

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 the Approval of a Schedule of Rates, Tolls and Charges and Terms of Service, pursuant to **Section 21** of the **GAS DISTRIBUTION ACT**

BEFORE: John A. Morash, C.A., Chair
Margaret A. M. Shears, Vice-chair
John L. Harris, Q.C., Member
Kulvinder S. Dhillon, P. Eng., Member
Peter W. Gurnham, Q.C., Member

APPLICANT: **HERITAGE GAS LIMITED**
John C. MacPherson, Q.C., Counsel
Ben Durnford, LL.B.

INTERVENORS: **EMERA ENERGY INC.**
Jennifer Feron
Manager, Regulatory Affairs

GASWORKS ENERGY CORP.
Dwight J. Jeans, President
J. Peters

IRVING ENERGY SERVICES LIMITED
Mark Brown

NOVA SCOTIA POWER INC.
Eric Ferguson

NOVASCOTIA DEPARTMENT OF ENERGY
Stephen T. McGrath, LL.B.
Allan L. Crandlemire
William O'Halloran

BOARD COUNSEL:S. Bruce Outhouse, Q.C.

BOARD COUNSEL'S

CONSULTANT:

Richard G.C. DeWolf, P. Eng.

HEARING DATE:

Heard at Halifax, Nova Scotia,
on May 17 and 18, 2004

FINAL SUBMISSIONS:

June 9, 2004

DECISION DATE:

July 29, 2004

DECISION:

Pursuant to Section 21 of the Gas Distribution Act, the Board approves Heritage's Schedule of Rates, Tolls and Charges and Terms of Service with the amendments noted herein.

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PART ONE

INTRODUCTION

[1] In this application Heritage Gas Limited (“Heritage”) applies to the Nova Scotia Utility and Review Board (“the Board”) pursuant to **Section 21** of the **Gas Distribution Act** (“the Act”) for approval of a Schedule of Rates, Tolls and Charges and approval of terms of service.

[2] Last year, in a decision dated February 7, 2003, NSUARB-NG-02, the Board granted Heritage a full regulation class franchise for a period of 25 years for the Counties of Cumberland, Colchester, Pictou and Halifax, the Municipality of the District of East Hants and the Goldboro area of Guysborough County, subject to the approval of the Governor-in-Council.

[3] The Governor-in-Council approved the grant of franchise on February 21, 2003. On June 3, 2003, Heritage accepted the franchise and since that time has been working on the development of a system for local gas distribution in its franchise area. It began service to its first commercial customer on December 23, 2003 and to its first residential customer on January 19, 2004.

[4] On November 21, 2003, Heritage applied to the Board for interim approval of a Schedule of Rates, Tolls and Charges. The Board, in Order NSUARB-NG-HG-R-03 dated December 19, 2003, provided interim approval. In its Order the Board directed that:

2. Subject to s. 21(1D) of the Act, the rates approved in this Order shall remain in force until changed by further Order of the Board.
3. Heritage shall file a fully allocated cost of service study with the Board at the time it applies for final approval of rates, tolls and charges.
4. Heritage shall file a proposed schedule of depreciation rates and a depreciation study with the Board at the time it applies for final approval of rates, tolls and charges.
5. In addition to its own evidence, at the time it applies for final approval of rates, tolls and charges, Heritage shall file a report by a qualified independent expert in regulatory accounting and rate making matters in support of its proposed gas cost recovery mechanism and its deferral accounts, including the deferred revenue account, the deferred regulatory account and the deferred gas account as described in the information provided by Heritage with its application for interim approval.

6. Heritage shall file a complete set of regulations for approval by the Board at the time it applies for final approval of rates, tolls and charges. The filing shall include Heritage's proposed main extension policy.

(Exhibit H-1, Section 1, pp.1-2)

Those directions are responded to in this application.

[5] As part of its prefiled evidence, Heritage filed expert evidence from the following:

- Larry Edwin Kennedy "The Appropriate Depreciation Rates for Use in the Determination of Depreciation Expense"; (Exhibit H-1, Section 16)
- Kathleen C. McShane "Report on Deferral Accounts"; (Exhibit H-1, Section 17)
- James J. Sarikas "Allocated Cost of Service Study and Levelized Rate Design". (Exhibit H-1, Section 18)

[6] Heritage called three witness panels:

- A General Panel consisting of Ken From, Ms. McShane, Ray Ritcey, Harvey Fedyk and Arnold Mantei;
- A Finance Panel consisting of Mr. Kennedy, Mr. Ritcey, Mr. Mantei and Ms. McShane and;
- A Cost of Service and Rate Design Panel consisting of Mr. Ritcey, Mr. Mantei and Mr. Sarikas.

[7] The hearing took place at the Board's offices in Halifax on May 17th and 18th, 2004, after due public notice. Five interventions were filed by other parties including Irving Energy Services Limited, Emera Energy Inc., Nova Scotia Power Inc., GasWorks Energy Corp. and the Province of Nova Scotia - Department of Energy ("NSDOE").

[8] The only intervenor who played an active role in the hearing by cross-examining certain of the panels and filing a final submission was the NSDOE.

PART TWO

1.0 TEST PERIOD

EVIDENCE

[9] This is the first general rate application for Heritage. Heritage is proposing a five-year

test period with the proposed distribution service rates to remain constant over the test period, to enable recovery of the estimated revenue requirement. Heritage testified that the five-year test period will permit development of the business and, in particular, permit the operation of the revenue deficiency account and the recovery of deferred revenue.

[10] Ms. McShane explained the rationale for a five-year test period:

In the early years of operation, Heritage Gas does not expect to be able to set rates which will be adequate to recover a full cost of service as measured by the traditional rate base/rate of return approach. Full cost of service rates using the traditional rate base/rate of return rate making methodology would be higher than what would be necessary to induce potential customers to convert to natural gas. In order to arrive at rates that will be competitive with alternative fuels, Heritage is proposing to levelize its forecast cost of service over a five year test period. During that five year period, the annual differences between actual revenues and the actual cost of service will be accrued in a revenue deficiency account. The accumulated amount of the revenue deficiency account, which represents amounts owed by customers, will be included in rate base. Heritage forecasts that the deferral account will be cleared at the end of the five-year test period.

(Exhibit H-1, Section 17,

pp.81-82)

[11] In response to NSDOE IR-4, Heritage stated:

Heritage Gas has proposed a five year test period to allow it to provide a stabilized rate environment for its customers. As is readily apparent in the early days of a new utility, the costs are high and the volumes are low. Consequently, rates, if prepared on an annual basis, would be high.

Customers in the early days would be paying a disproportionate cost of service. By using an extended test period, and averaging the rates, much of this problem is mitigated.

Because of the uncertainty surrounding this new utility it is certainly recognized that there may be variances from the business plan on which this application is based. Heritage Gas fully recognizes this, and is prepared to come back to the NSUARB, should these variances be material.

(Exhibit H-2 - Heritage, Information Requests Responses to NSDOE IR-4)

[12] Heritage explained in its post-hearing brief:

An initial test period of five years has been requested to permit the development of the information base which would allow Heritage to move from a "greenfield" utility status to the utilization of principles and approaches more commonly associated with "mature" utilities, such as the "lead/lag" cash working capital, completion of full mortality studies, etc.

(Heritage, Post-Hearing Written Submission, p.6)

[13] The Province in its post-hearing submission did not object to the five-year test period.

FINDINGS

[14] Having regard to the significant business challenges that Heritage faces and to allow reasonable operation of its deferral

accounts, and in particular the revenue deficiency account (discussed further at paragraph 18 of this decision), the Board approves the five-year test period as applied for by Heritage.

2.0 DEFERRAL ACCOUNTS

[15] Heritage proposes three deferral accounts:

- A deferred revenue deficiency account;
- A deferred regulatory account;
- A deferred municipal taxes account.

[16] Ms. McShane testified, and the Board has observed, that deferral accounts are a common feature of Canadian gas utilities.

