



DECISION

IN THE MATTER of an application by Enbridge Gas New Brunswick Limited Partnership regarding the approval or fixing of rates and tariffs pursuant to section 52.2 of the *Gas Distribution Act, 1999*

And

IN THE MATTER of a review of Enbridge Gas New Brunswick Limited Partnership 2011 Regulatory Financial Results

September 20, 2012

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

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NEW BRUNSWICK ENERGY AND UTILITIES BOARD:

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VICE-CHAIRMAN: Cyril Johnston

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COUNSEL: Ellen Desmond

APPLICANT:

Enbridge Gas New Brunswick

Len Hoyt, Q.C.
David MacDougall

INTERVENORS:

Atlantic Wallboard L.P. and Flakeboard Company Ltd.

Christopher Stewart

Competitive Energy Services

Jon Sorenson

Department of Energy

Patrick Ervin

Public Intervenor

René Basque

Truefoam Ltd

Debbie Coles

Introduction

Enbridge Gas New Brunswick Limited Partnership (EGNB) is a distributor of natural gas and the general franchisee under a general franchise agreement dated August 31, 1999 with the Province of New Brunswick. EGNB is a public utility, regulated by the New Brunswick Energy and Utilities Board (Board). The distribution of natural gas in New Brunswick is governed by the *Gas Distribution Act, 1999* (GDA).

In December 2011 the government of New Brunswick passed Bill 18 in the Legislature, which resulted in significant amendments to the GDA, including changes to the regulation of natural gas distribution in the province. In addition, New Brunswick Regulation 2012-49 (the Rates and Tariff Regulation), came into effect in April 2012. There were also consequential amendments to the Energy and Utilities Board Act (EUB Act) to harmonize the EUB Act with the amended GDA.

Section 52.2 of the GDA provides that:

A gas distributor who has been granted a general franchise shall file with the Board an application regarding the approval or fixing of rates and tariffs in accordance with section 52(a) on or before May 31, 2012.

EGNB submitted an application, as directed by section 52.2 of the GDA, but takes the position that the rates presented in the application should not be approved on the grounds that they are not just and reasonable.

Since the beginning of the delivery of natural gas in New Brunswick, EGNB's rates have been market based rather than cost based. The market based method sets delivery rates by calculating the cost of an alternative energy source, deducting the cost of the natural gas commodity and then setting delivery rates at an amount which provides the customer with savings in comparison to the energy alternative. The objective of EGNB's market based approach is to provide potential end use customers with the economic incentive to convert to, and continue to use, natural gas and to make use of the distribution system that EGNB committed to build in New Brunswick.

The market based system of rate making does not take into account the costs incurred by EGNB in distributing gas. Any shortfalls in the recovery of EGNB's costs have been permitted to be brought forward into a regulatory deferral account with the understanding that EGNB would have a reasonable opportunity to recover these amounts in the future.

The new regulatory structure created by Bill 18 and the Rates and Tariffs Regulation brought in many changes. Three of the most significant changes are:

- 1) The prescribing of new customer classes pursuant to section 3 of the Rates and Tariffs Regulation,
- 2) The requirement, pursuant to section 4(1) of the Rates and Tariffs Regulation that the Board adopt the cost of service method for approving or fixing just and reasonable rates unless such rates would exceed market based rates, and
- 3) The requirement, pursuant to section 52(5) of the GDA, that in setting just and reasonable rates, the Board not recognize or consider the regulatory deferral account as part of the regulated assets of the gas distributor or permit EGNB to depreciate, amortize, earn a return on or otherwise consider the regulatory deferral account.

The Board held a Pre-Hearing Conference on May 8, 2012 with respect to this application at which time a hearing process and filing schedule was established. This schedule provided for the filing of evidence, a technical conference, interrogatories and responses, motions days and the hearing itself. In addition, the Board determined that the annual review of the 2011 Regulatory Financial Results would be considered concurrently with this matter.

The following witnesses testified at the hearing:

- On behalf of EGNB, David B. Charleson, Lori A. Stickles and Dr. H. Edwin Overcast
- On behalf of AWL/FCL, Ronald J. Amen
- On behalf of the Public Intervenor, Robert D. Knecht.

Issues

In this decision the Board will address the following issues:

Regulatory Financial Results for 2011:

- Operations and Maintenance Spending – per GJ target
- Operations and Maintenance Spending – Professional Consulting
- The prudence of system expansion during the year
- Addition to the Deferral Account
- Whether the Development Period is over

Application for Rates effective October 1, 2012:

- Determination of Cost of Service Rates
 - Revenue Requirement
 - Allocation of Costs
 - Throughput Forecast
- Determination of Market Based Rates
- Approval of Rates for October 1, 2012
 - Comparison of market based rates and cost of service rates
 - Rate Design
 - Determination as to whether the rates are just and reasonable
 - Use of Rate Riders
 - Approval of Rate Handbook

2011 Financial Results

EGNB has requested approval of their Regulatory Financial Results for 2011. The Board has reviewed EGNB's Regulatory Financial Results each year since the beginning of the franchise. The purpose of the annual review is to examine EGNB's spending to ensure such spending is prudent and to determine what, if any amounts, should be added to the deferral account.

For 2011, the Board determined that the review should be held concurrently with the Application for new rates to allow for an efficient use of time and resources.

Operations and Maintenance spending- per GJ target

One of the largest cost items for EGNB is Operations and Maintenance (O&M) spending.

To assist the Board in determining the prudence of O&M spending, the Board has established a "per GJ" or "spending per throughput" target. For 2011, this target was set at \$1.62 per gigajoule of delivered natural gas.

From its evidence, it is clear that EGNB exceeded this target in 2011. Spending was \$1.81 per gigajoule.

In Exhibit EGNB 2.10, EGNB submits that the variance was due to two factors beyond their control. The first factor was that the weather was warmer than forecast which reduced the throughput and ultimately resulted in a higher O&M cost per GJ. No party took issue with this and the Board accepts this explanation for a variance.

