

**NOVA SCOTIA UTILITY AND REVIEW BOARD**

**IN THE MATTER OF THE GAS DISTRIBUTION ACT**

- and -

**IN THE MATTER OF Franchise Applications for the Distribution of Natural Gas in the Province of Nova Scotia**

**BEFORE:**

John A. Morash, C.A., Chair  
Margaret A. M. Shears, Vice-chair  
John L. Harris, Q.C., Member  
Charles J. McManus, P.Eng., Member

**APPLICANTS:**

**PROVINCE-WIDE**

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## **MUNICIPALITIES AND CO-OPERATIVES**

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John E. Parker, Representative

Central Annapolis Valley Natural Gas Co-operative  
Byron F. McDonald, Representative

Town of Annapolis Royal  
Philip D. Roberts, Mayor

Town of Berwick  
John P. Prall, Mayor

**INTERVENORS:** see Schedule 'B'

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

**BOARD CONSULTANT:** Richard G. C. DeWolf, P. Eng.

**BOARD STAFF:** Nancy E. McNeil, Board Clerk  
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Cynthia J. Matthews, Hearing Coordinator  
Paul G. Allen, C.A., Board Administrator

**HEARING DATES:** Heard at Halifax, Nova Scotia, between  
April 12, 1999 and July 29, 1999

**DECISION DATE:** **November 16, 1999**

**DECISION:** Pursuant to Section 8 of the Gas Distribution Act, the Board grants a full regulation class franchise for a period of 25 years to Sempra Atlantic Gas Incorporated, subject to the approval of the Governor in Council, and subject to the conditions set forth in Schedule 'A' attached; all other applications denied.

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## EXECUTIVE SUMMARY

The Board has determined that Sempra Atlantic Gas Incorporated (Sempra Atlantic) be granted a full regulation class franchise for the Province of Nova Scotia, and that all other franchise applications be denied. While each applicant's proposal is reviewed in this decision, and findings are made in respect thereto, the Board believes it is useful to begin this decision with a summary of the factors leading to its conclusion.

Sempra Atlantic's application was chosen over its principal competitor, Maritimes NRG (Nova Scotia) Limited (Maritimes NRG), because:

1. Sempra Atlantic has provided an unequivocal commitment to build-out its planned distribution system for at least four full years. Maritimes NRG has refused to provide such a commitment, indicating that, each year, the following year's build-out plan is subject to an economic feasibility review. While Sempra Atlantic has requested that there be a regulatory adjustment mechanism which could be invoked to delay further construction if the price spread between fuel oil and gas falls below \$3.50/GJ, it would only become effective after four full years of system build-out during which time a significant portion of the transmission facilities will have been constructed.
2. Sempra Atlantic has committed to build a gas distribution system that will meet or exceed the provincial access targets in each of the 18 counties within seven years. Maritimes NRG, on the other hand, has indicated it will meet or exceed the provincial access targets in only five of the 18 counties (assuming growth in the number of households) within the seven year period. Consequently, Maritimes NRG has requested an exemption from complying with the required access targets, stating that it is not financially feasible to do so. Further, Maritimes NRG has not even committed to build its base system.

The Board is satisfied that Sempra Atlantic's proposal meets the access targets. Clearly, the intent of the **GIC Gas Distribution Regulations** is that access to natural gas is to be

provided in all counties. Maritimes NRG's plan does not provide any access in four of the counties, and does not meet the required access targets in another nine counties. The Board is not convinced that it would be in the public interest to grant Maritimes NRG's request to be exempted from the application of the access targets.

3. Maritimes NRG's application relies heavily on the Maritimes & Northeast Pipeline (M&NP) lateral policy for purposes of constructing transmission facilities. Maritimes NRG argues that since the cost of these facilities will be rolled into the M&NP toll, pursuant to the lateral policy, Nova Scotia gas users will save approximately \$200 million, which costs will be absorbed by all shippers on the system, including M&NP's customers in New Brunswick and the United States.

The lateral policy was debated at great length during the hearing. However, the Board finds that insufficient evidence was presented on this issue by Maritimes NRG and the Board is not persuaded that the lateral policy can be relied upon to ensure the timely construction of transmission facilities in Nova Scotia.

4. Sempra Atlantic and Maritimes NRG arrived at different consumption estimates for purposes of calculating their revenue projections. While both parties have used reasonable methods to develop their estimates, the Board recognizes that there are likely to be inaccuracies in any estimates based on market analysis. Since these estimates directly affect revenue projections, the Board must be cognizant of its responsibility to protect customers from unnecessary risk.

In the case of Sempra Atlantic, the proposal to develop a gas distribution system is financed in total from corporate resources or corporate borrowing. No subsidy or other indirect financial assistance to build the system is sought or suggested. In the case of Maritimes NRG, while a subsidy is not sought as part of the application, losses incurred in building and operating the gas distribution system are proposed to be accumulated in what is called a

revenue deficiency account. Maritime NRG's plan is subject to the condition that the company will be permitted to eventually recover, from future ratepayers, all accumulated losses tracked through this account so as to ensure a cumulative 11% rate of return on equity. The ratepayers, therefore, ultimately bear the risk of Maritimes NRG's losses, including those losses which occur as a result of lower than expected penetration rates or consumption levels.

Sempra Atlantic, on the other hand, does not assume a guaranteed recovery of revenue deficiencies, or losses. Losses incurred in building and operating the gas distribution system are at the risk of Sempra Atlantic, which seeks only the opportunity to recover such losses through the potential for higher returns in later years, which are by no means assured. The company has committed to construct its system as planned, regardless of losses, for the first four full years.

5. Sempra Atlantic has guaranteed that the delivered cost of natural gas to customers will be at least 5% less than the price of fuel oil. While Maritimes NRG has indicated that the delivered cost of natural gas to customers will likely be 10% less than the price of fuel oil, it is not prepared to guarantee any particular level of savings. The Board finds that since Sempra Atlantic provides a guaranteed saving, customers face less exposure to risk under its plan.
6. The Board has also considered the issue of financial capability to undertake the project. The Board finds that, based on the evidence submitted, Sempra Atlantic has satisfied the requirements of the Act relating to financial capability. While Maritimes NRG did submit certain financial information, on a confidential basis, the Board finds that the evidence, while somewhat helpful, is not sufficient to satisfy the requirements of the **Act**, and does not enable the Board to reach a conclusion as to Maritimes NRG's financial capability.

In view of the above factors, and after considering all the issues set out in this



decision, the Board finds that the public interest is best served by choosing Sempra Atlantic to be the Province's distributor of natural gas.

Accordingly, pursuant to Section 8 of the **Gas Distribution Act**, the Board grants a full regulation class franchise to Sempra Atlantic for a period of 25 years subject to the terms and conditions attached in Schedule 'A'. By virtue of Section 8(3) of the **Act**, this grant of franchise is subject to the approval of the Governor in Council.

The Board also considered all the evidence in connection with the applications received from the two municipalities and the two co-operatives. The Board denies these applications because in the Board's view the financial risks associated with them are too great.

The Board has conducted an extensive public hearing process leading to its selection of a natural gas distributor for Nova Scotia. Considerable time, effort and monies have been expended by the various municipal and co-operative applicants, active intervenors, and finally, the two applicants for province-wide full regulation class franchises, Maritimes NRG and Sempra Atlantic. The Board appreciates the professional manner in which the applicants and intervenors acquitted themselves during the hearing, and the helpful participation of all the parties, their representatives, counsel, and witnesses. All parties have assisted in ensuring that the potential benefits and challenges of introducing natural gas to Nova Scotia were thoroughly reviewed and discussed at the hearing.

It is important to recognize that Nova Scotia is only at the beginning of the development of a major alternative energy source. Considerable work lies ahead for those who will be active in this endeavour. The public process is not over. Further review and discussion will continue regarding the introduction of marketers of natural gas in the Province. There will be an ongoing requirement by Sempra Atlantic and the licensed marketers to convince Nova Scotians of the benefits of natural gas. The activities of Sempra Atlantic and licensed marketers will be monitored by the Board to ensure the public interest is observed in the distribution and development of natural gas in this Province.

The Board wishes to gratefully acknowledge the valuable contribution brought to the hearing and this decision by panel member, friend and colleague Charles J. McManus, P. Eng., who passed away on November 4, 1999. His insight, experience, and humour will be very much missed.

## 1.0 INTRODUCTION

This decision follows a public hearing conducted by the Board over 49 hearing days between April 12, 1999 and July 29, 1999, in the matter of applications for franchises to construct and operate natural gas delivery systems in the Province of Nova Scotia. The applications were heard under the authority of the **Gas Distribution Act** S.N.S., 1997, c. 4 (the **Act**) and the **Gas Distribution Regulations (Nova Scotia)** made under that **Act** by the Governor in Council (**GIC Regulations**). The Board also made regulations, **Board Gas Distribution Regulations (Nova Scotia)**, which established the procedures, filing requirements and fees payable by the applicants (**Board Regulations**). As well, the Government issued a Policy Statement dated November 3, 1998, entitled “Policy Statement on Maximizing Benefits from Natural Gas Delivery” which, pursuant to **GIC Regulation 23**, forms part of the **GIC Regulations**. All relevant statutes, regulations and policy statements are found in the Addendum to this decision.