[17] The purpose of deferral accounts is described by Ms. McShane in her evidence at page 77 of the application:

Under what circumstances are deferral accounts generally used by Canadian utilities?

Deferral accounts are generally used to record differences between forecast and actual revenues or costs. The difference between the forecast amount (included in current rates) and the actual amounts are typically either refunded to, or collected from, customers in a subsequent period. Deferral accounts may be related to revenues or costs and may be either permanent in nature (e.g., weather variations), or for company-specific events (e.g., Y2K expenses).

Are there accepted criteria for determining whether the revenues or costs should be subject to a deferral account?

There are no universally accepted criteria. The Alberta Energy and Utilities Board has recently stated that, "The Board does not consider there to be a definitive Board policy regarding the use of deferral accounts. Rather, the Board's practice has been to evaluate the use of a deferral account on a case-by-case basis, on its own merit." (ATCO Pipelines, Decision 2003-100, December 2, 2003). However, in that decision, the Board did note a number of criteria put forth by various parties in that proceeding, and concluded that the suggested criteria were reasonable. These criteria were:

- ◆ Materiality of the forecast amount,
- ◆ Uncertainty regarding the accuracy and ability to forecast the amount,
- ◆ Whether or not the factors affecting the forecast are beyond the utility's control,
- ◆ Whether or not the utility is typically at risk with respect to the forecast amount.

How common are deferral accounts generally among Canadian utilities?

Deferral accounts are a very common feature of the regulatory framework of most mature Canadian utilities. However, the extent to which individual utilities rely on deferral accounts varies widely.

At one end of the spectrum lies Foothills Pipeline (a National Energy Board regulated gas pipeline) which has a full cost of service tariff. Foothills accrues all differences between annual forecast and actual revenues and costs. The accumulated balances are recovered from/refunded to customers,

so that the pipeline always earns its allowed return on equity. At the other end of the spectrum are the Alberta gas and electric distribution utilities and Nova Scotia Power which have a relatively limited number of deferral accounts.

(Exhibit H-1, Section 17, pp.77-78)

2.1 Deferred Revenue Deficiency Account

EVIDENCE

[18] Heritage is proposing a deferred revenue deficiency account which is intended to track the difference between the weather normalized annual revenue and over or under recovery of the annual revenue requirement. The account will be debited or credited for the first five years, on an annual basis with the weather normalized actual over or under collection of annual revenue. Since Heritage's rates are designed to under recover in the early years, Heritage expects to accrue a balance in the deferred revenue deficiency account in those years but to recover the balance in later years.

[19] As noted at paragraph 10 of this decision, Ms. McShane testified on this issue at pages 81 and 82 of the application:

... In order to arrive at rates that will be competitive with alternative fuels, Heritage is proposing to levelize its forecast cost of service over a five year test period. During that five year period, the annual differences between actual revenues and the actual cost of service will be accrued in a revenue deficiency account. The accumulated amount in the revenue deficiency account, which represents amounts owed by customers, will be included in rate base. Heritage forecasts that the deferral account will be cleared at the end of the five-year test period.

(Exhibit H-1, Section 17,

pp.81-82)

[20] Heritage indicated, under cross-examination by Counsel for NSDOE, that if there is a surplus or deficiency in the revenue deficiency account at the end of the five-year period, it will seek approval of the Board with respect to the disposition of the surplus or deficiency:

Okay. If there is a deficiency or a surplus in the revenue deficiency account at the end of the five-year period, what happens with that fund?

(Ritcey) If there is a deficiency in the account at the end of the five-year period, it would be our expectation that we would come back before the Board with a proposal either to - - depending on the state of the deficiency account, either to recover that from customers or rebate it to customers. Again, at this point in time, we haven't proposed, you know, what the mechanism might be, but again it's our expectation that we would come back before the Board with a recommendation and look for approval from the Board.

(Mantei) Just as a supplementary to that response, the rates that are proposed right now are five-year levelized rates, and at the end of that five-year term, those rates will probably not be appropriate. So it's pretty - - I guess pretty clear that at the end of that five-year period, that Heritage Gas will have to come back to this board and propose new sales rates that would be appropriate for that period.

[21] The balance in the deficiency account will go into rate base. Heritage proposes that the arithmetic average of the 12-month balance be included as a working capital item in determining annual rate base.

[22] In this application, Heritage proposed to use weather normalized annual revenues. Heritage indicates that the purpose of proceeding on a weather normalized basis is to eliminate the impact of weather from the determination of revenues earned by the utility. As noted in the post-hearing brief:

... Theoretically, there is an equal opportunity of warmer or colder weather which over time equalizes.

(Heritage, Post-Hearing Written Submission, p.12)

[23] Ms. McShane testified that the alternative to proceeding on a weather normalized basis is to operate on an actual revenue basis:

Okay. Dealing with then the risk aspect that you just finished off with, am I understanding correctly that without this adjustment in the revenue deficiency account, what you're telling me is that the risk of weather or the vagaries of weather is passed on to the customers without this adjustment? Is that - -

(McShane) Without the weather normalization procedure, yes, the risk of weather vagaries are with the customer.

Okay. And so the adjustment would be necessary to make sure that the risk of weather is kept where it traditional is, with the utility?

(McShane) That's correct.

...

Yes. And the weather normalization reserve that you're talking about, is that a mechanism that utilities have used to shift or share the risk of weather with customers?

(McShane) Yes, it is a mechanism that is used by several of the mature gas distribution utilities in Canada, but not the preponderance of the gas distribution utilities.

Okay. So the Heritage proposal would be more consistent with, in your opinion, what the preponderance of utilities are doing with respect to weather, and that's taking the risk of weather on themselves.

(McShane) That's correct.

pp.190-191)

[24] Board counsel, in cross-examination of Ms. McShane, noted that there is a potential of creating a public perception problem with respect to the utility's actual revenue situation in an abnormally cold year in comparison with the activity in the deferred revenue deficiency account. Ms. McShane conceded that possibility and indicated that the alternative was to proceed on an actual revenue basis. However, she noted that Heritage's application for weather normalized revenues is consistent with the position taken by Heritage in the franchise application hearing.

[25] In the end, Heritage chose not to state a preference for purposes of this application:

In its original application, Heritage had determined that the weather normalized approach, attaching both risk and benefit of weather variances to the shareholders, was a reasonable approach to managing this risk, in a greenfield utility. However, Heritage is prepared to accept a direction from the Board to operate on an actual revenue basis, in the event the Board determines the public interest is better served through that methodology.

(Heritage, Post-Hearing Written Submission, pp.16-17)

[26] The Province submits that any reporting to the Board should be done on both an actual and weather normalized basis. In its reply brief, Heritage agreed to do this.

FINDINGS

[27] The Board accepts the evidence of Heritage that it is not able to set rates which will be adequate to recover its full cost of service measured by the traditional rate base rate of return approach in the early years of the test period. In order to arrive at rates that will be competitive, Heritage proposes to levelize its forecast cost of service over a five-year test period.

[28] The Board agrees with this approach. The Board also agrees that in the operation of the revenue deficiency account Heritage use weather normalized revenues as opposed to actual revenues. Use of weather normalized actuals leaves the risk of weather with the utility as opposed to

the customer. It should also result in less dramatic variations in revenue differentials. The Board approves the deferred revenue account set forth in the application. The Board further directs that Heritage report data annually to the Board on both an actual and weather normalized basis. Disposition of any balance in the account at the end of the test period will be determined by further order of the Board.

2.2 Deferred Regulatory Account

EVIDENCE

[29] Heritage is proposing a deferred regulatory account which will be charged with regulatory costs such as consulting fees incurred by Heritage up to and including this regulatory proceeding. Heritage provided, in Undertaking U-12, a breakdown of these estimated costs. Future ongoing regulatory oversight expenses during the test period will be expensed, except for those costs which relate to capital expenditures and certifying authority expenses which will generally be capitalized.

