DECISION **2015 NSUARB 147**
M06582

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE GAS DISTRIBUTION ACT

- and -

IN THE MATTER OF AN APPLICATION by **HERITAGE GAS LIMITED** for approval of the treatment, and the recovery, of natural gas storage service costs

BEFORE:	Peter W. Gurnham Q.C., Chair Wayne D. Cochrane, Q.C., Member Murray E. Doehler, CA, P. Eng., Member
COUNSEL:	**HERITAGE GAS LIMITED** David MacDougall, LL.B. Sarah Mahaney, LL.B. **CONSUMER ADVOCATE** William L. Mahody, Q.C. **NOVA SCOTIA POWER INCORPORATED** Daniel M. Campbell, Q.C. Brian Curry, LL.B., Regulatory Counsel **ALTON NATURAL GAS STORAGE LP** David Birkett Ed Scarpace **NOVA SCOTIA DEPARTMENT OF ENERGY** Bill O'Halloran
BOARD COUNSEL:	S. Bruce Outhouse, Q.C.
HEARING DATE:	April 22, 2015
FINAL SUBMISSIONS:	May 6, 2015
DECISION DATE:	**June 4, 2015**
DECISION:	**Application approved.**

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1.0 INTRODUCTION AND BACKGROUND

[1] Alton Natural Gas Storage LP ("Alton") proposes to establish a large underground gas storage facility in Nova Scotia. Heritage Gas Limited ("Heritage"), a company regulated by the Nova Scotia Utility and Review Board wants to use the new facility. In a Decision dated February 20, 2014, the Board determined that storage costs could be included in Heritage's cost of service. On December 10, 2014, Heritage filed an Application ("Application") with the Board for approval of the treatment, and the recovery, of natural gas storage service costs.

[2] The parties to this proceeding were: Heritage Gas; Alton; the Consumer Advocate, appointed by the Board; Nova Scotia Power Incorporated (which supplies electricity in Nova Scotia, and a major user of natural gas); and the Nova Scotia Department of Energy.

[3] Underground storage of natural gas (in such things as large caverns) is a common practice around the world. Advantages include lower costs for natural gas customers, and improved security of supply. All parties in this proceeding agree that this proposal promises to be beneficial to natural gas customers in the Province for exactly these reasons.

[4] The proposed storage facility will give Heritage the opportunity to buy extra natural gas when prices are lower. When prices are higher, Heritage will be able to use the cheaper stored gas, and pass on the savings to its customers. In the present instance, the parties agree the savings may be large indeed. For example, Michael D. Sloan, of ICF International Inc., an expert witness retained by Heritage, suggests they may amount to around $17 million a year.

[5] Further, the presence of a large quantity of stored gas provides a margin of safety in the event that supplies of natural gas coming into the province are – for whatever reason – interrupted or impaired.

[6] On October 20, 2014, Heritage and Alton entered into an agreement (termed a "Precedent Agreement") for natural gas storage service, which forms the basis of the revenue requirement referred to in this Application.

[7] In the view of the Board, the appropriate level of scrutiny which it should bring to the Application is heightened still further by the fact that Alton and Heritage are affiliated: both are wholly owned by AltaGas Ltd. Nevertheless, the Board considers that the approach to a contract between the two should be similar to that used with respect to a contract between parties who are at arm's length.

[8] There was consensus among all parties on a number of aspects of the proposed arrangements between Heritage and Alton. However, there was also significant disagreement on some other issues, and it is those which are the subject of this Decision. These, and the Board's findings in relation to them, are summarized below under "Issues", and discussed in more detail in "Analysis and Findings."

2.0 WITNESSES

2.1 Witnesses for the Applicant, Heritage Gas

- Michael D. Sloan, ICF International;
- John Hawkins, VP, Engineering, Construction, & Operations, Heritage Gas Limited;
- Chris Smith, President, Heritage Gas Limited;
- Arthur Simpson, Director, Business Intelligence & Financial Planning, Heritage Gas Limited;
- Ralph Zarumba, Navigant Consulting, Inc.

