mechanism be added.
- In making our case for the application, we encouraged parties to focus on outcomes, the impact on rates; and not the detailed schedules and explanations that build cost of service evidence. The OEB accepted the logic. The 2004 case took five months, killed few trees, and our customers' rates increased less than the forecast rate of inflation.
- In contrast, in the decade of detailed cost of service applications before that, rate cases took 10 to 13 months, generated tons of paper (literally) and resulted in rate increases that were, on average, greater than the rate of inflation.
- We think that everybody is better off with a lighter handed process focused on customer impacts.
- Unfortunately, we've now returned to the more detailed cost of service process in Ontario. We've seen the requests for additional documentation escalate. I don't want to leave the impression that the regulatory burden is the fault of any single party. Within the rules of the system, we all try to achieve our goals and win the battles. But does that make sense? Why should the system make me fight with my customers?
- The future of distribution rate regulation may bring rate freezes, rate indexes, incentive regulation, or improvements to cost of service regulation. We look forward to working with customer representatives and Chairman Wetston and his staff at the OEB as partners for a future that benefits all parties.

Closing

- In closing let me offer a few thoughts on the attitudes and behaviour that I think can help foster movement towards the partnership model I am advocating.
- **Industry** needs to help regulators and stakeholders understand their business issues; communicating often with parties to exchange views on projects and regulatory hurdles. While all parties need to recognize and address the legitimate concerns about the protection of competitive information, industry needs to do a better job of disclosing the information

required by stakeholders and regulators in order for them to join in the partnership.

- **Regulators** can help by providing guidance, mediation and advocating change. Please publish your criteria for the approval of negotiated settlements and stick to them. Stakeholders and industry need to have confidence that they can manage regulatory risk through negotiation.
- Also, businesses need to be rewarded for risk-taking. I think Enbridge has demonstrated that we understand the value of earnings sharing, but the more that the rewards available for risk taking are diluted, the more the model becomes like cost of service. I think that improved earnings, appropriately shared in an incentive tolling or PBR plan, is a good thing. I'm afraid that some regulators do not.
- Finally, I don't think we can rely exclusively on international treaties and legislative change to address the multi-jurisdictional regulatory challenges associated with the delivery of Arctic gas to markets. Partnerships between business, community, producers, customers and regulators can help define the path.
- **Stakeholders**. I won't ask you to trust me. I will ask you to let me prove I am trustworthy. Let's negotiate, in good faith, towards a win for you, for my shareholders and most importantly, for the consumer. While regulatory and legal proceedings are a necessary backdrop, collaboration on issues can only happen when we sit down and talk directly.
- Thank you for your attention. I look forward to the discussion and your questions.