The **GIC Regulations** provide for three classes of franchise: full regulation class, producer class and single end user class. The franchise applications before the Board in this proceeding are for full regulation class franchises. Two applicants, Maritimes NRG (Nova Scotia) Limited (Maritimes NRG) and Sempra Atlantic Gas Incorporated (Sempra Atlantic) have applied for a province-wide full regulation class franchise for a term of 25 years.

Maritimes NRG, a Nova Scotia company, is sponsored by Westcoast Energy Limited (Westcoast) and Irving Oil Limited (Irving Oil).

Sempra Atlantic is also a Nova Scotia company. The parent company of Sempra Atlantic is Sempra Energy Utility Ventures, which is a wholly owned subsidiary of Sempra Energy, both being incorporated companies in the state of California.

Four other applicants, two municipal units and two co-operatives, filed applications for distribution franchises which were limited to specific geographic areas of the Province. Two other municipal applicants originally filed applications but later withdrew them.

It is useful to review the mandate of the Nova Scotia Utility and Review Board (Board) in this process. The Board’s role is set out in the **Act** and **GIC Regulations**. Section 2 of

the **Act** states that the purpose of the **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.*

The **Act** requires that the process for granting gas distribution franchises in Nova Scotia be public, with full opportunity for input from all interested parties. Accordingly, the Board issued Directions on Procedure for a public hearing on gas distribution franchise applications. The hearing was advertised throughout Nova Scotia. While the **Act** gives the Board the power to grant a franchise application after a hearing, it also stipulates that the Board's decision is subject to approval by the Governor in Council. Section 8 of the **Act** sets out the factors which the Board must consider when evaluating franchise applications.

The **Act** also gives the Board the power to set the rates and tolls to be charged by a franchise holder, and provides criteria for the Board to consider when determining what those rates and tolls should be.

While the **Act** confers additional responsibilities on the Board relating to gas, the granting of a franchise and approval of a rate plan are the relevant issues for purposes of this decision. Other duties of the Board include a licencing function under the **Pipeline Act**, R.S.N.S. 1989, c.345, which authorizes the construction and operation of pipelines by a franchise holder, and the licencing of gas sellers (frequently referred to as agents, brokers and marketers) under the **Gas Distribution Act**. The licencing of gas sellers and other related marketing issues will be the subject of a second phase of these proceedings. During the course of the hearing it became evident that these matters would be more productively dealt with after the Board made its decision with respect to the franchise applications. Accordingly, the Board will, in due course, convene a public hearing (known as Phase II) to deal with these matters.

It is against this backdrop of legislation, regulations and policy that the Board has carefully considered the mountain of evidence which has been presented in the course of this

proceeding. The Board must consider the evidence within the scope of its mandate as set out in the **Act** and the **GIC Regulations**. It is neither feasible, nor particularly useful, for the Board to attempt to recreate the hearing in this decision. Due to the volume of evidence, the Board will deal with the pertinent issues and evidence relating thereto in summary form.

For ease of reference, the Board has set out the relevant provisions of the **Act**, the **GIC Regulations** and the Policy Statement under each section in this decision. The Board has organized the decision into four distinct parts.

Part One consists of the Board's findings on the province-wide franchise applications. Each application is evaluated in the context of the statutory, regulatory and policy criteria established by the **Act** and **GIC Regulations**. The Board has drawn from these criteria the key factors upon which the decision has been based. A brief summary of the evidence provided by each applicant in respect of each key factor is presented, followed by the Board's findings in respect of that factor.

Part Two deals with the applications by the municipalities and co-operatives. A brief summary of each proposal is set out along with the Board's findings.

Part Three consists of comments by the Board in respect of other issues, including the regulatory environment, single end user class franchises and municipal fees.

Part Four contains a summary of the Board's findings and conclusions.

An Addendum is attached consisting of six schedules. Schedule 'A' sets out the terms and conditions of franchise award. Schedule 'B' lists the intervenors. Schedule 'C' is a list of abbreviations which appear in the decision. Schedule 'D' contains the **Act**, **GIC Regulations**, and the Province's Policy Statement. Schedule 'E' contains the **Board Regulations** and Directions on Procedure. Schedule 'F' contains the **Pipeline Act** and related **Regulations**.

## **PART ONE**

### **PROVINCE-WIDE FRANCHISE APPLICATIONS**

#### **2.0 AVAILABILITY OF ADEQUATE SUPPLY**

The relevant Section of the **Act** governing the Board's responsibility in making a determination on the issue of adequate gas supply is as follows:

*8 (2) Before granting a franchise, the Board shall be satisfied that the granting of the franchise is in the public interest and shall take into consideration . . . .*

*(b) the availability of adequate gas supplies;*

#### **2.1 MARITIMES NRG**

Maritimes NRG expressed its confidence in the actual and potential gas reserves offshore Nova Scotia. Maritimes NRG also advised the Board that it had made arrangements to ensure an adequate supply of gas is available to Nova Scotia consumers. Irving Oil has signed a letter of intent (Ex. A5-14) which outlines its ability, based on firm long-term commitments with Sable gas producers, to serve the baseload requirements of Nova Scotia markets in the first three to five years of operation. Maritimes NRG intends to work with gas sellers, but does not intend to act as a gas seller itself. Rather, the company will act as an agent to arrange default gas supplies, as well as seasonal and peaking supplies.

#### **2.2 SEMPRA ATLANTIC**

Sempra Atlantic also indicated its confidence in Nova Scotia's offshore gas reserves, and referred to the gas supply which will be available to and from Nova Scotia as part of the North American gas distribution grid. Sempra Atlantic filed with the Board a letter of intent (Ex. A1-46) which provides a commitment by Sempra Energy Trading, an affiliate of Sempra Atlantic, to act as a supplier of natural gas in an amount adequate to serve the Nova Scotia market, on terms to be

specified. The company also asked the Board, in its application, for a gas seller's licence to ensure that the core residential market is served. Sempra Atlantic explained that, at the time of filing its application, there was some uncertainty as to whether marketers would participate in the industry and, if so, whether their interest would be limited to large volume users. Sempra Atlantic's witnesses later modified the company's position. They indicated that Sempra Atlantic would be willing to defer commodity sales to an affiliated direct seller or to marketers through a bid process. However, in its closing argument, Sempra Atlantic submitted that it should be allowed to engage in direct sales during the transition period.

### 2.3 FINDINGS

In view of the evidence filed with the Board by the various parties in this proceeding, the Board has a reasonable assurance that there will be an adequate natural gas supply to meet both the immediate and long term needs of Nova Scotia natural gas customers. Further, the Board finds that both applicants have met the criteria outlined in the **Act** in respect of availability of adequate supply. The Board will address the issue of gas commodity sales by the franchisee later in this decision.

### 3.0 EXISTENCE OF MARKETS

The relevant Section of the **Act** governing the Board's responsibility in making a determination on the issue of the existence of markets is as follows:

**8 (2)** *Before granting a franchise, the Board shall be satisfied that the granting of the franchise is in the public interest and shall take into consideration . . . .*

*(a) the existence of markets, actual or potential;*

### 3.1 OVERVIEW

The Board considers that an assessment of the actual and potential markets for natural gas is best accomplished by focusing on two critical components -- penetration rates and

consumption estimates.

### **3.2 MARITIMES NRG**

The evidence presented by Maritimes NRG with respect to the existence of markets came from a number of sources. These included personal interviews, telephone surveys, focus groups, expert opinions, Irving Oil customer information, and a review of housing and business locations and their respective energy needs. Maritimes NRG divided the Province into 12 regions, and customers were divided into residential and commercial/industrial categories. Usage was then estimated for these categories based on all the information sources available to the applicant. The commercial/industrial sector was further subdivided based on annual usage.

Maritimes NRG indicated that persuading Nova Scotians to convert to natural gas will be challenging in this greenfield environment because natural gas is not a necessary or known commodity; the market is dominated by other heating sources, primarily fuel oil; and, depending on the circumstances, it may take considerable time for natural gas customers to recoup the cost of conversion. Consumption rates for all categories of consumers were estimated, with average residential consumption estimated to be 85 Gigajoules (GJ) per year eventually increasing to 105 GJ per year. The consumption and market penetration estimates serve as the foundation for Maritimes NRG's rate plan and revenue projections.

Maritimes NRG's approach to developing markets involves education of consumers, as well as positioning business development representatives throughout the regions to act as resource and liaison personnel for customers, recognized dealers and community organizations. Dealer alliances are also proposed.