The second factor was that EGNB was unable to sell unused capacity it had contracted for on the Maritimes and Northeast Pipeline, which again impacted on their O&M costs. EGNB recommended that the Board alter the calculation of the target to exclude costs related to the sale of capacity on the Maritimes and Northeast Pipeline, as this is likely to be a continuing issue in future hearings.

The Board agrees that this change is necessary and appropriate.

For 2011, the Board accepts that the per GJ target was not met and accepts the rationale offered by EGNB as to why this is the case.

The Board will continue to use a spending target. The target for 2013 will be set after the re-filing of EGNB's revenue requirement for 2013 in accordance with the orders contained in this decision.

Operation and Maintenance Expenses: Professional Consulting

O&M spending includes many expense items, including the costs incurred for professional consulting.

During the course of this hearing, intervenors took issue with the amount that was spent for professional consulting in 2011. In particular, it was suggested that EGNB has spent a considerable amount on litigation that is ongoing between EGNB or its affiliates and the Province of New Brunswick. Intervenors suggest that this should not be included in the costs to be passed on to ratepayers.

In response, EGNB submits that any spending in 2011 was related to consultation and preparing for anticipated regulatory changes, and not the current litigation. The Board notes that Bill 18 was not introduced until December 2011, causing litigation costs to be incurred in 2012.

The Board accepts that EGNB has an obligation to prepare for legislative changes that may be anticipated and that these costs are properly included the costs of a regulated entity. As a result, those costs incurred in 2011 for professional consulting are approved. Those legal and consulting costs which relate to litigation between EGNB and the province should properly be considered during the review of the years when the expense is incurred.

The prudence of system expansion during the year

During the annual review process, the Board also reviews EGNB's capital additions to ensure that system expansion was carried out in an economically prudent manner.

The assessment of prudent expansion is conducted through a system expansion test. The test requires that the annualized revenue from system expansion exceed the annualized cost of expansion by at least 2 percent.

In exhibit EGNB 2.11, EGNB submits that the annualized revenue from expansion in 2011 is \$2.38 million while the annualized cost is \$2.21 million, leading to the conclusion that the expansion test was passed.

Mr. Knecht, in his evidence, raises two issues with respect to this test. He submits that EGNB has not included all its capital costs in the expansion test. He also notes that, because of lost customers during the year, the net number of new customers is lower than the customer additions used in the calculation. Mr. Knecht recalculates the test using all capital costs and making an adjustment for lost customers. In this recalculation, the test is not passed, which would lead to the exclusion of some assets from the rate base.

EGNB responds to these issues in their rebuttal evidence. With respect to the additional capital costs, EGNB submits that these were incurred for the purpose of either repairing the existing system or for improving system integrity. As a result, EGNB submits these are costs that should be borne by the existing customers, not by new customers. The Board agrees with this analysis.

Similarly, EGNB does not agree with Knecht's suggestion that "net customers" include customers lost during the year. EGNB submits that this is not appropriate because the cost of capital is spent exclusively on new customers.

While it is difficult to forecast what new "net load" will be gained by EGNB in any given year, this issue does highlight the need for a system expansion test that will be an accurate indicator of prudence.

When this system expansion test was first established, the Board indicated that the test may be modified in future years. Specifically the "percentage" by which revenues must exceed cost, may need to be revised, particularly to account for unforeseen circumstances. Lost load or "net customer additions" is such a circumstance.

While the Board accepts that the system expansion test was passed in 2011, the Board finds that the percentage by which revenues must exceed costs should be increased from two percent to four percent in future years. The system expansion test will be modified accordingly.

The Board will continue to monitor this issue to determine what additional changes may be necessary in the future.

Additions to the Deferral Account

The Board heard no other evidence on the prudence of spending in 2011.

The Board will approve the 2011 Regulatory Financial Results as presented and will approve the addition to the deferral account of \$8,004,000 for the year ending December 31, 2011.

Whether the Development Period is over

In a decision dated December 1, 2009, the Board set out the test to be used in determining whether EGNB's development period is over. The Board stated as follows:

The Board finds that the appropriate criteria to be considered in determining if EGNBLP's Development Period is over are:

*Are the full costs equal to or below the currently available revenues?
Are such revenues sustainable?*

These tests, to determine if the Development Period has ended for EGNBLP, will be performed each year as part of the annual review process until the Development Period is over. When the Development Period is determined to be over, EGNBLP will no longer be permitted to add to the deferral account.

EGNB has conducted an assessment as to whether the full costs are equal to or below the revenue for 2011. This assessment is contained in exhibit EGNB 2.11 and determines that this is not the case.

No party took issue with the assessment prepared by EGNB. In light of this evidence, the Board concludes that the development period is not over.

Application for Rates Effective October 1, 2012

In this portion of the decision, the Board will determine rates for each class using the cost of service method. This will include the determination of the appropriate revenue requirement and the allocation of costs between rate classes. The Board will also determine an appropriate market based rate for each class and compare the market based and cost based rates for each class in order to determine which applies. The Board will address issues of rate design and fix appropriate customer and demand charges and the rate or rates to be charged per GJ of delivered gas in each rate class. Finally the Board will address the issue of whether the rates produced are just and reasonable.

Determination of Cost of Service Rates

In general, cost of service rates are fixed by determining a revenue requirement for a test year, often the upcoming year. This revenue requirement is then divided among the customer classes based on a cost allocation study. Once a revenue requirement for each class has been determined, rates for the class are established based on forecasts of throughput.

Revenue Requirement

The first step establishing cost based rates is the determination of the revenue requirement.

The revenue requirement is an estimate of the cost of operating the utility during the year the rates will be in place – referred to as the test year. EGNB proposes to use 2013 as the test year for setting rates. It is common practice to use a forward looking test year for rate setting purposes. The current circumstances are somewhat unusual, since the rates must, by statute, come in to force on October 1, 2012. The Board agrees that 2013 is the appropriate test year and will use the 2013 revenue requirement as the basis for the setting of cost based rates.

The revenue requirement consists of all of EGNB's projected expenses for the year including its return on rate base. Although all expense items were reviewed, the following matters were items of contention amongst the parties.