[30] The amount to be deferred totals \$794,750. Ms. McShane testified as to the appropriateness of this account and no party objected to the deferred regulatory account.

FINDINGS

[31] The Board approves the deferred regulatory account as set forth in the application.

2.3 Deferred Municipal Taxes Account

EVIDENCE

[32] Heritage requests approval of a municipal taxes deferral account.

[33] In its post-hearing brief, Heritage sets forth the reasoning and rationale for such a deferral:

... There are two elements to the municipal taxation of local natural gas distribution companies in Nova Scotia. The first element of the tax which is calculated on the basis of customer usage is readily ascertainable. The second, however, relates to the municipal tax as set out in Schedule "D", Municipal Tax Riders, Rate B at page 229.2 of the Application as follows:

"ELIGIBILITY

Additions to be made to the rates of customers who are resident of municipalities who are eligible to receive a tax pursuant to applicable provincial legislation in place from time to time. All high pressure distribution pipeline assets and pressure reduction stations of the franchisee excluding those serving a single end-user, will be taxed pursuant to Section 3 of the agreement between Heritage Gas and the Union of Nova Scotia Municipalities (UNSM)."

Heritage considers it appropriate to have a deferral account for municipal taxes because of the uncertainty in forecasting the amount of revenues which will be generated by this component of the municipal tax. In addition, revenues will be generated on a monthly basis but will be paid to the municipalities within a set time frame, usually 30 days. Hence, there is a "timing issue" in respect of the receipt of the funds from customers and the distribution of the funds to the municipalities. In particular, this timing inconsistency may extend from one calendar year to another which impacts on the reporting of these receipts on the financial statements of the company.

In respect of the proposed deferral account for municipal taxes, Ms. McShane stated at page 81 of her testimony:

Please comment on Heritage Gas proposed deferral account for municipal taxes.

Heritage Gas is obliged to pay to the municipalities it serves a tax that is in some cases a percent of revenue and in some cases based on assets. The amounts that will ultimately be due to municipal authorities are material and subject to considerable forecasting uncertainty.

Heritage's proposal to include a representative amount for municipal taxes in rates is consistent with the criteria set forth by the AEUB for the establishment of a deferral account and is similar to accounts established in other jurisdictions for the same expense.

Deferral accounts for municipal taxes are or have been implemented by provincial regulators for the utilities in British Columbia, Alberta and Ontario and by the National Energy Board (e.g., TransCanada Pipelines). In New Brunswick, while EGNB has no separate deferral account for municipal taxes, the actual amount of the expense is captured in its revenue deficiency deferral account (see Question 16 below).

(Heritage, Post-Hearing Written Submission, pp.28-29)

FINDINGS

[34] For the test period, the Board believes the account is reasonable and approves the deferred municipal taxes account as applied for. For purposes of future test periods, the Board intends to revisit whether it is necessary to include in the deferral, the first element of the tax calculated on the basis of customer usage.

3.0 AMORTIZATION/DEPRECIATION EXPENSE

EVIDENCE

[35] Larry Kennedy of Gannett Fleming Inc. was the expert who testified with respect to this aspect of the application.

[36] Mr. Kennedy testified that, as a greenfield utility, it was not possible to prepare a traditional depreciation study for Heritage where one would normally review the historic retirement patterns of a company. Therefore, Mr. Kennedy developed estimates of future retirement patterns of Heritage on the basis of retirement patterns of similar utilities with which he was familiar. It was his opinion that the depreciation rates included in the application were appropriate for the initial five-year period of the franchise.

[37] He states at page 54 of the application:

... The depreciation rates as developed in this application are appropriate for use for a five year period. Once the system is in service and operating procedures and practices are established, the average service life and net salvage parameters should be reviewed. ...

(Exhibit H-1, Section

16, p.54)

FINDINGS

[38] The Board is satisfied that the proposed depreciation rates are reasonable in this case and approves the depreciation rates as applied for and which are outlined in Appendix A annexed.

[39] The Board directs that Heritage undertake a new depreciation study at the end of the test period for the next test period.

4.0 RATES

EVIDENCE

[40] Heritage requests the approval of five Rate Classes:

- **Rate Class 1**
Any customer who is an end-user and whose total gas requirements at that location are equal to or less than 5,000 GJ per year.
- **Rate Class 2**
Any customer who is an end-user and whose total gas requirements at that location are greater than 5,000 GJ but not more than 50,000 GJ per year.
- **Rate Class 3**
Any customer who is an end-user and whose total gas requirements at that location are greater than 50,000 GJ per year.
- **Rate Class 4**
Any customer who is an end-user and whose contract demand is a minimum of 10,000 GJ per day per site and whose load factor is 100%. Within this rate class, Heritage requests the approval of Rate Class 4A for the Nova Scotia Power Inc. Burnside facility.
- **Rate Class 5 Emergency Service Rate**
This supplier of last resort or back-stopping service provided by Heritage to end-users in Rate Classes 1, 2 or 3 who may buy their gas from a licenced marketer or other source.

[41] The rates sought by Heritage are cost-based rates. Detailed information on the cost allocation was provided in the evidence of James Sarikas. Mr. Sarikas prepared a cost of service study using the traditional approach of functionalization, classification and allocation. He based it on projected revenue requirements as prepared by Heritage. The costs were levelized over five years.

[42] At page 32 of its post-hearing brief, Heritage described its rate design methodology:

Rate Classes 1 to 3 are designed to produce revenues such that a revenue to cost ratio of 95% to 105% is achieved over the five year test period. Rate Class 4A also covers its cost of service (Testimony of James Sarikas, p. 98). Heritage has endeavoured, in each Rate Class, as much as practical, to match the costs and revenue by cost parameter. One exception is in Rate Class 1 where customer costs were recovered in the base energy charge as well as the fixed customer charge. There are two reasons that this Rate is structured in that way. First the customer cost would otherwise be too high for most small customers and, secondly, not having a variable energy charge does not encourage conservation and prudent use of the commodity.

(Heritage, Post-Hearing Written Submission, p.32)

[43] Heritage testified that the rates for which it seeks approval will produce revenue such that the revenue to cost ratio of 95% to 105% over the five-year test period is achieved. In Undertaking U-17, Mr. Sarakis filed additional calculations showing the revenue to cost ratio for each of the rates as proposed is 100%.

[44] In Undertaking U-5, Heritage proposes to amend the wording of Rate Class 5, to clarify the methodology Heritage intends to rely on respecting customer charges under its emergency rate.

Heritage proposes that this provision of the tariff read:

In the event Heritage Gas is called on as a supplier of last resort, customers will be charged a rate equivalent to the actual price of the gas plus the actual administrative charges incurred by Heritage Gas as a result of being called upon to be the supplier of last resort.

[Heritage U-5]

[45] Rate Class 4 is for extra large users. It is intended there will be a specific rate for each site within Rate Class 4. Rate Class 4A for Nova Scotia Power's Burnside plant is included for approval in the application.

[46] Finally, Heritage corrected its application to note that Rate Class 5 applies to rate users in each of Rate Classes 1, 2, or 3 or licenced marketers providing service to customers in Rate Classes 1, 2, or 3.

FINDINGS

[47] Based on the evidence of Mr. Sarikas, the cost allocations appear reasonable. The Board approves Rate Classes 1 through 5 inclusive with the amendments noted herein.

[48] It also approves Rate Class 4A with respect to service to Nova Scotia Power's Burnside plant. Approval of this rate for service to Nova Scotia Power does not alter any requirement for Nova Scotia Power to obtain necessary approvals under the **Public Utilities Act** with respect to conversion of its Burnside facilities.

[49] Heritage is directed to file with the Board for approval rate schedules adjusted to reflect the changes noted herein.

5.0 HERITAGE GAS TARIFF

EVIDENCE

[50] The tariff for Heritage is found at Tab 20 of the application (Exhibit H-1) and includes: Service Rules for Customers, Service Rules for Licenced Gas Marketers and various contracts of service.