### **3.3 SEMPRA ATLANTIC**

Sempra Atlantic also presented extensive market information to the Board. This was drawn from telephone surveys, focus groups, interviews, and surveys of high-use businesses such as laundries and restaurants. Sempra Atlantic outlined the extent of market penetration by the forms of energy used currently in the Province, and discussed the challenges of convincing residents and

businesses to convert to natural gas. The company's market estimates conform to the regions of the Province designated in the Sempra Atlantic proposal to be provided with access to natural gas. It divided potential customers into three general segments: residential, commercial/industrial and major accounts. The segments were further subdivided depending on the nature of the residential units and, in the case of commercial facilities, depending on estimated usage. Sempra Atlantic plans an aggressive approach to promoting the use of natural gas in Nova Scotia, and consumption estimates for each of its categories of users were presented to the Board. In the residential market, gas usage is estimated to be approximately 144 GJ for single family units per year with the overall average residential usage estimated to be approximately 130 GJ per year. The penetration and consumption estimates for the various categories of users are the basis for the rate plan and revenue projections.

### **3.4 FINDINGS - MARKET PENETRATION ESTIMATES**

The Board believes that both province-wide applicants provided a satisfactory overview of the methodology and results of their respective market surveys. The primary differences between the applications centred on the estimates of the potential number of customers per category of user and the survey methodology concerning conversion costs. Notwithstanding the differences in approach, the Board finds that there are a number of similarities in the evidence presented by both parties in relation to penetration rates. This is illustrated by the following comparative table:



<b>Market Penetration Rate Comparisons for Residences (beginning when each service region receives access)</b>											
<b>Sempra Atlantic</b>											
Cumulative Market (%)	<b>Years with access to gas (in any given service region)</b>										
	0	1	2	3	4	5	6	7	8	9	10
	0	17.8	35.7	37.1	38.6	40.1	41.5	43	44.5	46	47.5
<b>Maritimes NRG</b>											
Cumulative Market (%)	<b>Years with access to gas (in any given service region)</b>										
	0	1	2	3	4	5	6	7	8	9	10
	0	13.0	23.4	32.6	36.7	40.5	42.9	45.1	47.3	49.4	51.5

Source: Ex. A1-137, page 15

The Board finds that the projected penetration rates of both applicants are justifiable and reasonable. The Board is well aware that the actual market penetration results will undoubtedly be different than those estimated by either Maritimes NRG or Sempra Atlantic.

### **3.5 FINDINGS - CONSUMPTION ESTIMATES**

Maritimes NRG and Sempra Atlantic have taken different approaches to estimating average annual consumption of natural gas by residential customers. Maritimes NRG has relied upon specific customer usage data provided by Irving Oil. Sempra Atlantic's estimates were based upon a model designed to measure average residential customer use. The model was developed by

Sempra Atlantic's affiliates in California, and takes into account a number of factors including variations in heating degree days in Nova Scotia. Sempra Atlantic compared the results of the model with various published data in order to corroborate its estimates.

In examining the extensive data, studies, and background information filed by the two parties, it appears that Maritimes NRG's reliance on the confidential Irving Oil customer data which was made public in summary form (Ex. A5-149), results in lower usage estimates than Sempra Atlantic because the data includes low energy users who may not convert to natural gas. Sempra Atlantic's estimates fall in the upper range of consumption as its calculation is weighted toward higher energy users. The Board has concluded that, given the respective penetration rates used by Maritimes NRG and Sempra Atlantic, and the varying estimates of customer savings to be achieved by converting to natural gas, it is a reasonable assumption that higher usage customers are more likely to convert since these customers have the greatest incentive to do so. Accordingly, the Board finds that Sempra Atlantic's consumption estimates are reasonable for those customers likely to use natural gas in Nova Scotia.

While both parties have employed reasonable methods to develop their estimates, the Board recognizes that there are likely to be inaccuracies in any estimates based on market analysis. Since these estimates directly affect revenue projections, the Board must be cognizant of its responsibility to protect potential customers from unnecessary risk. It is necessary therefore to review the evidence of each party from the perspective of risk, in the event that consumption or market penetration rates turn out to be less than projected.

In the case of Sempra Atlantic, its proposal to develop a gas distribution system is financed in total from corporate resources or corporate borrowing. No subsidy or other indirect financial assistance to build the system is sought or suggested. In the case of Maritimes NRG, while a subsidy is not sought as part of the application, losses incurred in building and operating the gas distribution system are proposed to be accumulated in what is called a revenue deficiency account. Maritimes NRG's plan is subject to the condition that the company will be permitted to eventually recover from future ratepayers all accumulated losses tracked through this account so as to ensure a cumulative 11% rate of return on equity. The ratepayers, therefore, ultimately bear the risk for

Maritimes NRG's losses, including those losses which occur as a result of lower than expected penetration rates or consumption levels.

Sempra Atlantic does not assume a guaranteed recovery of revenue deficiencies or losses. Losses incurred in building and operating the gas distribution system are at the risk of Sempra Atlantic, which seeks only the opportunity to recover such losses through the potential for higher returns in later years. The company has committed to construct its system as planned, regardless of losses, for four full years.

While Maritimes NRG's market estimates appear to be less aggressive than those of Sempra Atlantic, it remains clear that the ratepayers, under the Sempra Atlantic proposal, do not bear as great a risk as they would under the Maritimes NRG proposal. If Sempra Atlantic's estimates are incorrect, resulting in revenue shortfalls greater than anticipated, Sempra Atlantic bears the risk. Furthermore, due to the firm commitment of Sempra Atlantic to undertake the construction of its system, the Board is of the view that Sempra Atlantic has a greater incentive to promote the use of natural gas among Nova Scotians than does Maritimes NRG.

There is also an issue concerning Maritimes NRG's categorization of "consumer". "Consumer" is defined in the **Act** and **Board Regulations** as a user who consumes less than 500 GJ of natural gas annually. The **GIC Regulations** call for a uniform province-wide "postage stamp" gas transportation rate for all consumers.

**Section 23** *In Sections 24 to 30, "consumer" means a person who consumes gas on an annual basis in an amount less than the amount prescribed.*

**GIC Regulation 16**

- 1) *The Board shall create a single provincial rate, toll or charge for gas transportation services to consumers.*
- 2) *In Section 16(1), "consumers" shall have the meaning used in Section 23(1) of the Act.*

### ***Board Regulation 3***

*The amount prescribed for purposes of Section 23 of the Gas Distribution Act is 500 gigajoules per year.*

No distinction is drawn in the **Act** or **Regulations** between small commercial and residential users if consumption is less than 500 GJ annually. Maritimes NRG's plan would put small commercials under 500 GJ in a separate class. According to Maritimes NRG's response to Board Undertaking U-61 (Ex. A5-166), this results in a different transportation rate for small commercial customers under 500 GJ than is being proposed for residential customers. Such a result, in the Board's view, is not in compliance with the **Regulations**. However, the Board notes that Maritimes NRG indicated that this issue is not material from a financial standpoint and presumably, therefore, it would be willing to amend its rate plan in this respect if directed to do so.

The Board concludes that both Sempra Atlantic and Maritimes NRG have presented sufficient information and analysis with respect to the existence of actual and potential markets for natural gas in the Province.

## **4.0 ECONOMIC FEASIBILITY**

The relevant Section of the **Act** governing the Board's responsibility in making a determination on the issue of economic feasibility is set out below:

**8 (2)** *Before granting a franchise, the Board shall be satisfied that the granting of the franchise is in the public interest and shall take into consideration. . . .*

*(c) the economic feasibility of the proposed gas delivery system;*

The Board considers that economic feasibility is determined primarily by three basic elements. They are:

- A. The relative reliability of market penetration and consumption estimates;

- B. The relative reliability of the forecast price of fuel oil (since both applicants propose to charge rates based on the current and future price of fuel oil); and
- C. The extent and cost of the construction plans which will ultimately determine the number of potential customers.

The sections which follow deal with the first two of these elements. The third, which relates to the plans for service, is discussed in Section 5. The request by Maritimes NRG for an exemption from the access targets is closely related to its plans for service and they are dealt with together in that Section.

#### **4.1 RELIABILITY OF MARKET PENETRATION AND CONSUMPTION ESTIMATES**

In Section 3, the Board found that both applicants provided adequate and reasonable evidence of an actual and potential market for natural gas, thereby satisfying the first element of the economic feasibility test.

#### **4.2 RELIABILITY OF PRICE FORECASTS FOR OIL AND GAS**

##### **4.2.1 Maritimes NRG**

Maritimes NRG says that its pricing methodology is expected to result in a delivered cost for natural gas to the customer that is 10% lower than the price of fuel oil over the term of the rate plan. While Maritimes NRG expects the price to be 10% lower, the company is not prepared to guarantee a 10% savings to the customer. Oil prices are an important factor here because they have a direct impact on the price to be charged for natural gas.