2.2 Witnesses for the Other Parties

- None.

2.3 Witnesses for Counsel for the Board

- Brady Ryall, P.Eng., Energy Consultants International Inc. ("ECI").

3.0 ISSUES

[9] There are five principal issues before the Board in the present proceeding:

Issue 1: Is the classification of storage revenue requirements proposed by Heritage appropriate, and should allocation of cost be done using the seasonal volumetric approach proposed by Heritage?

For reasons discussed in this Decision, the Board's answer to both of these questions is "yes."

Issue 2: If Alton develops additional working gas capacity beyond that contracted by Heritage, may any of those costs be passed on to customers of Heritage?

For reasons discussed in this Decision, the Board's answer to this question is "no."

Issue 3: Did Heritage (as the Consumer Advocate argued in submissions to the Board) fail to pursue with reasonable vigour its negotiation of the precedent agreement with Alton, and thereby cause the project schedule to be delayed by one year, from April 1, 2018, to April 1, 2019?

For reasons discussed in this Decision, the Board's answer to this question is "no."

Issue 4: Did Heritage attempt to unduly protect Alton's commercial information, by seeking greater confidentiality for that information than was appropriate in the circumstances?

For reasons discussed in this Decision, the Board's answer to this question is "no."

Issue 5: Are the maintenance curtailment terms appropriate for this facility?

For reasons discussed in this Decision, the Board's answer to this question is "yes."

4.0 ANALYSIS AND FINDINGS

4.1 Issue 1: Is the classification of storage revenue requirements proposed by Heritage appropriate, and should allocation of cost be done using the seasonal volumetric approach proposed by Heritage?

[10] The agreement with Alton is that Heritage will pay an Inventory Demand Rate ("IDR"), an injection commodity rate ("ICR") and a withdrawal commodity rate ("WCR"). The IDR is subject to an adjustment based on the actual volume of storage capacity and a fixed annual escalation. The other two rates are subject to an annual adjustment equal to the Nova Scotia consumer price index.

[11] Heritage will incur costs equal to 2% of the gas stored to pay for the fuel required to operate the compressors at the facility. To maintain the availability of gas in storage, a supply of cushion gas is required. This cushion gas is to be equal to 25% of the maximum customer inventory at the facility. Finally, Heritage will incur carrying costs to finance the gas in inventory.

[12] All of the above costs are required to be recovered from customers. This storage revenue requirement is proposed to be classified as follows:

Table 5 – Proposed Classification of the Storage Revenue Requirement

Alton Contract Pricing Component	Deliverability	Capacity	Injection / Withdrawal
Injection / Withdrawal Commodity			100%
Inventory Demand Charge	50%	50%	
Natural Gas in Storage/Cushion Gas	50%	50%	

[Exhibit H-1, p. 20]

[13] The proposed allocation of costs was described by Navigant as follows:

> Navigant proposes a seasonal volumetric approach for the allocation of costs to specific tariff classes. Navigant believes the seasonal volumetric approach provides a cost-justified and equitable approach to cost allocation affording benefits to all tariff classes.
>
> 6.1 Seasonal Volumetric Approach
>
> The seasonal volumetric approach allocated storage field costs based upon usage incurred during the peak season (November to April). Navigant believes the seasonal volumetric approach is reasonable because costs are allocated based upon usage during that time of year when storage is providing service to customers. Therefore, customers using the Heritage system during summer months when the storage system is providing limited value will not be allocated costs associated with the storage system. Note that the costs associated with Natural Gas in Storage (i.e. the costs of carrying an average inventory on natural gas in the Alton facility) were not allocated to self supply tariff because the customers served under those tariffs would presumably provide their own natural gas to the Alton Facility.