Operation and Maintenance Expenses: Payments to Affiliates

EGNB makes payments to affiliated companies pursuant to both Service Level Agreements, and a corporate allocations policy. Service Level Agreements have been examined in detail in recent hearings and no one took issue with these payments in this

hearing. Parties did, however, take issue with the amount of corporate allocations to be included in the revenue requirement.

In its January 30, 2012 decision arising from the review of EGNB's 2010 Regulatory Financial Results, the Board wrote at page 5 as follows:

The second type of payments to affiliates is the payment by EGNB to Enbridge Inc. for its share of the allocation of corporate head office expenses. These corporate allocations have been a significant focus of the annual review for several years. Since 2004, the amount allowed in the Regulatory Financial Statements has been less than EGNB's total allocation by Enbridge Inc. Certain charges are excluded on the basis that they would not be incurred if EGNB was a stand-alone business.

In the May 16, 2011 decision, the Board indicated that it would continue to monitor the corporate allocations. The Board orders EGNB to file the following:

- 1. A detailed description of the current methodology used for calculating those portions of the costs allocated by Enbridge Inc. which are included as expenses in the Regulatory Financial Statements.*
- 2. A list of all costs allocated by Enbridge Inc. together with EGNB's position as to whether each of these costs, or a portion of them, would be incurred were EGNB a stand-alone corporation.*
- 3. EGNB's position with respect to how each cost benefits the ratepayers of EGNB.*

EGNB filed a report (exhibit EGNB 2.14) in this proceeding, proposing a new methodology for inclusion of corporate allocations in the revenue requirement. The report sets out each item for which a charge is assessed pursuant to the corporate allocation policy, whether that cost would exist if EGNB were a standalone company and describes the benefit EGNB submits is received by the ratepayers. The report allocates a percentage of each corporate cost to the revenue requirement. The percentages are 0 percent, 10 percent, 50 percent or 100 percent.

The Board finds the approach and format of the corporate allocations report to be very useful in analyzing this often contentious issue.

Intervenors took issue with aspects of the proposed corporate allocations. Certain costs are presented as costs which would not be incurred by a standalone company, but nonetheless a portion of them is sought to be added to the revenue requirement.

The Board will disallow the following Corporate Governance items as reported in exhibit EGNB 4.43 on the basis that they would not be costs incurred by a standalone corporation:

• Benefits and Pensions	\$2,335
• Business Taxes	\$210
• Compliance Systems	\$371
• Corporate Secretarial	\$375
• Directors Fees and Expenses	\$8,232
• EGD	\$2,088
• Employee Benefits	\$20,523
• Enbridge Pipelines Inc Direct Charges	\$13,785
• Investor Relations	\$2,049
• Other employee benefits	\$12,360
• Rent and Lease	\$6,484
• <u>Group VP Corporate Resources</u>	<u>\$5,555</u>

Total disallowed Corporate Governance Items \$74,367

EGNB also sought to include in the revenue requirement, costs for one other item which would not be incurred by a standalone corporation. This cost related to stock based compensation. The total amount sought to be included in the revenue requirement is \$166,210. Of this amount EGNB acknowledges that \$38,356 would not be a cost incurred by a standalone corporation. The Board disallows this portion of the expense reducing the allowed expense by \$38,356.

With respect to two other corporate allocated expenses, the Board does not agree that the benefit to ratepayers is as significant as claimed.

EGNB seeks to include in its revenue requirement 50 percent of costs allocated for Corporate Controller, and Corporate Law. The Board finds that the percentage sought by EGNB is in excess of the demonstrated benefit to ratepayers. The Board will allow 25 percent of the costs allocated to EGNB to be included in the revenue requirement and reduces the revenue requirement by \$36,883.

Finally, EGNB seeks costs relating Public Affairs and Corporate Communications at 100 percent with a total expense of \$200,984. Mr. Knecht, the expert witness for the Public Intervenor, took particular issue with this expense stating at page 11 of exhibit PI 1.01:

Of the large cost items, the one that is most suspect is the 100 percent allowability of "Public Affairs and Corporate Communications" costs. EGNB's description of this function indicates that it is primarily corporate self aggrandizement, with little in the way of a direct benefit to EGNB ratepayers.

The Board finds EGNB has not justified that all of this expense benefits ratepayers and will allow only 25 percent of this cost to be included in the revenue requirement. The Board reduces this expense by \$150,738.

The Board disallows a total of \$300,344 of the payments to affiliates corporate allocation expense from the revenue requirement.

Operation and Maintenance Expenses: Pension Costs

EGNB includes \$783,000 for pension costs in its 2013 revenue requirement.

Mr. Stewart, Counsel for AWL/FCL, took issue with the amount of these payments. He argued that the amount is excessive and it should be reduced.

The EGNB pension plan has both defined benefit and defined contribution options. The defined benefit plan is more costly. Mr. Stewart proposed that these costs be reduced to an approximation of what it would cost to have all employees in the defined contribution option.

He cites the cases of *Ontario Power Generation Inc. v. Ontario (Energy Board)*, [2012] O.J. No. 862 and *Canadian Union of Public Employees (Public Workers' Union), Local 1000 v. Ontario (Energy Board)*, [2012] O. J. No. 863 as precedents for the disallowance of excessive labour and benefits costs.

The Board notes that, in the cases cited, the Ontario Energy Board (OEB) had disallowed the costs in question after having heard detailed evidence on compensation levels and market comparisons.

In the present case, there was no market comparison evidence and no specific evidence as to the level of benefit provided under the EGNB plan. On the evidence before it, the Board cannot conclude that the pension contributions EGNB are excessive and will allow them for 2013. The EGNB pension situation may well warrant further exploration in future hearings.

Operation and Maintenance Expenses: Capitalization and Amortization

One major issue in past reviews has been the capitalization of incentives paid to customers who attach to the distribution system. In a decision dated January 30, 2012, the Board ordered that if EGNB intends to amortize incentives in the future it must provide evidence that this is in compliance with Generally Accepted Accounting Principles.