Maritimes NRG's rate plan involves a price calculation that starts with a total cost of gas to the customer based upon a forecast of oil prices for the year 2000 (the first year of service) expressed as an energy equivalent to natural gas, less 10%. Subsequent prices for natural gas are adjusted annually based on a three-year calculation of the annual change in the price of oil less a productivity factor of 0.5%. Since the 10% reduction is only applied to the first year (2000) price

forecast, and subsequent years are based upon a three-year calculation of the annual changes in the price of oil, there is no guarantee that the first year or subsequent years' prices for gas will in fact be 10% less than the actual equivalent price of fuel oil.

In order to estimate the future price of fuel oil, Maritimes NRG commissioned a study by a consulting firm to forecast the price of oil over the next twenty years. This forecast, which was the subject of considerable discussion at the hearing, sets out what was described as a conservative future price for fuel oil. Maritimes NRG submitted that the study was only one of a number of factors which it took into account when determining the price of fuel oil for the purpose of preparing its application. Its witnesses indicated that institutional experience, as well as aggressive business judgement, were also brought to bear and that the company, prior to filing the application, adopted a higher estimated price for fuel oil than was evident from the consultant's report. Maritimes NRG's application reflects calculations of distribution charges, and corresponding future revenue projections, based on this higher forecast of fuel oil prices.

#### **4.2.2 Sempra Atlantic**

Sempra Atlantic proposes to link its transportation rate to the price of fuel oil using a methodology which will result in a guaranteed saving to the customer of a minimum of 5%, except where the proposed regulatory adjustment mechanism is invoked (see Section 5.3). The future price of oil is very important to Sempra Atlantic since it forms the basis of the delivered cost of gas.

Sempra Atlantic's rate plan commences with a total cost of gas based upon the actual fuel oil price, expressed as an energy equivalent to natural gas, less 5%. Beginning in the first year of service (2000), Sempra Atlantic then makes monthly price adjustments to ensure that the total delivered cost of gas to the customer is, at a minimum, 5% less than the equivalent actual fuel oil price for each month.

Sempra Atlantic's forecast of fuel oil price for the first year of service is one of the determining factors in establishing Sempra Atlantic's initial rate cap. Sempra Atlantic's revenue forecasts were based on historical differences between the price of fuel oil and natural gas. During the hearing, under cross-examination by the Canadian Oil Heat Association (COHA), it became

evident that one of Sempra Atlantic's assumptions with respect to the price of oil was incorrect. Information concerning the historic price of fuel oil, which had been relied on by Sempra Atlantic as being exclusive of applicable taxes, actually included the taxes. Sempra Atlantic acknowledged the error, and adjusted other aspects of the application so as to mitigate the negative consequences of the error on estimated revenues. The adjustments included increasing its growth projections, based on anticipated growth in the Halifax Metropolitan area, as well as an increase from 10% to 15% in the proposed headroom factor in setting the rate cap.

### **4.2.3 Findings**

At the hearing, much evidence was tendered regarding the process followed by the parties in forecasting the price of fuel oil. Maritimes NRG spent a considerable amount of time reviewing the error by Sempra Atlantic, and the subsequent adjustments made to its application. In the Board's view, errors or omissions in filings have relevance only if the error or omission is of such magnitude that it is fatal to the application; the error or omission reasonably diminishes confidence in the applicant; or if the reaction of the applicant to an error or omission is reflective of a less than forthright corporate attitude which also could diminish confidence on the Board's part regarding its ability to deal transparently with the applicant in the future.

In the Board's view, Sempra Atlantic's error does not fall into any of these categories. The Board considers that, once the error was discovered, Sempra Atlantic acknowledged its mistake in a forthright manner and addressed the issue appropriately.

The Board finds that both applicants provided reasonable estimates of the likely outlook for oil and natural gas prices. Forecasting future oil prices is similar to estimating potential markets. There is inherent risk that the actual prices of oil and natural gas in the year 2000 and beyond will differ from the projected prices. Again, since the Board finds that both forecasts are reasonable, the issue becomes which franchise proposal involves the least risk to the ratepayer in the event the forecasts are less than accurate. The Board has concluded that, since Sempra Atlantic guarantees a minimum saving of 5% (except in circumstances where the regulatory adjustment mechanism is triggered, which cannot occur until after the first four full years of operation) and

Maritimes NRG does not guarantee any level of savings, consumers face less exposure to risk under the Semptra Atlantic proposal.

## 5.0 ACCESS TARGETS AND PLANS FOR SERVICE

The relevant sections of the **Act** and **GIC Regulations** governing the Board's responsibility in making a determination on the issue of access targets and plans for service is set out below:

**8 (2)** *Before granting a franchise, the Board shall be satisfied that the granting of the franchise is in the public interest and shall take into consideration. . . .*

*(f) the plans of the applicant to provide service in the franchise area; and*

### **Regulation 5**

*Subject to Section 6, the Board shall not grant a franchise over an area unless*

*(b) the applicant, or any combination of applicants gives a written undertaking to provide, at a minimum, the required access in all counties of the Province;*

### **Regulation 10**

*With the approval of the Governor in Council, the Board may exempt any class or classes of franchise from Sections 5-9 of these regulations.*

## 5.1 OVERVIEW

The provincial applicants have proposed very different distribution systems in scope, cost and process. As there is no common denominator on which to base a straight comparison of the systems, it is necessary to begin this section by reviewing the parameters of the distribution system as evidenced in the Policy Statement attached to the **GIC Regulations** concerning gas



development and distribution access targets, and the response of the applicants as outlined in their respective proposals. The table setting out the Province's access targets is found in Schedule "D" of the Addendum to this decision. The regulatory requirement for franchisees to meet these access targets in all 18 counties of the Province within seven years is set out below:

***Regulation 2(2)(v)***

*“required access” means that the gas delivery system is constructed adjacent to property boundaries to meet the distribution targets within 7 years starting 6 months after the grant of franchise, and for those franchise areas that require service from the Halifax Lateral, within 7 years of the first measurable unit of natural gas being transported on that lateral;*

Maritimes NRG argues that the access targets should be viewed as goals that are desirable but not mandatory. The company says that the **GIC Regulations** stress financial feasibility of the project as being a determining factor, and argues that mandatory compliance with the access targets would render its whole project uneconomic. Sempra Atlantic, on the other hand, undertakes to meet or exceed the access targets, and further argues that compliance with the access targets is an essential prerequisite for a successful application. The following table provides a numerical comparison between the two applications and the provincial access targets.

### Comparison of Household Access Targets

County	Access Targets	Sempra Atlantic	Maritimes NRG
Annapolis	4,400	5,737	4,447
Antigonish	3,100	3,849	2,091
Cape Breton	27,400	32,982	33,275
Colchester	11,700	13,514	10,031
Cumberland	8,600	9,190	6,946
Digby	4,000	6,642	1,471
Guysborough	1,400	1,407	348
Halifax	81,400	140,301	119,059
Hants	8,700	9,424	6,222
Inverness	3,600	3,712	1,370
Kings	13,500	24,388	14,484
Lunenburg	11,900	12,344	9,089
Pictou	11,700	16,929	11,480
Queens	3,100	3,327	0
Richmond	1,300	2,033	559
Shelburne	2,000	2,637	0
Victoria	1,000	1,015	0
Yarmouth	6,700	7,803	0
Total	205,500	297,234	220,872

Source: Excerpt from Ex. A5-38, Response to Board IR-4

## 5.2 MARITIMES NRG

Maritimes NRG stressed repeatedly throughout its application that the access targets should not be considered mandatory, and its application is premised on being exempted from

meeting the targets. The company states that it is not financially feasible to build a system which will meet the provincial access targets, and that it will not undertake to build an uneconomic system. Maritimes NRG has presented a very detailed and comprehensive engineering study for the construction of its less extensive distribution system, which would have an estimated cost of approximately \$560 million (Ex. A5-2, Vol. 2, Section 9, pg. 21, Table 9.3). This system would provide access to natural gas in 14 of the 18 counties over seven years and would only meet the provincial access targets in four counties. Even when Maritimes NRG's household access numbers are adjusted for growth, four counties remain entirely unserved and access targets are met in only 5 counties. The base system would be constructed only if it would be economically feasible for the company to proceed. The extension of service as contemplated in its proposed base system would be subject to an annual review by the Board.

The construction plan is predicated on using the "lateral policy" which is discussed in detail in Section 7 of this decision. Under this policy, M&NP would construct and own the transmission facilities needed to serve various communities. Jurisdiction over the portions of the system built under the lateral policy would rest with the National Energy Board (NEB). The Nova Scotia Utility and Review Board would annually review the construction schedule proposed by Maritimes NRG, and Maritimes NRG would make representations to the Board as to the economics of system expansion at that time. If system expansion were found to be economic, the portions of the distribution system to be built under the lateral policy would have to be approved by the NEB pursuant to an application by M&NP.

With respect to its commitment to build its base system, Maritimes NRG stated in its application that the application is a "non-binding indicative proposal". It is also the evidence of Maritimes NRG that there is no guaranteed commitment to build the base system. Relevant extracts from the record are set out below.