[Exhibit H-1, pp. 20-21]

[14] Mr. Ryall, of ECI, agreed with the Cost of Service methodology except for the method to allocate costs. ECI does not agree that the seasonal volumetric approach should be used:

> Ideally, coincident peak (CP) demand should be the basis of the demand allocator for storage deliverability costs. According to Heritage, coincident peak demand is not measured and thus is not available to use as an allocator. Chymko notes that: "*on a system such as Heritage Gas, where consumers are almost exclusively using natural gas for heat (as opposed to industrial processes), all rate classes tend to peak at the same time. Thus, there is little difference between CP and NCP on the Heritage Gas system.*" Consequently, ECI recommends that non-coincident peak demand, which has been used by Heritage for years and has been approved by the Board, is an acceptable alternative to using a coincident peak demand allocator for deliverability-related storage costs.

[Exhibit H-9, p. 7]

[15] Heritage disagreed stating:

> • The use of NCP demand unfairly penalizes customers with off season peaks. That is, certain Heritage Gas customers would be asked to pay fairly high storage related charges based on their off-season peak load but receive little or no benefit from storage due to their significantly lower use during the heating (withdrawal) season. This differs from the use of NCP demand for the purposes of allocating pipeline costs from which they do receive benefit.
> • The benefits of reduced upstream pipeline costs are not allocated to the rate classes based on NCP demand but rather based on volumes through the Gas Cost Recovery Rate. ECI recognized ..., that this would create a mismatch should NCP Demand be used to allocate storage costs. That is, ECI's proposed allocation would shift more storage-related costs to low load factor customer classes without them receiving the "preferentially distributed" benefits. The use of seasonal volumes to allocate costs eliminated this mismatch.
> • The majority of the deliverability costs would be collected on a seasonal volumetric basis regardless of the allocation methodology. A seasonal volumetric allocator therefore results in a better alignment between allocations to each rate class and allocation to each customer within the rate class.
> • The use of a seasonal volumetric allocation simplifies the offering to customers versus using NCP demand. All customers, regardless of class, receive storage services for exactly the same price per GJ.
> • The use of a seasonal volumetric allocation offers simplified reconciliation calculations versus the use of NCP demand. While the advantages to this for sophisticated parties are quite modest, this approach greatly simplifies explanations to Heritage Gas' average customer.
>
> [Exhibit H-12, pp. 12-13]

[16] Mr. Ryall agreed that it would be unfair to charge withdrawal costs to customers (of which Heritage has two) who have a summer peak. He said that this could be accommodated by only charging for the winter peak demand. In addition, he thought that Heritage was going to use a demand allocator to recover upstream pipeline capacity costs. Evidence was led by Heritage to refute this assumption and to establish that these costs, if incurred, would be allocated using the seasonal volumetric approach. On that basis Mr. Ryall stated:

> The alignment between the benefits to customers of storage and the costs to those customers, there would be better alignment if they were both done the same way, so as Heritage proposes, a seasonable volumetric basis. ...
>
> [Transcript, p. 178]

[17] In response to a question from the Board about possibly changing the method in the future, taking into consideration a new cost of service study, Mr. Ryall answered:

> You'll have some customer classes that will -- that start paying a higher rate and some would get a break on the storage part of the rate and depending on how big those rates change, you may have to phase it in over a number of years. But it would be a similar concept to a new cost-of-service study that determines that, you know, a certain customer class is getting dinged more than another.
>
> [Transcript, pp. 183-184]

[18] The CA, in his closing submission, said:

> In his direct testimony, Mr. Ryall indicated that there was no pressing need to go to NCP until such time as the Board knows what Heritage Gas is going to do with respect to upstream capacity. In light of Mr. Ryall's evidence and the clarification provided by Heritage Gas in its reply evidence and opening statement, the Consumer Advocate would urge the Board to adopt the Cost of Service as proposed by Heritage Gas until such time as circumstances warrant a change.
>
> [CA Closing Submission, p. 10]

4.1.1 Findings

[19] The Board finds that the classification of the storage revenue requirements as proposed by Heritage is appropriate. The Board also finds, at this time, there is no compelling reason to use NCP for the allocation of costs. The Board approves the use of the seasonal volumetric approach.