In this hearing, EGNB filed a report from Price Waterhouse Coopers confirming that the capitalization of incentives is appropriate. The Price Waterhouse Coopers report did not, however, address the length of the amortization period. In the January 30 decision the Board expressed concern about the length of the amortization. On page 10 it stated:

It is noted, for example, that incentives are amortized over a longer period of time than service lines. If EGNB wishes to amortize incentives in future years, the Board will require evidence in support of the appropriateness of the policy.”

The Board finds that EGNB did not provide any evidence to justify the practice of amortizing incentives over such an extended period of time. The Board orders that any new incentives which EGNB intends to capitalize after January 1, 2013 are to be amortized over no more than five years. The Board will not require any change in the amortization period for any incentives paid prior to 2013.

The Board has reviewed all projected expenses for the test year. Having considered all of the evidence and submissions by the parties, the Board accepts the costs presented by EGNB with the exception of those items disallowed above.

Subject to the changes in corporate allocations and the amortization of incentives set out above, the Board approves the 2013 Revenue Requirement.

Allocation of Costs

The second step in the determination of cost based rates is the allocation of costs.

The revenue requirement, as approved above, must be allocated among the customer classes. In the case of EGNB the rate classes are established in section 3 of the Rates and Tariff Regulation and are as follows:

- Small General Service (SGS);
- Mid-General Service (MGS);
- Large General Service (LGS);
- Contract General Service (CGS);
- Industrial Contract General Service (ICGS);
- Off-Peak Service (OPS); and
- Contract Power Plant Service (CPPS)*

**No evidence was filed for the CPPS class because there are no customers in this class.*

In using the cost based method or technique the process begins by allocating the utility's costs among the various customer classes. Cost of service studies are conducted in order to determine the portion of costs to be allocated to each class.

The Board recognized that EGNB would eventually move towards cost based rates and conducted a hearing into the cost of service methodology in 2010. In a decision issued on December 21, 2010 many of the allocation issues were determined by this Board and are not reviewed in this decision.

As part of the evidence in this matter, the Board was presented with various cost of service studies that incorporate the Boards rulings from 2010 and make proposals regarding the outstanding issues. EGNB's final amended cost of service study was filed on August 24, 2012 and is exhibit EGNB 7.07.

Mains Allocation Methodology

One of the significant outstanding issues in the cost allocation methodology is the allocation of the cost of pipeline mains which is among the largest costs for a distribution utility. This requires a number of decisions to be made by the Board.

A key issue in the allocation of mains costs is the division of the costs between "customer" and "demand." Put another way, what portion of the mains costs were incurred because of the *number of customers* the system was built for versus the portion of the mains costs incurred because of *the volume of natural gas* these customers would demand to be delivered.

There are two primary theoretical approaches used in dividing the costs between customer and demand: the minimum system approach and the zero-intercept approach.

Mains Allocation Methodology: Minimum System

In the minimum system method, the process is to establish the cost of building the absolute minimum system – a distribution system that uses the smallest pipe and other components used by the utility. It is the system required to deliver the first gigajoule of gas to each customer on the system. This is then compared to the actual cost of the system. This minimum system cost is then the cost related to attaching customers – the customer component. These customer costs are allocated to each customer class based on the number of customers. All costs over and above the minimum system are considered demand costs and are allocated to customer classes by the volume required by each class on the coldest day anticipated by the utility.

Mains Allocation Methodology: Zero Intercept

The second method for dividing pipeline mains costs between the customer and demand components is called the zero-intercept method. This method, also establishes the cost of building the smallest system, but instead of using the smallest diameter pipe used by the utility, the zero-intercept method estimates the cost of building a system

with no-load carrying capacity – a zero-diameter pipe. The cost of a zero-diameter pipe is estimated by graphing the cost of different sizes of pipe and then, using statistical regression and extrapolation methods, the cost of a pipe with no diameter is established.

The cost of building the distribution system using this zero-diameter pipe is then calculated. This, like the minimum system method, becomes the portion of the mains costs related to customer attachment – to be allocated by customer count. The remainder of the costs are demand related and allocated by peak design volume.

In the present matter, the pre-filed evidence of Mr. Knecht advocated the use of the zero intercept methodology, whereas Dr. Overcast and Mr. Amen advocated the use of the minimum system approach. However, during the hearing Mr. Knecht changed his position. In closing argument the Public Intervenor indicated that they were withdrawing their preferred methodology and supporting the position of EGNB for this year to use the minimum system method. Mr. Knecht explains this position at page 462 and 463 of the transcript he states:

Let me explain why I am making that recommendation for this proceeding. If the Board adopts the 120 percent maximum revenue cost ratio that is specified in the regulation, adopting my recommendation which would lower the customer component of customer mains costs, would simply have the effect of increasing the rates for the MGS, LGS and CGS classes and that increase in rates would flow only to EGNB. There would be no benefit to any other ratepayer. The benefit would flow directly to EGNB and EGNB doesn't want it. So in light of that, I re-evaluated my position and taking off my cost analyst hat and putting on my regulator hat, I said where is the public interest in adopting a methodology that benefits no classes and the utility does not appear to want. And I therefore conclude that that change would not be in the public interest. Thus until such time as SGS class rates are set based on allocated costs, I do not oppose EGNB's proposed mains classification approach in this proceeding.

Given that, by the conclusion of the hearing, all parties advocated the minimum system approach, the Board will approve the use of that system for EGNB's Cost of Service Study.

Mains Allocation Methodology: Minimum Pipe Size

Within the minimum system methodology, there remain a number of issues to address. One issue is the size of pipe to be used in the hypothetical construction of the minimum system. In a decision dated December 21, 2010, the Board directed EGNB to use 1.25-inch pipe as the minimum sized main. EGNB prepared its studies in accordance with the Board's direction but advocated, as in the previous cost of service hearing, for the use of 2-inch pipe in the analysis. The Board considered EGNB's position both now and

during the previous hearing and does not consider that any new arguments have been advanced. The Board will not alter its previous finding and continues to direct that 1.25-inch pipe be used as the minimum main size.