[51] The Board raised a number of concerns with respect to the tariff and Heritage agreed to make certain amendments.

[52] Heritage agreed to amend its Service Rules to specifically alert its customers of their right to bring disputes with Heritage to the Board for its consideration:

Therefore paragraph 4 of page 2 of the Heritage Gas Limited Service Rules, found at page 150 of the Application, should be amended to read as follows:

“These Rules are set by the Nova Scotia Utility and Review Board (which we refer to as the “Board”) and can’t be changed without its approval. Once the Board sets the rules, they are legally binding on you and us. If a dispute should arise concerning the application of these Rules, you have the right to complain to the Board and have the Board determine how that dispute should be resolved.”

(Heritage, Post-Hearing Written Submission, p.34)

[53] The Board also expressed some concern with regard to provisions of the Service Rules that relate to reconnect fees and, in particular, the charging of a minimum monthly charge for each month of disconnect. Heritage agreed to modify the fourth sentence of item 7 of the Service Rules found on page 159 of the application to read as follows:

We will also charge the minimum monthly charge for each month of disconnection **to a maximum of 24 months.**

(Heritage, Post-Hearing Submission,

p.34)

[54] To avoid confusion, Heritage also agreed that the part of its tariff entitled “Licenced Gas Marketer Service Regulations” be called “Licenced Gas Marketer Service Terms and Conditions.” Concern was also expressed by the Board in respect of Article 11 of the Licenced Gas Marketer’s Service Contract found at page 190 of the application. Specifically, there was a concern that the

provisions of the contract do not permit a licenced gas marketer to terminate the contract. The approach which Heritage proposes to adopt in respect of a revision to the Licenced Gas Marketer's Service Contract was filed in Undertaking U-6 as follows:

"Heritage Gas Limited acknowledges the comments of the Board regarding the terms and conditions of the proposed Licensed Gas Marketer's Contract, specifically in respect of a defined term of the contract, and the absence of a "no-fault" termination right of the gas marketer. As previously outlined to the Board, Heritage Gas will participate in a working group with all licensed gas marketers regarding the proposed terms and conditions of their contracts, and is prepared to make adjustments to the terms and conditions proposed, which are satisfactory to both parties."

(Heritage, Post-Hearing Written Submission, p.35)

[55] Heritage includes for approval as part of its tariff Municipal Tax Riders, Rate A, Rate B and Rate C.

FINDINGS

[56] Based on the revised provisions adopted by Heritage noted above, and the additional changes directed by the Board below, the Board is satisfied that the tariff is reasonable and approves it as revised.

[57] The Board directs the following changes. At page 150 of the application, Service Rules, Part 1, paragraph 4 is amended to read as follows:

In the Application

These Rules are set by the Nova Scotia Utility and Review Board (which we refer to as the "*Board*") and can't be changed without its approval. Once the *Board* sets the Rules, they are legally binding on you and us.

As amended by the Board

These Rules are approved by the Nova Scotia Utility and Review Board (which we refer to as the "*Board*") and can't be changed without its approval. Once the *Board* approves the Rules, they are legally binding on you and us.

[58] Page 156 of the application, Part 6 of the Service Rules, paragraph 1 is amended by the Board to read as follows:

In the Application

The Board must approve our rates and charges, including those in the Special Charges Schedule. If you think any charge is unfair, you can complain to the Board and they have the ability to change it.

As amended by the Board

The Board must approve our rates and charges, including those in the Special Charges Schedule.

[59] With respect to the response to Undertaking U-6, Heritage is directed to draft a termination provision for inclusion in the contract and submit it to the Board for approval. A copy of the revised tariff with the changes approved herein is to be filed.

6.0 FEASIBILITY TEST/CONTRIBUTION POLICY

EVIDENCE

[60] In its Order of December 19, 2003, the Board directed Heritage to include in this application its proposed main extension policy. Heritage proposes a two-part test. The community feasibility test relates to the extension of a distribution system to various communities in the franchise area. Once the high pressure distribution system has been extended to those areas, the second part of the feasibility test in relation to main and service line extensions becomes applicable. In its application, at page 230, Heritage outlined how a feasibility test would work:

... The acceptance criteria without customer contribution requirement is a NPV profitability ratio (NPV of the revenue stream for 25 years divided by the NPV of the revenue requirement stream for 25 years) of 1.00 or greater and a year 7 profitability ratio (revenue divided by the revenue requirement) of 1.00 or greater.

- Utilizing the following criteria a net present value for the project will be calculated:
 - An estimate of the total incremental capital costs of providing service;
 - An estimate of the total annual incremental operating costs of providing service;
 - The Board approved return on common equity, interest rates, amortization (depreciation) rates, income taxes and capital structure;
 - An estimate of the expected incremental net revenue that will result from the addition of the service.

Incremental capital costs includes direct material and labour, inspection or other third party costs, but is exclusive of fixed overheads. Incremental operating costs includes meter reading and billing costs, a service call and leak and cathodic protection surveys.

Should the net present value so determined have a profitability ratio greater than one, then the year 7 revenue to cost ratio is reviewed. Should this calculation have a profitability ratio greater than one and the net present value profitability ratio is greater than one, then the project can be accepted.

Should the project not meet either or both of the feasibility tests Heritage Gas may still accept the project if a customer contribution is received which

makes up the deficiency.

(Exhibit H-1, Section

21, p.230)

[61] Under cross-examination, Mr. Ritcey clarified the two parts to the test:

(Ritcey) ... So within our model, and the approach taken by Heritage in dealing with all those communities that we're actively dealing with today, that's the approach that we've taken to get the required commitment to build the line into the market -- to build the line from Maritimes & Northeast or extend the line from Heritage in Dartmouth to Peninsula Halifax. Once we're within the community, then in order to build out -- so within that yellow area franchise map, we will then be extending the existing gas mains within that community and applying this test, both for gas mains and for service lines, and those service lines -- so the gas mains generally run down the street, the service lines connect to the facilities, where there's a house or a building, from the street, from the gas main. So this --

Sorry, a service line, do you mean -- I perhaps didn't quite understand you, do you mean you've got the gas main down the street, you would apply this feasibility test to hook up to a residence?

(Ritcey) In order to build out from our existing system, we will be looking to -- because there's going to be a capital cost required attaching those different customers, we will go down -- if it's a new area, we have to factor those service line costs into the capital cost.

Yes, I understand that. I assume once the main is run, and somebody along there wants to hook up --

(Ritcey) Absolutely.

-- that you wouldn't be applying this test. If you do, you're in trouble.

(Ritcey) Absolutely.

All right.

(Ritcey) I should qualify that, again it depends if -- depending on where we run the main, if there's -- you know, if there's an entity that's, I don't know, a mile up the road, then we --

I appreciate that, sure. They would have to make a capital contribution unless they were a very large customer --

(Ritcey) Correct.

-- to justify that extension.

(Ritcey) That is correct.

(Transcript, May 18, 2004,

pp.223-225)

[62] No other party objected to the proposed feasibility test.

FINDINGS

[63] The feasibility test seems reasonable having regard to Heritage's circumstances. It is in Heritage's interest to encourage build out of the system. At the same time, the proposed feasibility test provides the necessary control in terms of preventing uneconomic expansions. The Board

approves the feasibility test as applied for in the application.

7.0 GAS COST VARIANCE ACCOUNT

EVIDENCE

[64] Heritage has proposed a Gas Cost Variance Account (“GCVA”). Details with respect to the account and the associated Gas Cost Recovery Rate (“GCRR”) are outlined as follows at page 26 of the application:

9.1 Gas Cost Variance Account

The Gas Cost Variance Account (GCVA) was referenced in the Franchise Application. This type of account is utilized by most North American gas utilities. In some jurisdictions it is also known as a Purchase Gas Variance Account (PGVA) or a Deferred Gas Account (DGA). The term “Deferred Gas Account” was used in Heritage Gas applicable [sic] for Interim Approval of a Schedule of Rates, Tolls, and Charges of November 21, 2003. It is Heritage Gas view for consistency it is preferable to use the term Gas Cost Variance Account (GCVA).