Application of Maritimes NRG (Executive Summary):

17. *Even with all of this information we cannot make, nor should Nova Scotia expect or desire their distributor to make, a predetermined commitment to build infrastructure irrespective of market, economic and financial realities. The public interest constraints recognized in our Plan - providing value to*

*the customers in the form of a lower price fuel option, maximizing benefits to Nova Scotians in the construction of the system and maintaining the economic viability of the system - were taken into account. Despite the challenges and the uncertainties, we are optimistic that a broad distribution service can be developed in Nova Scotia.*

Source: Ex. A5-2, Vol. 1, Section 1, Page 7, paragraph 17

24. *Our Plan is not a financial commitment to build the Base System. To ensure Nova Scotians have access to a distribution system that is economically and financially viable and, consequently, in a position to deliver gas at a price lower than alternate fuels, it is clear that Maritimes NRG must apply sound business practices in determining the speed and extent to which the system is expanded. For Maritimes NRG to do otherwise, would be neither in the public interest nor ours.*

Source: Ex. A5-2, Vol. 1, Section 1, Page 9, paragraph 24

#### Maritimes NRG's Projected Financial Statements, Note 2:

*The company [Maritimes NRG] has not made a commitment to build the Base System. Its plan is to develop a gas delivery system in Nova Scotia over time with the timing and extent of development subject to current economic conditions. There is no provision in the projected financial statements for adjustments to the base system roll out.*

Source: Ex. A5-2, Vol. 2, Section 12, Page 35

#### Hearing transcript:

- Q. Yes. So Mr. Bart, Nova Scotians should come away from this understanding that while your company is committing to a process, it is certainly not committing to build the system described as your Base System?*
- A. (Bart) Nova Scotians already understand that. We've been very clear with how we've communicated our approach to customers before we established-- before we filed our application and in the meetings that we had following our application, going around to all the municipalities and explaining to them what was in our application and what we saw as key features. Yes.*
- Q. So that when you gave your opening statement this morning and you*

*concluded with the words that "deliver natural gas at the lowest price to the most people in the best possible time," you're not going to commit at all to getting gas to any specific number of people to any specific number of counties by any specific time. Is that correct? You will not make a specific commitment as to those numbers of people or the time?*

A. (Bart) Yes. That's correct.

Source: Transcript - Cross-Examination of Maritimes NRG panel by Sempra Atlantic Counsel - June 23, 1999, Pages 5374-5375

### 5.3 SEMPRA ATLANTIC

Sempra Atlantic's engineering plans do not contain the same degree of detail as those of Maritimes NRG. Sempra Atlantic's position is that the plans submitted are adequate for this stage of the process. The company argues that its preliminary design work and plans are reasonable, and that more detailed plans clearly would have to be filed with the Board upon the granting of a franchise.

Sempra Atlantic appears to have taken a different approach to the access targets and, correspondingly, to system design. The evidence suggests that Sempra Atlantic used the access targets as a starting point, and then developed and costed the system with the objective of meeting or exceeding the targets. Sempra Atlantic argues that it has proposed the only distribution system which complies with the Province's requirements. It will reach all counties of Nova Scotia within seven years, will exceed the required household access targets, and will cost approximately \$1.1 billion to construct. The company proposes to undertake construction of the distribution system on its own, without recourse to the lateral policy. It intends to construct a significant portion of the high-pressure transmission lines by the end of the fourth year of the franchise. It has provided a written undertaking in its application to build the system as described subject only to *force majeure* events or if, after the fourth year of operations, the differential between the price of fuel oil and gas has fallen below the historic levels as outlined in the application. In such circumstances, Sempra Atlantic reserves the right to invoke its regulatory adjustment mechanism and appear before the Board to review the implementation of the balance of the construction schedule remaining at that

time.

This regulatory adjustment mechanism can only be invoked after the fourth year of operation. If, at that time, the differential between the price of natural gas and fuel oil is less than \$3.50/GJ (in constant 1999 dollars), Sempra Atlantic reserves the right to come before the Board with a view to setting the transportation rate at a minimum of \$3.50/GJ and possibly slowing the expansion of the distribution system until the oil and gas price differential reaches \$4.00/GJ. Sempra Atlantic asserts that the likelihood of the regulatory adjustment mechanism being invoked is remote.

#### **5.4 FINDINGS - ACCESS TARGETS**

Maritimes NRG has applied for a province-wide franchise on the basis that the Board exempt it, subject to the approval of the Governor in Council, from the requirement to comply with the provincial access targets prescribed in the **GIC Regulations**.

The Board has carefully considered the submissions of both parties as to whether an exemption can or should be granted in respect of the access targets pursuant to **GIC Regulation 10**. While the Board appreciates the helpful arguments of Counsel on this point, the Board finds that it is not necessary to make a determination on this issue. This question only becomes paramount in the event that neither applicant is prepared to meet the stated targets, or the Board is not satisfied that it is possible or feasible to meet the targets. In this proceeding, one applicant has undertaken to meet or exceed the access targets.

Clearly, the intent of the **GIC Regulations** is that access to natural gas is to be provided to all counties. It is equally clear to the Board that the Province did not intend to permit a franchise holder to unilaterally determine the extent and timing of access to natural gas. Presumably, the Province established the access targets to ensure that Nova Scotians living in all 18 counties would benefit to the greatest extent possible from the distribution of natural gas. It is reasonable to conclude that the Province felt the need to establish the access targets in recognition of the indisputable fact that the public interest and corporate interests do not always coincide. The access targets protect the public's legitimate interest in having gas distributed to all counties of the Province within the specified time frame of seven years.

In this case, the Board is satisfied that Sempra Atlantic's proposal meets the access targets. After a careful and objective assessment of Sempra Atlantic's application and after a detailed and lengthy cross-examination of Sempra Atlantic's witnesses by Maritimes NRG, the Board has not been persuaded by Maritimes NRG's arguments that Sempra Atlantic's proposal is overly optimistic and uneconomic. No serious challenge was made to the competency of the Sempra Atlantic team. Maritimes NRG's own witness, Bruce Ellsworth, acknowledged the competence and reputation of Sempra Atlantic's parent company. Further, no plausible motive has been advanced for Sempra Atlantic to base its franchise application on overstated customer projections, overstated revenues, overstated fuel oil prices and understated construction costs. This scenario is especially doubtful since the result of such misstatement on Sempra Atlantic's part would be to put \$1.1 billion dollars of the company's money at significant risk.

Accordingly, the Board is not prepared to grant Maritimes NRG's request to be exempted from the application of the access targets. The Board finds that Maritimes NRG's proposed base system does not comply with the access targets established by the **GIC Regulations**. The Board finds that Sempra Atlantic's proposed distribution system, on the other hand, does meet the prescribed access targets.

## **5.5 FINDINGS - PLANS FOR SERVICE**

The Board is satisfied that both applicants provided engineering feasibility studies in adequate detail to permit a sufficient understanding of their respective plans. The Board believes that the degree of detail provided by Sempra Atlantic through its company witnesses, as well as its local consultants, was adequate. The Board is also satisfied that variations in the ultimate cost of the proposed facilities from those forecast should not unduly impede Sempra from meeting its expected financial objectives over the life of its rate plan.

Maritimes NRG raised considerable concerns about the adequacy of the engineering plans of Sempra Atlantic. Without question, Maritimes NRG filed a more detailed construction plan than did Sempra Atlantic. However, in the Board's view, the degree of engineering, mapping and construction detail filed by Maritimes NRG, while commendable, exceeded the requirements for the

granting of a franchise.

There was considerable discussion regarding the Sempra Atlantic build-out plan and engineering estimates for the length and cost of pipe to meet the access targets. The Board agrees with the views expressed by the witnesses from the engineering firm of Porter Dillon Limited, a consultant to Sempra Atlantic, to the effect that engineers frequently approach the estimation of required facilities and their associated costs from different perspectives. While discrepancies in estimates did occur with respect to specific sections of Sempra Atlantic's build-out plan when compared to the estimates calculated independently by Porter Dillon, they appeared to be minor from an overall standpoint.

Further, while there was a good deal of argument about Sempra Atlantic's service regions, the Board believes that, in light of the fact that Sempra Atlantic has requested a franchise for the entire Province of Nova Scotia (as has Maritimes NRG), it is reasonable to treat the service regions as illustrative of the particular areas Sempra Atlantic is planning to serve to meet the province-wide access targets. The Board is not persuaded by Maritimes NRG's argument that Sempra Atlantic's estimated system build-out costs are understated. The Board expects that, as the service regions are refined in the future, changes in Sempra Atlantic's preliminary plans can be expected to occur. In the Board's view, the important point is the commitment by Sempra Atlantic to meet or exceed the access targets in all 18 counties and the risk which Sempra Atlantic bears that the ultimate cost may exceed its estimates.

While Sempra Atlantic's plans were more preliminary than those of Maritimes NRG, the Board finds that, based on the evidence of Sempra Atlantic's witnesses and consultants, Sempra Atlantic has provided adequate estimates of its required facilities, and the costing of those facilities, in order to go forward with its plans for natural gas service throughout the Province. Clearly, the Board expects Sempra Atlantic to comply with the requirements of the **Pipeline Act**, and to file more detailed engineering studies at the appropriate time.