Mains Allocation Methodology: Allocation of Costs to ICGS Class

Another issue within the minimum system approach relates to the division of mains between steel mains and plastic mains. In his pre-filed evidence Mr. Amen points out that the members of the ICGS class are served solely by steel mains. He maintained that, as a result, the ICGS class should not be allocated any portion of the costs relating to the plastic mains. Dr. Overcast and Mr. Knecht agreed with Mr. Amen on this point and in EGNB's final Cost of Service Study, submitted August 24, 2012, it followed Mr. Amen's recommendation in this regard. The Board agrees with this position.

Another of Mr. Amen's recommendations was with respect to the direct assignment of the main serving AWL. In his evidence in Exhibit AWL/FCL 1.01 at page A-6, Mr. Amen addressed the subject of direct assignment as follows:

"The term "direct assignment" means the allocation to a specific customer or class of customers based on that customer's or class exclusive identification with the particular plant or expense at issue. Usually costs that are directly assigned relate to costs incurred exclusively to serve a specific customer or classes of customers"

Mr. Amen recommended that the main serving AWL should be directly assigned to the ICGS class. The Board disagrees and concludes that the main serving AWL is part of the integrated delivery system and should not be directly allocated. The Board notes that when the main was initially proposed it was to serve AWL as well as other expected customers, and that the main is attached to a looping connection which provides service to a nearby industrial park. Most persuasively, the Board notes that the main has been recently extended beyond AWL to serve other customers of EGNB. For these reasons the Board concludes the main should not be directly allocated.

In conclusion, the Board finds that the cost of service study will use a minimum system methodology with a 1.25 inch pipe as the minimum pipe size. The Board further finds that the ICGS class will not be allocated any portion of the cost of plastic mains and that cost associated with the main to which AWL is connected will not be directly allocated.

The Board approves the methodology contained in the cost of service study as filed by EGNB on August 24, 2012.

Determination of Cost Based Rates

Having determined the cost based methodology, the next step is to establish the average revenue per GJ that will be necessary to meet the revenue requirement for each class. These rates are arrived at by dividing the total cost allocated to each class by the forecasted throughput for that class.

This calculation was completed by EGNB using the proposed revenue requirement and can be found in exhibit EGNB 7.07. While changes in the revenue requirement will result in some adjustments this calculation provides the Board with an adequate indication of the resulting rates.

In its initial evidence EGNB filed estimated cost of service rates based on its proposed revenue requirement and its proposed cost of service methodology. These rates incorporated the maximum revenue to cost ratio of 1.2 to 1 allowed by the Rates and Tariffs Regulation. The Board heard no evidence to suggest nor did any party argue that the rates should be less than 1.2 times the allocated costs for the classes. The Board approves this ratio for all classes for this application.

These rates arising from the application of cost based method or technique and the 1.2 revenue to cost ratio must be compared with the market based rates described below.

Determination of Market Based Rates

To determine rates based on the market value of the service, a market based formula was developed and has been the prime determinant of distribution rates since the inception of the franchise.

The formula was designed with the goal that customers would experience some savings while using natural gas, as opposed to an alternative fuel. This would encourage customers to use natural gas and stay on the distribution system.

To achieve savings the formula was designed to allow a typical customer to achieve a set percentage savings target (target savings) on the combined delivery and natural gas costs (burner tip price). To calculate the target savings, it is necessary to forecast the cost of both the alternative fuel and natural gas over the next 12 months.

The formula also involves assumptions about the gain in efficiency when customers switch to natural gas, their annual consumption and the amount of savings required to entice customers to convert to natural gas.

Section 4(2) of the Regulation sets out some of aspects of the formula, specifically the target savings level for each class as well as the alternate energy source to be used in the calculation. It reads:

4(2) In determining rates and tariffs for classes of customers under subsection (1) utilizing the market based method or technique, the Board shall use electricity as the alternative energy source and ensure a target savings level of 20% for the Small General Service class, and use No. 2 Heating Oil as the alternative energy source and ensure a target savings level of 15% for those classes of customers other than the Small General Service class.

In their initial evidence, EGNB filed market based rate calculations based on the historical rate classes. In response to an interrogatory from Board staff, market based rates were filed based on the rate classes prescribed by regulation. The Board concludes that market based rates must be set for each of the rate classes prescribed by regulation and that the historical rate classes no longer play a role in the setting of rates.

The rates arising from the application of the market based formula or technique were unchallenged and can be found in Exhibit EGNB 4.14. These rates must be compared with the Cost of Service rates as described below.

Approval of Rates for October 1, 2012

Comparison of market based rates and cost of service rates

Paragraph 4(1) of the *Rates and Tariffs Regulation* directs the Board to adopt *either* the cost of service method or technique *or* the market based method or technique when approving or fixing just and reasonable rates.

Section 4(1) states:

The Board shall, when approving or fixing just and reasonable rates and tariffs under section 52 of the Act for each class of customers, adopt the cost of service method or technique, with a revenue to cost ratio not exceeding 1.2:1 for any class of customers, provided that the rates and tariffs for any class of customers shall not exceed the rates and tariffs that would apply to that class of customers if determined through the application of the market based method or technique.

A comparison of the average market based rates and the estimate of the average cost based rates for each class using the approved cost of service study and a 1.2:1 Revenue to Cost ratio are as follows:

	Market Based	Cost based
SGS	\$13.5287 per GJ	\$26.5052 per GJ

MGS	\$22.8922 per GJ	\$9.6643 per GJ
LGS	\$22.6113 per GJ	\$5.8269 per GJ
CGS	\$17.0906 per GJ	\$3.3727 per GJ
ICGS	\$17.1291 per GJ	\$2.2202 per GJ
OPS	\$17.1691 per GJ	\$2.9727 per GJ

Although precise cost of service rates cannot be determined until EGNB re-files its revenue requirement and adjusts the costs allocation under the approved Cost of Service study, it is clear that the cost of service rates for all classes except the SGS class will be lower than the comparative market based rate.