Heritage Gas proposes that this account would be charged with the cost of the commodity, transportation and fuel costs upstream of the utilities pipeline system, portfolio management and administration costs. Heritage Gas further proposes that the account be charged with other gas supply costs including hedging costs and cost of gas related bad debts. It would be credited for the gas related cost portion of late payment revenue. The account would be credited monthly by the amount of revenue collected through the billings to sales customers (i.e., those who purchase the natural gas commodity from Heritage Gas) under the Gas Cost Recovery Rate.

This account is important in that it allows Sales and Distribution Service Revenue customers to be billed the actual cost of the product. It must be timely so that proper price signals are provided and the rate does not get offside with the market.

The actual operation of the account and the development of the gas cost recovery rate are discussed in the sections below.

9.2 Gas Cost Recovery Rate

The Gas Cost Recovery Rate (GCRR) will be determined on a forecast basis for each period by dividing the aggregate un-recovered costs in the Gas Cost Variance Account (GCVA) plus the forecast costs for the next period by the number of Sales and Distribution service units for that forecast period. These costs would only apply to customers of Heritage Gas who purchase their natural gas from Heritage Gas.

(Exhibit H-1, Section 9,

p.26)

[65] Heritage submits that the manner in which it proposes to operate the account is consistent with the way those accounts are operated by utilities in other jurisdictions. This is supported in the evidence of Kathleen McShane. In its application, Heritage seeks approval of the

GCVA, but not the GCRR. Heritage did confirm in evidence (transcript p. 52) that it will submit the GCRR to the Board for approval. Indeed a separate application respecting an adjustment to the current GCRR was submitted to the Board on May 7, 2004.

[66] In a memorandum to the Board following conclusion of the hearing, Board Counsel advised the Board that, in his opinion, the Board does not have jurisdiction to grant approval of either the GCVA or the GCRR. The Province, in response, took an opposing view.

[67] The relevant sections of the **Act** are as follows:

Purpose of Act

2 The purpose of this Act is to

- (a) provide a framework for the orderly development and operation of a gas delivery system in the Province; and
- (b) allow for fair competition in the sale of gas for consumption in the Province. 1997, c. 4, s. 2.

Interpretation

3 In this Act,

- (b) "franchise" means a franchise granted pursuant to this Act to construct and operate a gas delivery system;

Approved tariff

21(1) The holder of a franchise shall not impose, observe or follow rates, tolls or charges except those that are specified in a tariff that has been filed with the Board and approved by an order of the Board.

Approval and fixing of rates, tolls and charges

22(1) The Board may, on its own initiative or on the application of a person having an interest, by order in writing, approve or fix just and reasonable rates, tolls or charges for the delivery of gas by a gas delivery system, including related services. [emphasis added]

Requirement for licence

24 No person shall act or purport to act as a gas marketer unless that person has been issued a licence by the Board. 1997, c. 4, s. 24; 2002, c. 18, s. 12.

Application for licence

25(1) A person may apply, in the time and in the manner prescribed, for a licence.

(2) A franchise applicant may apply for a licence at the same time as making the franchise application. 1997, c. 4, s. 25; 2002, c. 18, s. 13.

Terms and conditions of licence

26 The Board may issue a licence upon such terms and conditions as the Board considers appropriate or as are prescribed. 1997, c. 4, s. 26.

[68] The relevant sections of the **Gas Distribution Regulations (Nova Scotia)** are:

Interpretation

2(2)(da) “bundled service provider” means a franchise holder who provides both transportation and commodity services;
 Clause 2(2)(da) added: O.I.C. 2002-266, N.S. Reg. 72/2002.

2(n) “gas marketer” means a person who, through a gas delivery system,

(i) sells or offers to sell gas to a customer,

(ii) acts as the agent or broker for a seller of gas to a customer, or

(iii) acts or offers to act as the agent or broker of a customer in purchasing gas,

and “gas marketing” has a corresponding meaning;

Clause 2(2)(n) replaced: O.I.C. 2002-266, N.S. Reg. 72/2002.

Franchise terms and conditions

13 (1) A full regulation class franchise shall be subject to the following terms and conditions:

...

(j) subject to subsection 18(d), a bundled service provider shall be permitted to sell gas and transportation services upon terms and conditions as are determined by the Board;

Clause 13(1)(j) replaced: O.I.C. 2002-266, N.S. Reg. 72/2002.

Rates

16 (1) The Board shall create a single, franchise-wide rate, toll or charge for gas transportation services to each customer class of a franchise holder.

Franchise amendment

18 The Board may on its own initiative, at the request of the franchise holder or upon receipt of a complaint, and shall at the request of the Governor in Council, consider amending the franchise and without restricting the generality of the foregoing,

...

d) where the franchise holder is a bundled service provider, conduct a hearing after 7 years from the award of the franchise to determine whether the development and operation of the marketplace is being unduly restricted because the franchise holder is a bundled service provider and, if so determined, amend the franchise by restricting the terms and conditions under which the franchise holder may engage in gas marketing.

Clause 18(d) added: O.I.C. 2002-266, N.S. Reg. 72/2002.

Section 18 amended: O.I.C. 2002-266, N.S. Reg. 72/2002.

[69] Heritage has been granted a franchise to construct and operate a gas delivery system.

It also holds a licence to act as a gas marketer.

[70] Board Counsel's submissions in this regard are summarized in the following extract from Board Counsel's submission dated May 26, 2004:

8. In considering the jurisdictional issue, the starting point is that the Board, as a statutory tribunal, only possesses the authority conferred upon it in the enabling legislation, either expressly or by necessary implication. As stated in *Administrative Law in Canada* (2nd ed.) Blake 1997, Butterworths Canada Ltd. (Toronto), at page 99:

An administrative tribunal has no inherent powers to make orders or take proceedings that may affect interested members of the public. Being created by statute, it has only those powers conferred on it by statute or . . .

9. Over the years, courts have adopted various approaches to the interpretation of statutes. However, in the last decade, the so-called "modern rule of interpretation" has achieved widespread acceptance. In *Bishop-Beckwith Marsh Body et al. v. Wolfville (Town)* (1996), 151 NSR (2d) 333, the Nova Scotia Court of Appeal quoted the rule from *Construction of Statutes* (3rd Ed., 1994), by Ruth Sullivan, as follows:

There is only one rule in modern interpretation, namely, courts are obliged to determine the meaning of legislation in its total context, having regard to the purpose of the legislation, the consequences of proposed interpretations, as well as admissible external aids. In other words, the courts must consider and take into account all relevant and admissible indicators of legislative meaning. After taking these into account, the court must then adopt an interpretation that is appropriate. An appropriate interpretation is one that can be justified in terms of (a) its plausibility, that is, its compliance with the legislative text; (b) its efficacy, that is, its promotion of the legislative purpose; and (c) its acceptability, that is, the outcome is reasonable and just.
[p. 131]

10. The *GDA* clearly envisages a very different regulatory regime for gas distribution franchises than it does for gas marketing. The regulatory regime for franchises is much more comprehensive and includes rate regulation. With respect to gas marketing, however, all that is required is that the seller of gas hold a license.

11. It is in this context that s. 21(1) and 22(1) must be interpreted. While s. 21(1) prohibits the holder of a franchise from charging rates, tolls or charges which have not been approved by the Board, it is my opinion that the prohibition only applies to rates, tolls or charges for delivery service and not to the sale of the commodity itself. This seems clear from s. 22(1) which specifically states that the rates, tolls or charges to be approved by the Board are "for delivery of gas by a gas delivery system including related services".