The Board will require, as a condition of franchise award, that Sempra Atlantic undertake and fulfil its build-out plan subject only to *force majeure* and the regulatory adjustment mechanism. In terms of the proposed regulatory adjustment mechanism, the Board believes that,



through the required reporting procedures as outlined in Schedule ‘A’, the Board, other interested parties, and the general public will be able to measure Sempra Atlantic’s performance to ensure compliance with the company’s undertakings , and monitor the indicators which have the potential to trigger the regulatory adjustment mechanism.

## 6.0 RATE DESIGN

The relevant provisions of the **Act** governing the Board’s responsibility to make a determination on rate design are set out below:

**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.*

## 6.1 OVERVIEW - PERFORMANCE-BASED RATES

One of the cornerstones of applications for gas distribution franchises in Nova Scotia is the rate design proposal. In recognition of the requirement to meet specific household access targets, the **GIC Regulations** direct the Board to provide franchise holders with performance-based rates. The relevant regulation states:

*15(1) In awarding a franchise, the Board shall provide the franchise holder with performance-based rates, tolls or charges as determined by the Board.*

*(2) Performance indicators on which the rates, tolls or charges in Section 15(1) are based shall be measured against criteria specified by the Board in the terms and conditions of the franchise, which criteria shall include but shall not be limited to the provision of required access and the implementation of the benefits plan.*

Performance-based rate plans differ from the traditional cost of service approach. The cost of service approach consists of establishing rates which recover the cost of providing the service, plus a reasonable return on investment. In recent years, performance-based rates have been introduced in various jurisdictions. The move away from cost of service rates has been motivated by a need to address some of the inherent deficiencies in this type of rate making. Both applicants have indicated that traditional cost of service rate design is simply not appropriate for this project. This is a greenfield market which involves a costly delivery system. Gas cannot be distributed at a competitive price if start up rates reflect the actual cost of service. Performance-based rates are said to result in a number of improvements over the traditional method. The advantages of performance-based rates are often said to include the following:

- Streamline the regulatory process
- Reduce the size and complexity of rate cases
- Provide economic incentives to operate efficiently and promote productivity
- Provide the opportunity for fair and reasonable return
- Provide flexibility to design and price services

Some of the issues suggested by Maritimes NRG and Sempra Atlantic to be considered when assessing their rate plans are:

- |                       |                                |
|-----------------------|--------------------------------|
| • Pricing flexibility | • Direct cost reduction        |
| • Incentives          | • Sharing                      |
| • Innovation          | • Simplicity of administration |
| • Cost minimization   | • Equity                       |
| • Efficiency          | • Understandable tariffs       |

It is a considerable understatement to describe the rate proposals filed by the applicants as “complex”. The Board sets out the general elements of each plan in point form below.

## 6.2 MARITIMES NRG

The following highlights represent the key elements of Maritimes NRG’s rate plan:

- Transportation rates that are unbundled from the commodity cost of gas.
- Establishment of maximum delivery rates for consumers in the first year of service based upon achieving a 10% reduction from the estimated fuel oil price.
- Annual indexing of the delivery rate in accordance with a New York Mercantile Exchange (NYMEX) based index based on a three year calculation of changes in the price of oil less a productivity factor of 0.5%. The NYMEX index applies to the transportation rate only.
- Creation of an Ownership Expansion Fund for use in expanding the base system. This Fund would receive its funding through member investments in a consumers co-op and from a sharing mechanism if actual performance exceeds projections.

- A profit sharing mechanism, whereby customers share on a pro-rated basis in revenues above a benchmark return after Maritimes NRG achieves a cumulative return on equity of 11%.
- A cumulative revenue deficiency account that captures all annual revenue deficiencies (below the benchmark 11% return on equity), which are intended to be recouped from the ratepayers.
- A term of ten years for the initial rate plan.
- Ability to discount transportation rates by customer class.
- Major natural gas customers rates to be negotiated within a predetermined range of rates.
- Annual Board review of rate changes.

### **6.3 SEMPRA ATLANTIC**

The following highlights represent the key elements of Sempra Atlantic's rate plan:

- Transportation rates unbundled from the commodity cost of gas.
- Establishment of the delivered cost of gas for consumers (customers below 500 GJ annual usage) in the initial service year based on guaranteed minimum savings of 5% below the fuel oil price.
- Uniform average provincial transportation rates for all consumers using less than 500 GJ of gas per year.
- Establishment of a rate cap equal to 115% of the forecast initial transportation rates.
- The rate cap is indexed to the annual change in the Gross Domestic Product - Price Index (GDP-PI).
- Actual consumer transportation rates are reset monthly based on the then current spread between heating oil prices and gas prices in Nova Scotia to ensure a minimum 5% savings.
- Ability to discount transportation rates by customer class.

- Major natural gas customers' rates are negotiable subject to a minimum transportation rate.
- Monthly and annual reviews of rate changes by the Board to ensure conformity with the rate plan.
- Minimum consumer transportation rates of \$3.50/GJ, after the fourth year of system operation if the differential in price between natural gas and fuel oil falls below \$3.50/GJ.
- Annual sharing mechanism of excess earnings with customers when the annual return on equity exceeds 20%.
- A term of 20 years for the rate plan.

#### **6.4 FINDINGS - PERFORMANCE-BASED RATES**

Considerable time was spent during the hearing examining the merits of each of the rate plans of Maritimes NRG and Sempra Atlantic. The Board is not satisfied that Maritimes NRG's rate plan, during its initial 10-year term, achieves the benefits normally associated with those of performance-based rates. For example, Maritimes NRG's principal method of earnings-sharing only commences after the full recovery of all shortfalls recorded in the revenue deficiency account and the cumulative return on equity of 11% has been achieved. Under its proposal, Maritimes NRG does not anticipate that there will be any sharing of excess revenues until well past the initial rate plan period of 10 years, and possibly not until approximately the 30-year point (Ex. A5-152). Further, due to the uncertainty of the rate design in subsequent periods (i.e., past the initial 10 years), there is no guarantee that Maritimes NRG would continue with its existing rate plan. Also, Maritimes NRG has made it clear, through the testimony of its witnesses that, while it expects its rates will result in a 10% saving over the price of fuel oil, it is not prepared to guarantee this saving. In contrast, Sempra Atlantic does guarantee a minimum 5% saving to the consumer over the prevailing cost of alternate fuel. Its revenue-sharing proposal is quite straightforward in its application and is not subject to any recovery of accumulated revenue deficiencies, as is the case with Maritimes NRG.

The Board has two other concerns respecting the revenue deficiency account. First,

the generally accepted practice with respect to deferral accounts is that they should be amortized as soon as practical after the deferral period to avoid any conflict with the principle of intergenerational equity. This principle holds that all costs should be written off against revenues in the period to which they pertain. The longer a deferral continues, the greater the potential to charge expenses against revenues for a period to which they do not relate. Thus, ratepayers in future years end up paying for expenses incurred in prior years. In the case of the revenue deficiency account, it is possible that the deferral period will continue for 30 years and beyond.

Secondly, if Maritimes NRG is able to effectively defer significant costs for many years, year after year, this could result in a lack of incentive to ensure that costs are controlled, since any losses caused by excessive costs, or inefficiencies in operations, can be charged to the revenue deficiency account and amortized over a number of years to be recovered against future revenues. This runs contrary to the underlying rationale for performance-based rates, which is to reward efficiency with increased profit. Further, the utilization of a revenue deficiency account is likely to require a high degree of regulatory oversight in order to determine the appropriateness of charges to the account. The Board believes that the concept of a revenue deficiency account as proposed by Maritimes NRG is indicative of a cost of service approach to rate making, rather than performance-based rate making.

After considering the criteria set out in Section 22(3) of the **Act**, and in **GIC Regulation 15**, the Board finds that the Sempra Atlantic rate plan has more of the elements of a performance-based rate plan than that of Maritimes NRG, and accordingly, the Board accepts the rate plan of Sempra Atlantic.

## **6.5 PRICING (RATE PLAN)**

### **6.5.1 Overview**

Both applicants told the Board that, from the perspective of a customer, the full delivered cost of natural gas is one of the most important factors in considering whether to convert (the other being the capital cost to convert). Given the greenfield nature of natural gas development in Nova Scotia, potential customers will want a guarantee from the gas distribution company that

it will maintain the delivered price of natural gas below the cost of fuel oil for a significant period of time. While both applicants proposed rates that were responsive to the price of fuel oil, there are fundamental differences between their approaches.

### **6.5.2 Maritimes NRG**

Maritimes NRG proposes establishing rate classes for customers with similar consumption patterns and setting initial rates within these classes based on the forecast price of fuel oil for the year 2000. This price will be used as a benchmark to determine the price for the distribution service. The objective, according to Maritimes NRG, is to achieve a rate for the delivered cost of natural gas that is 10% below the cost of fuel oil. This rate is divided into a distribution charge and a fixed monthly charge, and is to be adjusted annually, having regard to indexed changes in the price of fuel oil.