In light of these estimated rates and as required by the regulation, rates for all classes, except SGS, will be set using the cost of service method or technique. The SGS class will have its rates set using the market based method. The CPPS class will not have rates set at this time as there are no customers in this class.

It is important to note that the rates generated by both the cost of service study and the market based formula represent the total costs per GJ to the customers and that in the rate design process these amounts will be allocated to customer charges, demand charges and delivery charges according to the rate design for each class.

Rate Design

Rate design uses a variety of tools to promote the efficient use of the natural gas distribution system. These include dividing the revenue-per-GJ required into monthly charges, demand charges, different seasonal rates as well as tiered delivery charges. The use of these tools of rate design reduces the intra-class subsidization while balancing the need for easy to understand rates.

Rate Design: All Classes except ICGS

EGNB filed its proposed rate design for all regulated classes. No party took issue with the proposal for any of the classes except ICGS. The Board approves the Cost of Service Rate Design for the following classes:

- SGS: There will be a customer charge of \$16 per month, no contract demand charge, and a per GJ delivery charge for all volumes delivered.
- MGS: There will be a customer charge of \$50 per month, no contract demand charge, and a two-tiered delivery charge. The first tier will cover the first 100 GJs

of natural gas delivered each month. The second tier will be for amounts in excess of 100 GJs.

- LGS: There will be two customer charges – one of \$125 for customers with maximum consumption of up to 650 GJs in a month and for customers with maximum consumption of greater than 650 GJ in a month the customer charge shall be \$225. There will be no contract demand charge. There will be a two tiered delivery charge. The first tier will be for the 250 GJs delivered per month. For volumes of natural gas delivered in excess of 250 GJs per month there will be a Winter Rate (delivered between September 1 and April 30) and a Summer Rate (delivered between May 1 and August 31).
- CGS: There will be no customer charges, the contract demand charge will be \$13.30 per GJ of Contract Demand. There will be a Winter Delivery rate for volumes delivered between September 1 and April 30 and a Summer Delivery rate for volumes delivered between May 1 and August 31.

Rate Design: ICGS

There were two proposals put forward in evidence with respect to the rate design for the ICGS class. EGNB proposed a rate design with no customer charge, a Contract demand charge of \$26.50 per GJ of Contract Demand and a seasonal delivery charge.

Mr. Amen proposed a rate design with a customer charge of \$3,300 per month, a Contract Demand charge of \$15.00 per GJ of Contract Demand and seasonal rates that included three tiers based on usage.

Mr. Amen testified that the EGNB rate design resulted in significant intra-class cross subsidization. He asserted that under EGNB rate design the largest users in the class would pay more than their fair share of costs and that smaller users of the class would not pay their fair share.

The Board finds that the concern about intra-class subsidization can be dealt with by adding a customer charge and a lower Contract Demand Charge to the EGNB model.

The Board therefore approves a rate design for the ICGS class with a customer charge of \$3,300 per month, a Contract demand charge of \$15.00 per GJ of Contract Demand. The Board approves the seasonal delivery charge as proposed by EGNB and directs EGNB to recalculate the charge taking into account the changes to the customer and demand charge.

Determination as to whether the rates are just and reasonable

EGNB takes the position that the rates presented in the application should not be approved on the grounds that they are not just and reasonable. It submits that the Board is obligated by statute to approve only just and reasonable rates and that just and reasonable rates are not produced by applying the Rates and Tariffs Regulation. It submits that just and reasonable rates can be set with both cost of service and market based rates but not with the conditions provided in the Regulation.

EGNB submits that the Board retains the authority to determine whether rates are just and reasonable. In EGNB's view, the Legislature has not removed the Board's discretion with respect to the fixing of "just and reasonable" rates and the jurisprudence, discussed below, is still applicable. EGNB submits that if the rates, arising from the regulation, are not just and reasonable as defined by the regulatory jurisprudence, they must not be approved. It submits the Board should set new rates and that the Board has discretion to do so under section 65 of the EUB Act.

Counsel for EGNB submits that nowhere in the legislation has "just and reasonable" been defined. At page 565 of the transcript, counsel states:

The Legislature is to be taken to have perfect knowledge of all legislation and case law in existence at the time a statute or amendment is enacted. Moreover, the lawmakers will know the social and historical context. Thus the New Brunswick Legislature is presumed to have known of the judicial statements on the meaning of "just and reasonable" and yet chose not to explicitly re-define that term.

EGNB argues that the GDA requires the Board to set just and reasonable rates. However, it argues that the application of section 4(1) of the Rates and Tariffs regulation in this case does not produce just and reasonable rates. EGNB submits that the GDA could have been amended to re-define "just and reasonable" but was not. As such, the Board must follow the GDA and not those sections of the Rates and Tariffs Regulation they maintain are inconsistent with the GDA.

The Board is a creature of statute and is guided by the legislation that outlines its powers and obligations. Any consideration of the Board's powers and obligations must first consider the relevant statutes. In this case, the relevant legislation is the EUB Act and the GDA. Prior to the amendments, section 67 of the EUB Act provided as follows:

67(2) In approving or fixing just and reasonable tolls and tariffs, the Board may adopt any other method or technique that it considers appropriate, including an alternative form of regulation.

Section 67(2) of the EUB Act was amended and 67(3) was added. These legislative changes provide as follows:

67(2) *In approving or fixing just and reasonable tolls and tariffs for water and electricity, the Board may adopt any method or technique that it considers appropriate, including an alternative form of regulation.*

67(3) *In approving or fixing just and reasonable tolls and tariffs for the transmission, distribution, delivery or furnishing of natural gas by means of a pipeline or gas distribution system, the Board shall adopt the methods or techniques prescribed in the relevant regulation made under the Gas Distribution Act, 1999.*

Similarly, the GDA was amended. Section 52 previously read:

52(5) In approving or fixing just and reasonable rates and tariffs, the Board may adopt any method or technique that it considers appropriate including an alternative form of regulation.

It now reads (in part):

52(5) In approving or fixing just and reasonable rates and tariffs, the Board Shall adopt the methods or techniques prescribed by regulation.