4.2 Issue 2: If Alton develops additional working gas capacity beyond that contracted by Heritage, may any of those costs be passed on to customers of Heritage?

[20] The IDR provision of the Precedent Agreement contains a percentage limit on the potential increase in the rate which, if reached, provides Heritage with the option to terminate the arrangement. Heritage advised that earlier versions of the Precedent Agreement did not contain this cap provision, and that it was unacceptable to Heritage.

[21] However, also under the Precedent Agreement, Heritage customers are at risk of paying potential costs for which they receive no benefit. If Alton spends up to the percentage limit under the IDR, and as a result was able to achieve additional storage capacity above the Initial Project Target Capacity, that capacity would be for the exclusive benefit of Alton, even though it would be included in the cost of service charged to Heritage.

[22] In Heritage's view, the two provisions in the Agreement are linked:

> As part of the negotiations with Alton, Heritage Gas was able to obtain a trigger level for its option not to proceed (at a figure that still provides significant value to customers as noted above). In exchange, Heritage Gas forewent the opportunity to have access pursuant to the Precedent Agreement to capacity in excess of the target capacity. As Mr. Smith noted, prior to the negotiation of the increased cost trigger to protect Heritage Gas and its ratepayers, there was symmetry with respect to capacity and cost for Heritage Gas.
>
> It is important to consider, as the record shows, that the negotiation of the Precedent Agreement, like all commercial arrangements, required a series of puts and takes on both sides. There obviously has to be value for both parties in order to come to a final commercial arrangement. The Precedent Agreement ultimately entered into by Heritage Gas has been shown to bring "extraordinary" value to Heritage Gas' customers. One could presumably look at various clauses of the Precedent Agreement (and in fact any commercial arrangement) in isolation, and determine that they appeared more favourable to one party than another. However, that is not how a commercial arrangement should be evaluated either from its commercial perspective or, Heritage Gas respectfully submits, from the perspective of the Board in this proceeding. As Mr. Smith noted, "the PA was evaluated on the basis of a total value proposition and I can confirm that we've negotiated a reasonable contract which is beneficial to ratepayers, from a security of supply and a cost perspective".
>
> [Heritage Closing Submission, pp. 4-5]

[23] During the hearing, both the CA and the Board expressed concern as to whether this arrangement was commercially reasonable. To avoid the issue, with its Final Submission, Heritage filed a letter from Alton. Alton undertook that, should it achieve additional working gas capacity in excess of the Initial Project Target Capacity, Alton would not allocate to Heritage any additional costs incurred in order to expand the capacity above the Initial Project Target Capacity level. The letter stated:

> As you are aware representatives of Alton Natural Gas Storage L.P. were in attendance at the recent oral Hearing before the Utility and Review Board ("Board"). In light of the nature of the concerns we observed at the oral Hearing by the Consumer Advocate and the Board, Alton can now confirm that to the extent that the Board otherwise grants approval to Heritage Gas' Application on or before June 29, 2015 such that Heritage Gas will be proceeding with the arrangements contemplated by the Precedent Agreement ("PA"), Alton undertakes that should we achieve additional working gas capacity in excess of the Initial Project Target Capacity we will not allocate to Heritage Gas any additional costs directly incurred in order to expand the working gas capacity above the Initial Project Target Capacity level.
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> [Heritage Closing Submission, Attachment]

4.2.1 Findings

[24] The Board accepts the alteration to the arrangement between Alton and Heritage as noted in Alton's letter. To be clear, if costs are incurred to increase the project capacity paid for by Heritage, for which customers of Heritage receive no benefit, those costs may not be passed on to customers. The burden will be on Heritage to satisfy the Board that Heritage customers are not paying for additional storage costs.