### **6.5.3 Sempra Atlantic**

Sempra Atlantic proposes that the delivered cost of gas will be at least 5% less than the price of fuel oil. Sempra Atlantic acknowledges that, in order to attract customers, savings will have to be greater than 5%, and the company stressed that its ability to ensure this saving is passed on to customers is fundamental to the success of the project. It states that this challenge, and the uncertainty surrounding the willingness of marketers to serve residential consumers, is the reason for its initial request to be permitted to sell gas.

### **6.5.4 Findings**

The Board finds that the rate plan put forward by Sempra Atlantic best serves the public interest. This plan offers a guarantee of savings, places all the risk on the company and contains more of the features of performance-based rates than the rate plan of Maritimes NRG. In view of this finding, it is not necessary to address in depth other issues relative to Maritimes NRG's plan.

Although the Board approves Sempra Atlantic's rate plan for the most part, it does have several concerns which are addressed in Sections 6.6, 6.7 and 6.8. Specifically, the Board wishes to comment on the following aspects of Sempra Atlantic's rate plan:

- Term of the Rate Plan;
- Profit Sharing and Return on Equity;
- Discounts and Rate Cap.

## **6.6 TERM OF RATE PLAN**

The Board finds that it is in the public interest to approve the 20-year term for the rate plan as requested by Sempra Atlantic. While the term is lengthy, the unique nature and challenges of greenfield development in Nova Scotia render a 20-year term acceptable in these special circumstances.

## **6.7 PROFIT SHARING AND RETURN ON EQUITY**

The annual sharing feature proposed by Sempra Atlantic is one which the Board accepts as an important aspect of performance-based rate plans. Sempra Atlantic has proposed that all annual returns on equity in excess of 20% are to be shared equally between the company and ratepayer. The Board is to determine whether the ratepayers' share should be used to reduce the delivered cost of gas, or to fund extensions to the distribution system. Since it is not expected that annual returns will exceed the 20% level until well into the term of the rate plan, the actual method of disposing of the ratepayers' share need not be decided at this time.

Under the Sempra Atlantic plan, as currently proposed, there is no upper limit on the amount of the excess annual return or cumulative average return which the company can earn. The Board does not believe it is in the public interest to approve this aspect of the rate plan. While it is reasonable for the company to receive a return in proportion to the degree of risk it bears, the Board believes that a ceiling on any excess return is necessary. As a condition of franchise award, Sempra Atlantic must accept the following modification to its plan:



- 1) For earnings in excess of an annual 20% return on equity but less than 30%, sharing will be on a 50/50 basis. Annual returns in excess of 30% will be shared on the basis of 75% to the credit of the ratepayer and 25% to the credit of Sempra Atlantic.
- 2) If at any time during the initial 20 year rate plan Sempra Atlantic's cumulative average return on equity reaches 14%, Sempra shall file, within six months of its year end, a five year financial outlook.
- 3) The Board accepts Sempra Atlantic's projected cumulative average rate of return of 15.2% as a reasonable rate of return on equity. However, the cumulative average return on equity cannot exceed 20% at any time during the 20 year term of the rate plan. If, prior to the end of the 20 year term, it appears that Sempra Atlantic may reach this limit, the Board reserves the right to call the company before the Board to review the issue of excess revenues and to make such amendments to the rate plan as the Board deems necessary to ensure that the cumulative average return on equity will not exceed 20% for the remainder of the term of the rate plan.

## 6.8 DISCOUNTS AND RATE CAP

The Province's Policy Statement dated November 3, 1998 dealing with maximizing benefits from natural gas delivery states, in part, as follows:

*Nova Scotia could enjoy up to a 20% discount on transmission tolls relative to New Brunswick due to a discount in tolls and the Nova Scotia Gas Market Development Initiative. This discount will ensure Sable gas is delivered from the Maritimes & Northeast Pipeline at the lowest available delivery charge. This cost advantage should encourage demand for natural gas and, as a result, improve the business case for build out by the franchise holder.*

These discounts are described in the text of the Memorandum of Understanding between the Province, Sable Offshore Energy Project Producers (SOEP), Nova Scotia Power Inc. (NSPI), and M&NP dated December, 1997 and in the Joint Position document of July, 1997. Based upon the evidence in these proceedings, there are two distinct discounts which apply to Nova Scotia. The first discount is the M&NP toll reduction. This discount, as the Board understands it, is for a period of ten years (10% per year for the first 8 years and 4% per year for the last 2 years) and will reduce the cost to Nova Scotia shippers on the M&NP system. Since the definition of "shipper" is

unclear at this time, there is corresponding uncertainty as to how this discount will flow to consumers in Nova Scotia.

The second discount for Nova Scotia customers relates to a market development fund negotiated by the Province and SOEP. However, since the details of this fund have not been made public, there is some uncertainty as to the initial magnitude of the fund and how it will be distributed to gas customers in Nova Scotia. From the Policy Statement issued by the Province, it appears that the total annual discount, including the M&NP discount, equals 20% of the annual M&NP toll.

The Petroleum Directorate stated in its final brief that the intent of the discounts is to reduce the delivered cost of gas to Nova Scotia users. Due to the time limits on the availability of these discounts, while they could be incorporated in setting delivery rates, the Petroleum Directorate recommends that the initial rate cap be established without factoring in the discounts.

The Board appreciates the position of the Petroleum Directorate regarding the use of the various discounts. As previously discussed, the Board has established an overall cap on Sempra Atlantic's cumulative rate of return on equity. Given the level of committed investment in infrastructure by Sempra Atlantic and the virtual certainty of considerable losses in the early years, the Board believes that Sempra Atlantic should be provided the opportunity to achieve a reasonable return on its investment over the life of the rate plan. However, given the apparent uncertainty about specific application of the discounts, the Board is not prepared to make a determination, at this time, as to whether Sempra Atlantic's initial rate cap should take these discounts into account. The Board directs Sempra Atlantic to undertake a review of the application of these discounts with the appropriate parties and file with the Board, prior to the commencement of delivery of natural gas to customers in Nova Scotia, its recommendations as to the appropriateness of including discounts in the determination of its rate cap, as well as its recommendations concerning the use of the discounts in relation to its rate plan to ensure, at a minimum, a 5% discount off the current price of fuel oil. The Board accepts the change in headroom from 10% to 15% in the calculation of Sempra Atlantic's rate cap.

## **7.0 M&NP LATERAL POLICY - OVERVIEW**

A recurring topic at the hearing concerned the creation and application of the M&NP lateral policy. The applicants held widely divergent views on the merits of using the policy.

Essentially, according to the limited evidence before the Board, the policy was developed by M&NP and endorsed by the NEB. Theoretically, the lateral policy provides for the addition of pipeline facilities (i.e. branch lines off the main pipeline) to markets within the Maritime Provinces to be built by M&NP, with the cost of such extensions to be paid for by all customers on the mainline, including shippers to the United States. This policy was developed in conjunction with the decision to establish a postage stamp toll methodology for the M&NP pipeline. The NEB agreed with M&NP that the Maritime Provinces should be considered as one market region and that the introduction of the lateral policy, coupled with the postage stamp toll, would assist the development of natural gas markets in the Maritimes. Provided certain economic tests are met, (and the application of these tests appears to be evolving in view of the evidence before the NEB in the Halifax lateral hearing), the cost of constructing laterals would be offset by the revenue generated from the additional volumes of gas flowing through the system. The cost of these lateral facilities would be “rolled in” to the existing M&NP tariff.

The NEB is the body which approves any such lateral extension through the use of the M&NP lateral policy, and the Maritime Provinces would essentially be considered as one indivisible region for purposes of assessment by the NEB. It also appears that there are various interpretations of the economic tests being advanced by parties before the NEB and that the NEB has decided to review the applicability of the lateral policy on a case by case basis rather than deal with its application on a generic basis.

Both New Brunswick and Nova Scotia clearly have an interest in expansions to the M&NP system under the lateral policy, as would all users of the system including US shippers, and these parties could intervene in the NEB process. Indeed, this was the case in the recent NEB hearing on the Halifax lateral as reflected in the evidence filed as part of the record before the Board. In that proceeding, the Province of New Brunswick objected to the approval of the Halifax lateral in the absence of a condition being placed on the approval to ensure that the full risk of the \$31 million customer contribution in aid of construction would not fall on mainline shippers.

## **7.1 MARITIMES NRG**

Maritimes NRG based its application on extensive use of the M&NP lateral policy. Significant components of the distribution system's transmission facilities proposed by Maritimes NRG (in the order of \$200 million) would be constructed, owned and operated by M&NP. Provided these facilities meet the M&NP toll test, their cost would be rolled in to the overall capital costs of M&NP, and recouped from all M&NP system users, including those shippers moving natural gas to New Brunswick and the United States. Maritimes NRG asserts that it will contract for sufficient long term capacity, if necessary, in order to meet the toll test. Maritimes NRG argues that, provided it contracts for capacity for a term of sufficient length on M&NP (25 years or greater), these lateral facilities to Nova Scotia communities can meet the M&NP toll test. Maritimes NRG further argues that since the facilities will be rolled into the costs of the M&NP system, its proposal will in fact save Nova Scotia gas users approximately \$200 million in facility costs, which costs will be shared among all users on the M&NP system.