12. It might be argued that the phrase "including related services" is sufficiently broad to include gas sales by a franchisee providing a bundled service. However, the better view, in my opinion, is that "related services" refers to services which are incidental to delivery service, such as, for example, back-stop or storage services. The whole scheme of the *GDA* is that the sale of gas is not incidental to gas delivery service. Even though bundling of the two services is permissible, they remain separate and distinct.

13. To interpret "related services" to include the sale of gas would lead, in my opinion, to an absurd result. Since the *GDA* does not expressly give the Board authority to set gas prices, it cannot seriously be contended that the Board could regulate the price at which gas is sold by a gas marketer who does not hold a distribution franchise. Thus, giving an expansive interpretation to "related services" in s. 22(1) would result in a situation where the Board could regulate gas prices charged by franchisees but not by gas marketers. It would seem highly unlikely that such was the legislative intent.

14. Apart from s. 21(1) and 22(1), the only other provision which might conceivably provide the Board with jurisdiction to set gas prices is s. 18(d) of the Gas Distribution Regulations. This provision enables the Board to set "terms and conditions under which the franchise holder may engage in gas marketing" if the market place is "being unduly restricted because the franchise holder is a bundled service provider". It is debatable whether the authority to set "terms and conditions" includes the power to set rates. However, even if it does, the Board's jurisdiction under s. 18(d) of the Regulations can only be invoked seven years after the award of franchise. Consequently, it is not relevant for purposes of the present application.

15. I conclude, therefore, that the Board lacks the requisite jurisdiction to approve the proposed GCVA and GCRR. I believe this interpretation is consistent with the modern rule of construction for the following reasons:

- (a) it is plausible because there is nothing in the legislative text which expressly or by necessary implication gives the Board the power to set gas prices;
- (b) it promotes the legislative purpose of the GDA by providing stringent regulatory control over the construction and operation of gas delivery systems while allowing market forces and competition to determine the price of gas; and
- (c) the outcome is just and reasonable in that it results in a less onerous regulatory regime being imposed on a non-monopoly service (i.e. the sale of gas) than on a monopoly service (i.e. the transportation of gas).

16. I wish to emphasize that there is nothing in the *GDA* or Regulations which would prevent Heritage from agreeing with its customers to sell them gas on terms which would incorporate the GCVA and GCRR. In that event, the GCVA and GCRR would operate as a matter of contract and would not require any Board approval with respect to customers using over 500 gigajoules per year. In the case of customers using 500 gigajoules per year or less, the form of the contract, but not the price of gas, would be subject to Board approval pursuant to s. 5 of the Board Gas Marketers Regulations.

(Board Counsel's Submission, May 26, 2004, pp.4-8)

[71] The Province's submissions are summarized in the written brief filed by the Province dated June 1, 2004:

24. The Province agrees with Board counsel that the Board, as a statutory tribunal, only possesses the authority conferred upon it in its enabling legislation, either expressly or by necessary implication. The Province also agrees that when considering that enabling legislation, the "modern rule of interpretation", which directs a comprehensive, contextual approach to determining the meaning of legislation is the basis upon which the Board's governing legislation must be interpreted.

25. The use of the modern rule as the starting point for interpreting legislation was discussed recently by the Nova Scotia Court of Appeal in *Myers et al. v. Minnette et al.* (2003), 216 N.S.R. (2d) 106. As was noted in *Myers*, using this contextual approach, one of the admissible aids to determining the meaning of legislation is legislative evolution. In the case of the GDA and the *Gas Distribution Regulations (Nova Scotia)*, N.S. Reg. 86/98 as amended by N.S. Regulations 72/2002 (the "GDR"), changes made in 2002 need to be considered.

26. In its original form, the GDA prohibited a franchise holder from being issued a license to sell gas:

- s.30 (1) Notwithstanding anything contained in this *Act*, no public utility as defined in the *Public Utilities Act* or holder of a franchise shall be issued a license pursuant to this Part.
- (2) For greater certainty, nothing in subsection (1) precludes an affiliate or subsidiary of a public utility as defined in the *Public Utilities Act* or holder of a franchise from applying for and being issued a license pursuant to this Part.

27. Similarly, the original language in s.13(1)(j) of the GDR restricted a franchise holder to a limited sales function:

- s.13(1) A full regulation class franchise shall be subject to the following terms and conditions:

(j) a franchise holder may sell gas upon such terms and conditions as are determined by the Board, and in making such determination, the Board shall restrict such sales to those necessary for the effective and efficient operation of the gas delivery system.

28. In *Re Distribution of Natural Gas in Nova Scotia*, [1999] N.S.U.A.R.B. No. 121 (Nova Scotia Utility and Review Board), the Board considered these earlier provisions:

The Board's view is the *Act* and GIC Regulations require, as a matter of principle, that the natural gas market in Nova Scotia should operate in an unbundled manner. This entails a clear separation between the functions of buying and selling natural gas and the physical delivery of natural gas to customers.

[1999] N.S.U.A.R.B. No. 121, para. 152

29. And later:

It is clear from the above-noted provisions that they are intended to permit the franchisee to ensure that the gas distribution system is operated in an effective and efficient manner, but that the distributor's ability to purchase and sell natural gas should be limited to this objective. This may include, for example, such items as the purchase of linepack and balancing daily fluctuations due to various operating conditions on the pipeline. The Board anticipates that Senpra Atlantic may also wish initially to provide peaking, default and backstopping services to ensure adequate supplies of natural gas to customers. However, the Board is of the opinion that these services must, even in the initial stages, be provided by an affiliate. The Board expects that, as the competitive natural gas market develops in Nova Scotia, these services will also be provided by independent third parties.

[1999] N.S.U.A.R.B. No. 121, para. 154

30. In 2002, the GDA was amended to expressly permit a franchise holder to apply for a license to act as a gas marketer at the same time as making a franchise application (s.25(2)). Section 30 was repealed.

31. The restriction in s.13(1)(j) of the GDR was also removed, though significantly the Board's ability to impose terms and conditions on the sale of gas was not:

s.13(1) A full regulation class franchise shall be subject to the following terms and conditions:

(j) subject to subsection 18(d) a bundled service provider shall be permitted to sell gas and transportation services upon terms and conditions as are determined by the Board.

32. The Board's ability to impose terms and conditions on the sale of gas by a bundled service provider under s.13(1)(j) of the GDR is in addition to the general authority of the Board to attach terms and conditions to the issuance of a gas marketing license, which has always existed in s.26 of the GDA. This view is further supported when one considers that the terms and conditions on the sale of gas under s. 13(1)(j) of the GDR are terms and conditions of the franchise itself, whereas the terms and conditions contemplated in s.26 of the GDA relate to the license to act as a gas marketer. The legislation contemplates that additional or special terms and conditions may be necessary in the case of the sale of a gas by a bundled service provider.

33. The 2002 amendments also included the addition of subsection 18(d) of the GDR:

s.18 The Board may on its own initiative, at the request of the franchise holder or upon receipt of a complaint, and shall at the request of the Governor in Council, consider amending the franchise and without restricting the generality of the foregoing...

(d) where the franchise holder is a bundled service provider, conduct a hearing after 7 years from the award of the franchise to determine whether the developments and operation of the marketplace is being unduly restricted because the franchise holder is a bundled service provider and, if so determined, amend the franchise by restricting the terms and conditions under which the franchise holder may engage in gas marketing.

34. Subsection 18(d) was discussed by Board counsel who noted that a hearing under this subsection could only be conducted after 7 years

from the award of the franchise. This requirement, however, does not restrict the Board from imposing terms and conditions on the franchise relating to the sale of gas under s.13(1)(j). Subsection 18(d) gives the Board the additional ability to conduct a hearing (after 7 years), relating to the development of the marketplace itself, and to amend the franchise based on its findings.