The Rates and Tariffs Regulation, under the GDA (the Regulation) was passed in April 2012. Section 4 of this Regulation states as follows:

Rates and tariffs

4(1) *The Board shall, when approving or fixing just and reasonable rates and tariffs under section 52 of the Act for each class of customers, adopt the cost of service method or technique, with a revenue to cost ratio not exceeding 1.2:1 for any class of customers, provided that the rates and tariffs for any class of customers shall not exceed the rates and tariffs that would apply to that class of customers if determined through the application of the market based method or technique.*

4(2) *In determining rates and tariffs for classes of customers under subsection (1) utilizing the market based method or technique, the Board shall use electricity as the alternative energy source and ensure a target savings level of 20% for the Small General Service class, and use No. 2 Heating Oil as the alternative energy source and ensure a target savings level of 15% for those classes of customers other than the Small General Service class.*

4(3) The Board shall, when approving or fixing just and reasonable rates and tariffs under section 52 of the Act, ensure that the expenses and investments included in the revenue requirement are prudent.

It is these legislative and regulatory provisions which direct the Board in the rate setting process.

In this case, the Board is faced with a unique situation. EGNB did file a rate application on May 31, 2012 and did provide evidence of the rates that would be produced, using both a cost ratio not exceeding 1.2:1 and the market based method. However, EGNB does not support the adoption of these rates and does not believe they are just and reasonable. This is because the revenue requirement for the 2013 test year is greater than the revenue that is expected to be produced by these rates. A shortfall of approximately \$6 million is anticipated. This may result in a situation where the return on investment that would otherwise be provided to the investor will be less than expected and less than the amount approved by the Board.

Counsel for EGNB states as follows at page 540 of the transcript:

The issue is that in the present circumstances, due to the fact that the SGS class is capped at market rates, the application of cost of service rates at a R/C ratio of 1.2 to 1 does not recover sufficient costs to make up for the shortfall in the difference of the cost to serve the SGS customer class and its actual market based rates. As such, the rates as a whole does not provide EGNB a reasonable opportunity to recover its prudent revenue requirement.

The words “just and reasonable” are found in many pieces of regulatory legislation throughout Canada and the United States. Regulatory boards are generally given discretion to interpret these words and determine whether given rates are “just and reasonable”.

While there is considerable case law interpreting the phrase “just and reasonable,” boards do approach the issue from different perspectives, according to the circumstances of different utilities and jurisdictions.

An illustration of a different approach to the topic can be seen in the Board’s approach to the regulation of EGNB during its development period. The Board has always had the obligation to ensure that EGNB’s rates were just and reasonable. EGNB, however, has never recovered its full revenue requirement since its inception. Its rates have been set on a market based system and these rates have not been sufficient to cover its expenses including its cost of capital. The Board has found the rates, produced by the

market based system and applied for by EGNB to be just and reasonable despite the fact that the rates did not produce sufficient revenue to meet EGNB's revenue requirement. The rates were found to be just and reasonable on the basis that they provided savings to the customers and minimized EGNB's additions to the deferral account.

In the past, any short fall in revenues has been placed in a "deferral account" which was recognized as a regulatory asset with the expectation that there would be a reasonable opportunity for recovery from customers in the future. The deferral account formed part of rate base and EGNB was entitled to earn a return on it. As a result of the legislative amendments, the deferral account is no longer considered or recognized as part of the regulatory assets, except as prescribed by regulation. To date, no such regulation has been passed.

While this Board has taken a different approach to "just and reasonable" during EGNB's development period, regulatory boards addressing the issue of just and reasonable rates would typically be guided by the extensive Canadian jurisprudence. In the seminal case of *Northwestern Utilities Ltd. v. Edmonton (City)*, [1929] S.C.R. 186 (SCC), the Supreme Court of Canada confirms that when fixing just and reasonable rates, the said rates must be fair to the consumer and must secure to the company a fair return for the capital invested.

Similarly, in *TransCanada Pipelines Ltd. v. Canada (National Energy Board)*, [2004] F.C.J. No. 654, (FCA), the Board had adopted a cost of service methodology whereby the utility was to be compensated through tolls for its prudently incurred costs, including its cost of capital. The Court held that even though the cost of capital may be more difficult to estimate than some other costs, it is a real cost that the utility must be able to recover through its revenues.

The regulatory objective of providing shareholders with the opportunity to earn a "reasonable return" while ensuring that rates are fair to customers, is well recognized in the case law and often referred to as the "regulatory compact".

In the present circumstances an important distinction exists. These traditional concepts are generally applied where the authority of the Board is not limited by the type of statutory direction that now exists in New Brunswick. As set out above, both section 67(3) of the EUB Act and section 52(5) state that, in the case of natural gas rates, the Board **shall** use the methods or techniques prescribed by regulation. The Act has taken away the Board's broad discretion to determine the method or technique used in setting just and reasonable rates and that issue is now determined by the Rates and Tariffs Regulation.

As discussed above, since 1999, gas distribution rates in this province have been set using a “market based methodology”. This methodology was approved by the Board, in light of its broad discretion to adopt any method or technique when approving rates. Now, with the more recent amendments to the GDA, the Board no longer has that broad discretion.

This legislation has been the subject of a recent Court of Queen’s Bench decision, *Enbridge Gas New Brunswick Limited Partnership, Enbridge Energy Distribution Inc. and Enbridge Inc. v. The Attorney General in and for the Province of New Brunswick*-decision dated August 23, 2012. The specific issue before the Court was the validity of section 4(1) of the Regulation, Justice Garnett did find the regulation to be valid and went on to consider the impact of these amendments and states as follows at paragraph 24:

Enbridge says the regulation fetters the discretion of the Board. It is the legislation which has done that. While historically the Board did have very broad discretion, it no longer does with respect to natural gas regulation. The cases cited by Enbridge were decided in situations where Boards had broad discretion. In New Brunswick the Legislature has decided that the government will tell the Board what it “shall” do. The regulation is in keeping with that legislative determination. The EUB does not have a right of broad discretion. It has only that degree of discretion which the legislation decides it should have.