4.3 Issue 3: Did Heritage (as the Consumer Advocate argued in submissions to the Board) fail to pursue with reasonable vigour its negotiation of the precedent agreement with Alton, and thereby cause the project schedule to be delayed by one year, from April 1, 2018, to April 1, 2019?

[25] The Precedent Agreement had an Expected In-service Date of April 1, 2018, if Heritage was able to obtain Board approval of its Application by March 31, 2015. Otherwise, the Expected In-service Date would slip by one year to April 1, 2019. Heritage was not able to obtain approval by March 31, 2015, and indicated that the consequence of that was not to shorten the term of the Precedent Agreement, but to simply delay the start by, potentially, up to one year. The CA argued that the In-Service Date of the Precedent Agreement had been delayed by one year because of Heritage's inability to meet an approval deadline of March 31, 2015. Among other things, the CA

argued that Heritage did not pursue negotiations in a timely way and should have adopted a tougher stance in negotiations to ensure Alton clearly understood the importance of the target In-Service Date.

[26] In response, Heritage denied the suggestion that it did not undertake the negotiations in a timely way. In its Reply Brief, Heritage argued that it did everything commercially reasonable, short of putting the entire Precedent Agreement at risk, in order to try and preserve the April 1, 2018, start date.

4.3.1 Findings

[27] The Board finds, based on the evidence, there is no reason to conclude that Heritage failed to vigorously pursue the negotiation of a Precedent Agreement or failed to take a proper or an appropriate negotiating stance.

[28] Additionally, for reasons outside of the control of Heritage, related to other approvals, the project schedule has been delayed. Accordingly, the Board does not find there has been any unreasonable delay of the Expected In-service Date due to the actions of Heritage.

4.4 Issue 4: Did Heritage attempt to unduly protect Alton's commercial information, by seeking greater confidentiality for that information than was appropriate in the circumstances?

[29] The CA pointed out that large sections of the Precedent Agreement were filed in confidence. The CA complained of Heritage's "unsolicited attempts to protect the alleged commercial interest of an affiliate."

[30] In response, Heritage argued it was not seeking to protect the information of an affiliated entity in a manner any different than it would in trying to protect the

confidential information negotiated in any commercial arrangement with an arm's length third party. Heritage went on to say:

> Heritage Gas takes its obligations regarding the public interest and transparency very seriously, and is cognizant of the concerns expressed both by the Chair and the Consumer Advocate with respect to limiting claims for confidentiality to the greatest extent possible. Heritage Gas will keep this issue in mind in future filings.
>
> [Heritage Reply Submission, p. 5]

[31] There was no objection to the redactions at the hearing and the Board accepted the redactions of the Precedent Agreement, as filed.

[32] The Board reminds Heritage that it will continue to be vigilant with respect to the degree of confidentiality in Heritage's future filings.

4.5 Issue 5: Are the maintenance curtailment terms appropriate for this facility?

[33] In NSUARB-IR-18, the Board asked if Heritage could avoid any of its IDR in the event of service interruptions due to maintenance, repairs, additions or modifications to the Alton facilities. Heritage replied:

> No. Please refer to Section 4.1 of the Firm Service Schedule attached as Schedule A to the Alton Tariff, General Terms and Conditions. Please note that Alton intends to use reasonable efforts to provide thirty days notice of preplanned maintenance and to use commercially reasonable efforts to perform planned maintenance and repairs during the months of April, May, June, July, August, September, October and November. The Tariff also states that Alton shall also use commercially reasonable efforts to minimize the duration of any planned or unplanned maintenance, repairs, additions or modifications.
>
> [NSUARB-IR-18]

[34] Section 4.1 of the Firm Storage Service Schedule reads:

On any Gas Day, Alton Gas Storage may reduce Customer's Request for Service duly made hereunder, in whole or in part, without penalty, in order to perform planned or unplanned maintenance, repairs, additions or modifications to any of the Alton Gas Storage Facilities (the "*Curtailment Allowance*"); provided that, Alton Gas Storage shall use reasonable efforts to give thirty (30) days prior written notice thereof, where the activity in question is pre-planned. Alton Gas Storage shall use commercially reasonable efforts to avoid scheduling planned maintenance and other planned outages of the Alton Gas Storage Facilities during the months of December, January, February and March. Alton Natural Gas shall use commercially reasonable efforts to minimize the duration of any planned or unplanned maintenance, repairs, additions or modifications to any of the Alton Gas Storage Facilities.

[Exhibit H-2, Schedule A, p. 3]

[35] Board Counsel questioned the Heritage witness panel on the issue, with a focus on whether or not it was appropriate that Heritage, on behalf of its customers, accept all the risk associated with curtailments resulting from Alton's activities (Transcript, pp. 77-89).

[36] The CA was particularly concerned about curtailments created by Alton during a facility expansion.

[37] Heritage responded:

As Heritage Gas noted in its Rebuttal Submission, Alton must use commercially reasonable efforts to minimize the duration of any planned or unplanned maintenance, repairs, additions or modifications and "Heritage Gas will closely monitor any maintenance periods and work with Alton to endeavour to fully utilize its MCI if an extended maintenance period does arise".

Further, as Mr. Hawkins made clear under cross-examination by Board counsel (as extracted in the Transcript reference quoted by the Consumer Advocate):

". . . there is reference to commercially reasonable efforts, and so there would have to be some discussion obviously about whether totally curtailing service to Heritage Gas in order to provide an expansion for their [Alton's] benefit alone would be commercially reasonable."

The Consumer Advocate's comments pre-suppose Alton carrying out work solely to its own benefit and in a manner which would cause Heritage Gas not to be able to fully utilize its MCI for a given storage season. As Heritage Gas noted, it will work with Alton to avoid the potential occurrence of such a situation. That being said, the record is clear that provisions of this sort are not uncommon, and Heritage Gas respectfully submits that the overall value of the Precedent Agreement far outweighs any potential for limited "interruption costs" that could be triggered by this provision.

The savings being generated by virtue of Heritage Gas entering into the Precedent Agreement are savings associated with the delivered cost of natural gas to Heritage Gas' customers. They are not savings of Heritage Gas per se. Heritage Gas respectfully

> submits that the terms of the Precedent Agreement as a whole provide significant value to its customers, and it would be inappropriate to suggest that Heritage Gas should be responsible for costs arising in relation to one term only of the Precedent Agreement, particularly where the cost savings are accruing to Heritage Gas' customers by virtue of Heritage Gas entering into the Precedent Agreement on their behalf.
>
> [Heritage Reply Submission, pp. 2-3]

4.5.1 Findings

[38] As with any industrial facility, it is reasonable to expect that routine maintenance shutdowns will be necessary. It is also inevitable that there will be occasional unplanned shutdowns. The Board anticipates that Alton will manage any such shutdowns to minimize their frequency and duration, as it is in Alton's own best interest to do so.

[39] As noted above, the Board sees no reason to conclude that Heritage failed to take an appropriate stance in negotiating the terms of the Precedent Agreement. The overall benefit to Heritage's customers is clear.

[40] When viewed in the context of the entire Precedent Agreement and assuming the shutdowns will be well managed, the provision for a Curtailment Allowance appears reasonable.

[41] The Board finds the provision to be acceptable. The Board directs Heritage to maintain a record of Curtailment Allowance occurrences, and include the record with the financial package filed annually with the Board, to ensure these are:

> ... commercially reasonable efforts to minimize the duration of any planned or unplanned maintenance, repairs, additions or modifications ...
>
> [Heritage Reply Submission, p. 2]

[42] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 4th day of June, 2015.

Peter W. Gurnham

Wayne D. Cochrane

Murray E. Doehler