35. The amendments to the GDR in 2002 also added other provisions specifically aimed at the “bundled service provider”. Section 5(e)(i) requires a bundled service provider to outline, in its code of conduct, the steps it proposes to take to eliminate any undue competitive advantage arising from that position. Subsection 34(1)(aa) gives the Board the ability to prescribe, in a case of a full regulation class franchise, where a franchise holder is a bundled service provider, that separate books and accounts be kept for the sale of the commodity and transportation tolls or charges. These provisions address the concern underpinning what, it is submitted, was the original basis for restricting the sales function in the first place; that a bundled service provider would gain an unfair competitive advantage by virtue, primarily, of its access to information and the potential subsidization of the costs of providing a sales function by distribution customers.

36. A review of the legislative history of the GDA and the GDR informs the present exercise of legislative interpretation in a couple of ways. First, that concerns relating to the ability of a bundled service provider to impede the development or negatively impact the operation of the marketplace for the sale of natural gas originally restricted the ability of a franchise holder to sell gas to limited circumstances. Second, while amendments to the GDA and GDR in 2002 permitted a franchise holder to sell gas, this was not done in a completely unrestricted fashion.

37. The legislator’s intentions in this regard are manifest in the amendments to the GDA and GDR aimed specifically at the “bundled service provider”. These provisions permit the Board to undertake a broadly based review of the natural gas marketplace following 7 years, and give the Board the ability to actually amend the franchise on the basis of that review. They also require a bundled service provider to include special provisions in its code of conduct to ensure competition. A bundled service provider is subject to a direction to maintain completely separate books and accounts for distribution and gas sale services. The Board, in what remained of s.13(1)(j) of the GDR, was also left with the ability to impose further terms and conditions on the franchise relating to the sale of gas.

(NSDOE Post-Hearing

Brief pp.7-11)

[72] Heritage, in a submission dated June 7, 2004, somewhat surprisingly, takes no position with regard to the legal jurisdiction of the Board in respect of the GCVA and the GCRR.

FINDINGS

[73] The Board has considered this matter and agrees with the submissions of Board Counsel that the Board does not have jurisdiction to approve either the GCVA or the GCRR.

[74] A reasonable view of the **Act** is that there are two distinct regulatory arrangements under the **Act**. Tolls, rates and charges “for the delivery of gas by a gas delivery system” (s. 22) are the subject of “traditional” regulation including regulation of price and terms of service.

[75] On the other hand, the sale of the commodity, which may be undertaken, subject to market forces, by any number of persons, including the franchisee, is subject only to the requirement

that the marketer be “licenced”. In the Board’s view, under the **Act**, the commodity, “gas”, is not the subject of price regulation.

[76] Counsel for the Province has set out in his submission, the evolution of the **Act** and **Regulations** since originally enacted. To facilitate development of a gas franchise, the franchisee has recently been given the right to market gas, a right it did not enjoy under the **Act** as originally drafted. The **Regulations** have been amended to ensure fairness in the marketplace (i.e., **Regulation 13(1)(j)** and **18(d)** among others). The fundamental structure of the **Act** however, has not been altered. It is the delivery system service that is subject to price regulation not the commodity.

[77] **Section 22** of the **Act** gives the Board clear directions with respect to the setting of rates, “for the delivery of gas by a gas delivery system”.

[78] **Section 22(3)** states:

Approval and fixing of rates, tolls and charges

22 (3) In approving or fixing rates, tolls or charges, the Board shall give due regard to the following criteria and may give appropriate weight to each of them relative to the others:

- (a) the related practical attributes of simplicity, understandability, public acceptability and feasibility of application;
- (b) freedom from controversies as to proper interpretation;
- (c) effectiveness in yielding total revenue requirements under the just and reasonable return standard;
- (d) revenue stability from year to year;
- (e) stability of the rates, tolls or charges themselves, with a minimum of unexpected changes seriously adverse to existing customers;
- (f) competition;
- (g) fairness of the specific rates, tolls or charges in the apportionment of total costs of service among the different consumers;
- (h) avoidance of undue discrimination in rate relationships;
- (i) efficiency of the rates, tolls or charges in discouraging wasteful use of service while promoting all justified types and amounts of use; and
- (j) such other matters as the Board deems appropriate.

[79] The **Act** is silent in respect of any terms and conditions for the setting of the commodity price. This is consistent with an interpretation that the commodity price is not subject to the Board's jurisdiction.

[80] The Province's argument is founded in **Section 13(1)(j)** of the **Regulations**:

Franchise terms and conditions

13 (1) A full regulation class franchise shall be subject to the following terms and conditions:

...

- (j) subject to subsection 18(d), a bundled service provider shall be permitted to sell gas and transportation services upon terms and conditions as are determined by the Board;
Clause 13(1)(j) replaced: O.I.C. 2002-266, N.S. Reg. 72/2002.

[81] The interrelationship between **Regulation 18(d)** and **Regulation 13(1)(j)** is not entirely clear. However, **Regulation 18(d)** applies only seven years from the date of the award of the franchise. Given the absence of any authority in the **Act** with respect to price regulation of the commodity, the phrase "terms and conditions as determined by the Board" in **Section 13(1)(j)** would, in the Board's view, reasonably relate to the sort of provisions the Board might impose to ensure fairness in the marketplace or to prevent the exercise of market power - but not commodity price regulation.

[82] The Board does not view either **Regulation 5(e)(i)** or **Regulation 34(1)(aa)** as imposing price regulation on the commodity sale.

[83] As noted by Board Counsel, it appears to be common ground that if Irving or ExxonMobil, for example, were to sell gas - there is no suggestion the price of the commodity charged by them would be regulated.

[84] Finally, the following extract from Board Counsel's reply brief dated June 9, 2004, is instructive:

6. The Province's submission on the jurisdictional issue relies quite heavily on the Gas Distribution Regulations. However, regulations must be used with caution when attempting to interpret a statute. Sullivan and Driedger on the Construction of Statutes (4th Ed.; Butterworths Canada Ltd., 2002), makes the following observations on the use of regulations in statutory interpretation:

Regulations. Where the provision to be interpreted appears in a regulation, it is read in the context of both the regulation and the enabling Act as a whole. Where the provision to be interpreted appears in the enabling Act, the regulations are generally ignored. Because regulations are a subordinate form of legislation, usually made after the enabling Act has been passed, they have limited value in interpreting provisions of the Act. In appropriate circumstances, however, and particularly when the Act and the regulations are closely meshed, provisions in the Act may be interpreted in light of the regulations.

(Board Counsel's Reply Submission, June 9, 2004, p.2)

[85] The Board appreciates the thorough submissions from Mr. Outhouse and Mr. McGrath on this issue. The Board has determined that the Act does not give it authority to regulate either the GCVA or the GCRR. If as a matter of contract, Heritage wants to enter into the GCVA or the GCRR type arrangement with its customers, it appears free to do so. The theoretical underpinning of the Act would be that if customers do not like this arrangement they are free to seek another marketer. The practical concern is that at present there are not many, if any, other options the customer can pursue in terms of marketers. No doubt this factual reality was of concern to the Province in making its submissions and this concern can be addressed by the Province through legislative changes if it is considered necessary.

8.0 OTHER ISSUES

8.1 Reporting Requirements

[86] In light of the five-year test period, the Board directs that Heritage report to it annually in respect of both its cost of service and earnings so that the Board may monitor Heritage's financial performance. In addition, and having regard to the Board's determination with respect to the GCVA

and the GCRR, the Board directs that information be filed, in a form satisfactory to the Board, to enable the Board to ensure that costs associated with the sale of gas are not being allocated to the regulated delivery service. Otherwise the reporting requirements in the franchise application decision, NSUARB-NG-O2, in particular those contained in Appendix A of that decision, continue to apply.

8.2 Revenue Requirement and Rate Base

[87] The forecast revenue requirement includes a return on equity of 13% as approved by the Board in the franchise decision. The revenue requirement also includes forecasts of operating expenses, amortization/depreciation and income taxes. Revenues are forecast using the rates proposed in the application. In the development of rate base, net plant in service is calculated as the arithmetic average of the 12 months for each calendar year. Cash working capital has been calculated by taking one-twelfth of operating expenses. The Board accepts as reasonable Heritage's forecast revenue requirement and rate base.