In light of the statutory interpretation provided by Garnett, J., it is clear that the Board no longer has the broad discretion it had before the legislative amendments. The “regulatory compact” as it relates to the setting of natural gas distribution rates, has been modified. “Just and reasonable” rates are now the rates that are produced when the methodology, defined by regulation, is applied.

The GDA and Rates and Tariffs regulation effectively re-define “just and reasonable” in the context of natural gas distribution rates in New Brunswick.

EGNB argued that the Board can forbear from setting new rates. The Board disagrees. Section 85 of the GDA reads as follows:

85 (1) *the Board may forbear, in whole or in part and conditionally or unconditionally, from the exercise of any power or the performance of any duty of its own making, where the Board finds as a question of fact that forbearance would be consistent with the purpose of this Act.*

85(2) *Where the Board finds as a question of fact that the sale of gas or a customer service is or will be subject to effective competition sufficient to protect customers’ interests, it shall make a determination to forbear, to the extent it considers appropriate, conditionally or unconditionally, from regulating the rates, tariffs, price and other contractual provisions of that service or class of service.*

85(3) If the Board does forbear from regulation, it may later resume a greater degree of regulation if it considers that its level of forbearance is no longer warranted.

Section 85 must be read in conjunction with section 52.4 of the GDA which states as follows:

52.4 The Board shall, on or before September 30, 2012, make an order approving or fixing rates and tariffs in accordance with section 52 and the order shall take effect on or before October 1, 2012

The Board considers that section 52.4 imposes a duty on the Board to make an order. It is a duty imposed by the legislature. Since the duty is not one of the Board's own making, section 85(1) does not grant the Board the authority to forbear. Moreover, given the clear statutory direction contained in section 52.4, the Board does not consider that forbearance could be considered consistent with the purposes of the GDA.

Section 85(2) applies only to the sale of natural gas or a customer service and not to distribution rates. If section 85(2) did apply, there is no evidence upon which one could conclude there was sufficient competition to protect customers' interests.

In summary the Board finds that the amendments to the GDA and the making of the Rates and Tariffs regulation have limited the Board's previous broad discretion to determine what constitute just and reasonable rates. Rates will be set rates in conformity with the Act and Regulations and these rates will, therefore, be just and reasonable. The Board finds that it has no authority to forbear from the exercise of its duty to set rates.

Rate Riders

The use of rate riders has been an integral part of the principles and practices of the Board in applying the market based method or technique.

The rate riders were developed to allow EGNB to adjust the rates below the maximum approved rate to ensure that the target savings were maintained. Rate riders allow an expedited process to adjust the delivery costs quickly. The Board will continue to permit the use of rate riders for classes whose rates are set using the market based method.

The Board does not consider that the use of rate riders falls within generally recognized utility regulatory principles and practices relating to cost based method or technique. As a result, the Board will not permit the use of rate riders in those classes where rates have been set using the cost of service method.

Until at least the next rate application this will limit the use of rate riders to the SGS class.

In the event that market conditions cause EGNB to wish to reduce rates in a class that has had its rates set using the cost based method, a new application will be required. The Board will make every effort to deal with such an application on an expedited basis and would consider any request for an interim order.

Approval of the Rate Handbook

In addition to setting rates, the Board must also approve EGNB's rate handbook, which contains the terms and conditions on which service is provided to EGNB's customers. Much of the handbook provides guidance to both EGNB staff and customers on items such as security deposits, disconnection notice, etc.

EGNB did submit a revised handbook for consideration, which contains numerous changes and amendments from the existing handbook. This handbook will be approved, as submitted, on an interim basis subject to two conditions.

First, the handbook makes reference to rate riders. As indicated above, the Board will no longer allow the implementation of rate riders (except in the SGS class) and as a result, any other reference to rate riders must be removed.

Secondly, EGNB is directed to work with Board staff to modify the handbook and update the language contained therein to ensure that the new regulatory structure is being reflected. In addition, the rate handbook will be reviewed at the next rate hearing in the event further comment is required.

BOARD ORDERS

The Board makes the following orders:

EGNB shall re-file its Revenue Requirement in accordance with this decision.

EGNB shall re-file the approved Cost of Service Study using the updated Revenue Requirement.

EGNB shall re-file updated rate schedules in accordance with this decision.

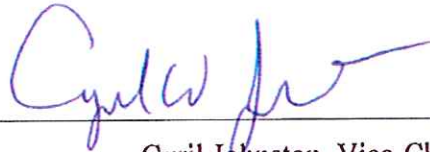
EGNB shall re-file its proof of revenue to ensure that the revenue to cost ratio does not exceed 1.2 to 1 for any class.

EGNB shall comply with all of the above orders on or before September 25, 2012. The Board will issue an order approving or fixing rates and tariffs on September 26, 2012 which shall take effect October 1, 2012.

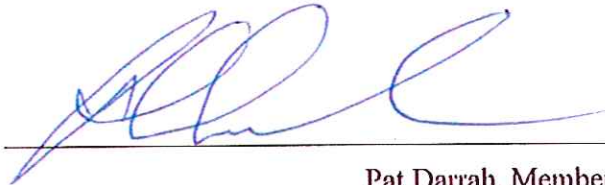
Dated at the City of Saint John, New Brunswick this 20th day of September, 2012.



Raymond Gorman, Q.C., Chairman



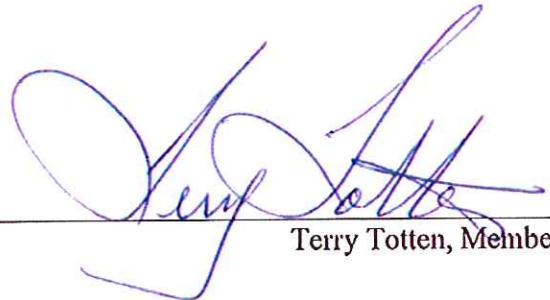
Cyril Johnston, Vice-Chairman



Pat Darrah, Member



Edward McLean, Member



Terry Totten, Member