8.3 Capital Expenditures and Plant Continuity

[88] Details with respect to capital expenditures and plant continuity appear at pages 9 through 16 of the application. Funds are forecast to be spent in each of the five project expansion areas for capital expenditures to build out from the Maritimes & Northeast ("M & NP") pipeline and for construction of high pressure custody transfer stations. Since there are no minimum transportation volumes which would satisfy M & NP's lateral policy, the build out of the system will

be undertaken in accordance with the feasibility test discussed earlier. In its post-hearing brief, Heritage states as follows:

... Heritage is confident that the build out of the system described in this Application is realistic and attainable so as to permit Heritage to attach the number of customers with appropriate volumes to enable a successful implementation of its business plan. The details in regard to the number of customers and customer volumes required to enable the successful implementation of the business plan is set out in the tables in NSUARB-13 (Revised).

(Heritage, Post-Hearing Written Submission, p.10)

[89] The Board accepts Heritage's estimate of capital expenditures and plant continuity.

8.4 Working Capital

[90] Heritage has forecast its working capital requirements utilizing one-twelfth of its annual operating expenses. This approach, as opposed to the "lead/lag" approach adopted by most utilities, was adopted because operationally valid data did not exist that would support a more sophisticated analysis. The Board accepts this mechanism for forecasting working capital, but directs Heritage to review and report whether sufficient data is available to permit the use of "lead/lag" or some other approach for the next test period.

8.5 Utility Income

[91] Heritage notes, in its application, that its estimates of utility income are consistent with those utilized in the franchise application. The forecast customer additions have been refined to reflect experience gained by Heritage since commencement of the operation of the franchise. The Board accepts as reasonable Heritage's estimates of utility income.

8.6 Operating Costs

[92] The details with respect to Heritage's operating costs appear at page 29 through 31 of the application and are summarized in the table which appears at page 31. Heritage proposes that all expenses incurred in 2003 be capitalized because they were start-up costs. On a go-forward basis, costs will be capitalized in the following manner:

Department	2003	2004	2005	2006	2007	2008
Executive	100%	75%	50%	25%	0%	0%
Marketing	100%	100%	100%	100%	100%	100%
Engineering	100%	100%	100%	100%	100%	100%
Construction	100%	100%	100%	100%	100%	100%
Operations	100%	75%	50%	25%	0%	0%
Human Resources	100%	75%	50%	25%	0%	0%
Finance and Administration	100%	75%	50%	25%	0%	0%
Regulatory and Public Affairs	100%	100%	100%	100%	100%	100%
Overhead	100%	75%	50%	25%	0%	0%

The table outlining Heritage's operating costs by expense type is attached as Appendix B. The Board accepts as reasonable Heritage's estimates of operating costs.

9.0 SUMMARY OF THE FINDINGS

[93] In summary the Board's principal findings are:

- The Board approves the five-year test period as applied for by Heritage;
- The Board approves the revenue deficiency account using weather normalized revenue;
- The Board approves the deferred regulatory account as applied for by Heritage;
- The Board approves the deferred municipal taxes account. For purposes of future test periods, the Board intends to revisit whether it is necessary to include in the deferral, the first element of the tax calculated on the basis of customer usage;
- The Board approves the depreciation rates as applied for. The Board directs that Heritage undertake a new depreciation study at the end of the test period for the next test period;
- The Board approves Rate Classes 1 through 5 as amended herein. It also approves Rate Class 4A with respect to service to Nova Scotia Power's Burnside plant;
- The Board approves the Heritage tariff as amended herein;
- The Board approves the feasibility test as applied for by Heritage; and
- The Board finds that it does not have authority to regulate either the GCVA or the GCRR.

10.0 ORDER

[94] An Order will issue following filing of the rates and tariff with the amendments noted herein.

DATED at Halifax, Nova Scotia, this 29th day of July, 2004.

John A. Morash, Chair

Margaret A.M. Shears, Vice-chair

John L. Harris, Member

Kulvinder S. Dhillon, Member

Peter W. Gurnham, Member

APPENDIX A

Summary of Average Age Estimates and Depreciation Accrual Rates

	<u>Life Estimates</u>	<u>Depreciation Rate (%)</u>
<u>Distribution System</u>		
Steel Mains	60-R1.5	2.56
Plastic Mains	55-R3	2.10
Steel Service Lines	50-R2	2.70
Plastic Service Lines	45-R3	2.56
Residential Meters	35-R2.5	3.51
Regulating Facilities	35-R2	3.74
Metering Stations	30-S1	4.18
Building and Structures	45-R3	2.56
Other Distribution Plant	30-S2	3.78
<u>General Plant</u>		
Personal Computer Hardware	3-SQ	33.00
Servers, Routers and Switches	4-SQ	25.00
Printers and Other Hardware	5-SQ	20.00
Office Furniture and Equipment	20-SQ	5.00
Tools and Work Equipment	20-SQ	5.00
Vehicles	7-L1.5	16.38

Notes: Calculated using the Equal Life Group (ELG) Procedure
 Represents the 5 year average of accrual rates from age 0.0 through to age 5.0
 All net salvage percentages were assumed to be 0.0%

APPENDIX B

EXPENSE BY TYPE

Line	Normal	2003 Actual Normal	2004 Forecast	2005 Forecast Normal	2006 Forecast Normal	2007 Forecast Normal	2008 Forecast Normal
1 Salaries and wages \$ 3,415,212		\$ 485,000	\$ 2,971,705	\$ 3,350,756		\$ 3,493,376	\$ 3,662,724
2 Contractor costs 206,555		759,232	592,841	215,216	246,358		209,020
3 Transportation 259,326		39,000	215,687	230,382		245,397	
		243,558					
4 Moving -		98,000	46,436	25,756		-	-
5 Marketing 446,505		56,000	427,000	433,405		439,906	
		421,361					
6 Regulatory amortization 158,950		-	158,950	158,950		158,950	
		158,950					
7 Professional and consulting 73,234		114,000	220,035	71,086			72,152
		74,333					
Operating expenses							
8 Insurance 338,488			100,000	175,120		291,892	
		367,469					
9 Audit fees 63,682			60,900	61,814		62,741	
		64,637					
10 Directors expenses and fees 116,000			159,000	116,000		116,000	
		116,000					
11 Directors and Officers insurance 36,000			36,000	36,000		36,000	
		36,000					
12 Emergency response 63,682			60,900	61,814		62,741	
		64,637					
13 SCADA 33,600			4,800	19,200		26,400	
		38,400					
14 Helpdesk support 64,637			60,900	61,814	62,741	63,682	
15 Meter reading 94,702			5,718	28,271	52,318	74,195	
16 Meter shop 25,855			24,360	24,725	25,096	25,473	
17 Call centre 48,478			45,675	46,360	47,056	47,761	
18 Billing system			42,400	55,976	103,590	146,906	187,509

19 Financial information system		76,125	77,267	78,426	79,602
80,796					
20 Rent		223,013	257,265	261,124	
265,041	269,016				
21		152,799	899,791	1,021,625	1,226,124
1,458,137					1,354,112
Office expenses					
22 Telecommunications		113,396	126,841	128,148	
130,070	117,898				
23 Meals and accommodations		95,067	99,611	93,267	95,950
82,314					
24 Cellular phone		19,577	22,567	23,564	24,817
22,685					
25 Professional development and dues		58,372	61,803	59,494	59,756
54,444					
26		107,000	286,413	310,822	304,473
310,593	277,341				
27 Sub Total		1,811,031	5,818,857	5,817,997	6,186,735
6,255,447					6,474,463
28 Capitalizations and credits		(1,811,031)	(5,045,038)	(4,383,162)	(3,633,407)
(2,475,040)					(2,859,161)
29		\$ -	\$ 733,819	\$ 1,434,835	\$ 2,553,328
\$ 3,780,407					\$ 3,615,302