## **7.2 SEMPRA ATLANTIC**

Sempra Atlantic argues that there is great uncertainty surrounding the application of the lateral policy. Sempra Atlantic points to the intervention at the Halifax lateral hearing by the Province of New Brunswick, and the lack of consensus on the application of the lateral policy by parties at the Halifax hearing, as clear indications of this uncertainty. Further, Sempra Atlantic stated that its plan does not rely on subsidies by others and, accordingly, it does not require the use of the M&NP lateral policy to undertake the construction of its system. The company submitted that if economic tests, such as the enduring market concept, have any validity at all, they should apply to a large metropolitan area such as Halifax. If the position taken by the Province of New Brunswick with respect to contributions in aid of construction should prevail with the NEB in future applications, then it is unlikely that the M&NP lateral policy would ever be of any assistance to rural Nova Scotia.

### 7.3 FINDINGS

The Board finds little substantive evidence before it as to the potential use of the lateral policy, beyond the existing laterals to Point Tupper, Halifax, and Saint John. Since M&NP withdrew from participation in this hearing, and no evidence was presented on its behalf, the Board is left with no definitive information from M&NP concerning the lateral policy. The letter dated July 14, 1999 (Ex. A5-114) from the President of M&NP to Maritimes NRG is not particularly helpful in this regard.

The Board has been told by witnesses at the hearing that relevant information concerning the M&NP lateral policy, particularly in respect of its effect on available capacity and tolls, may be available to parties participating in the M&NP tolls and tariffs task force. However, in testimony and in response to Board Undertaking 18 (Ex. A5-144), Maritimes NRG indicates that discussions at these meetings are confidential to the members of the task force, and cannot be shared with the Board. While the Board can understand the need for some confidentiality respecting the negotiating position of various parties, it is difficult to review an issue as important as the lateral policy in a public forum when pertinent information concerning it is withheld from the Board and other parties who are not part of the M&NP tolls and tariffs task force.

Accordingly, the Board is left to draw inferences based on an incomplete record with respect to the lateral policy. The evidence raises grave doubts as to the usefulness of the lateral policy as a vehicle for expansion of the Nova Scotia distribution system to areas outside of Metro Halifax and Point Tupper. The Board is not persuaded that the NEB will accept the proposition that a shipper or group of shippers on M&NP in a particular region will be subsidized by other shippers to the extent that has been suggested by Maritimes NRG.

The Board believes that there is also some question as to whether the existing contracted pipeline capacity can support the additional volumes contemplated by Maritimes NRG. While witnesses for Maritimes NRG attempted to clarify this issue, the only real insight into the impact of additional contracted gas volumes on the main pipeline was provided by Irving Oil witnesses who appeared in the last days of the hearing to give evidence about marketing and supply issues. They were cross-examined by Board Counsel, and, after hearing their evidence, the Board

has an unanswered concern that an increase in the current contracted capacity of M&NP, in the magnitude suggested by Maritimes NRG, to serve the Nova Scotia market, would necessitate a mainline expansion. This expansion could take the form of the addition of compressor stations, or looping of sections of the existing pipeline. The Board understands that, should this type of expansion be undertaken, the existing lateral policy would be subject to renegotiation and change.

In the Board's judgment, the potential for review of the policy itself, the distinct possibility that arguments such as those put forward by the Province of New Brunswick at the Halifax lateral hearing might be found to be persuasive by the NEB in future applications, and the approach by the NEB in determining applicability on a case by case basis, are all reflective of the uncertainty surrounding the lateral policy issue. The Board finds that insufficient evidence on this issue was presented by Maritimes NRG, the only province-wide applicant at the hearing advocating the use of the lateral policy, to persuade the Board that the lateral policy is a reliable and effective means of constructing transmission lines in Nova Scotia at this time.

The Petroleum Directorate's final submission, which suggests that the lateral policy could be beneficial to a gas distributor, has not provided any concrete information or guidance on the application of the lateral policy. The Board is aware that staff of the Petroleum Directorate participate on the M&NP tolls and tariffs task force and have specialized knowledge of these issues. However, the Board notes that references to the lateral policy in the Directorate's brief are couched in the language of possibilities rather than certainty. They do not provide the Board with definitive answers to fundamental questions concerning application of the lateral policy.

Even if the Board were to assume that the lateral policy will work exactly as Maritimes NRG predicts, it believes there are significant public interest considerations which could negate the value of the policy in Nova Scotia. Due to the requirement for NEB hearings, with the likely intervention of other parties and uncertainty of result, there could be significant delays or even cancellation of the construction of transmission facilities required to meet the provincial access targets in a timely manner. Nova Scotia would cede any claim to jurisdiction it might have with respect to the laterals to the federal government.

Sempra Atlantic proposes to build a distribution system that does not rely on M&NP

shippers to subsidize its construction or require approval by federal regulatory authorities. This independence offers considerable long term benefit to the residents of Nova Scotia and, in the Board's view, has to be carefully balanced against unsubstantiated savings which might be available under a lateral policy which is administered by a federal regulator and which may not be capable of application to many parts of Nova Scotia.

The Board remains unconvinced that the M&NP lateral policy will ensure the maximum penetration of natural gas throughout Nova Scotia in a timely manner or that tolls will be lower than they otherwise would be. That said, and notwithstanding the many uncertainties associated with the application of the lateral policy to the roll-out of a gas delivery system in Nova Scotia, if, in the future, the concerns outlined by the Board have been adequately dealt with, the Board would not preclude Sempra Atlantic from taking advantage of the policy should it determine that it makes good business sense to do so.

## 8.0 SOCIO-ECONOMIC IMPACT STATEMENT AND BENEFITS PLAN

The relevant sections of the **GIC Regulations** governing the Board's responsibility with respect to the socio-economic impact statements and benefits plans are set out below.

### *Franchise evaluation*

5 . . . . the Board shall not grant a franchise over an area unless

- (c) *the applicant has submitted to the Board a Socio-Economic Impact Statement that shall include*
  - (i) *a benefits plan, together with a written undertaking that if the applicant is granted a franchise, the applicant will take all reasonable measures to implement the benefits plan,*
  - (ii) *evidence that the applicant is fully aware of any significant socio-economic effects of the proposed franchise, has measures in place to mitigate adverse socio-economic impacts and promote positive outcomes, and is committed to carrying out those measures in order to ensure that the franchise benefits the people directly affected by it with minimal*

- (iii) *disturbance to desirable aspects of their way of life, the probable benefits of the construction and operation of the delivery system, and*
- (iv) *the nature and extent of the impact of the sale and consumption of natural gas within the proposed franchise area;*

(d) *the benefits plan has been approved by the Board;*

**7(1)** *The Board shall not approve a benefits plan unless the plan provides that*

- (a) *the applicant will establish in the Province an office where decisions are made at a level of authority that the Board considers appropriate;*
- (b) *the applicant and its contractor shall train and employ persons residing in the Province unless the applicant can demonstrate that all reasonable efforts to employ and train persons residing in Nova Scotia have been explored and exhausted requiring the recruitment and hiring of persons residing outside the Province;*
- (c) *where the Board considers appropriate, the applicant will carry out a program and make expenditures for the promotion of education and training in the Province;*
- (d) *the applicant and its contractors will contract for services to be provided from within the Province and procure goods manufactured in the Province, where those services and goods are competitive in terms of fair market price, quality, performance and delivery;*
- (e) *the majority of the applicant's Board of Directors are residents of Nova Scotia; and*
- (f) *if the applicant is not a municipality, residents of Nova Scotia shall have a meaningful and significant opportunity to participate in the ownership of the applicant by the end of the tenth year of the franchise.*

**(2)** *Subject to subsection (1), the Board may approve a benefits plan if, in the Board's opinion, it would be in the public interest to do so.*



- (3) *The Board may make the approval of a benefits plan subject to such terms and conditions as are specified by the Board at the time the benefits plan is approved.*

## **8.1 MARITIMES NRG**

Maritimes NRG provided evidence to the Board of the importance of natural gas generally to the provincial economy, as well as the specific benefits of the Maritimes NRG plan. The company commissioned studies by consulting firms which examined the potential employment, environmental, economic and social impacts of the introduction of natural gas to Nova Scotia under the Maritimes NRG plan. Employment will be generated by system construction, as well as the ongoing operation of the Halifax head office of Maritimes NRG (where the President of the company will be located), and in regional offices. Maritimes NRG argues that its slower paced roll-out plan will prove to be an advantage in that more time is available to train Nova Scotia residents and this will create more opportunity for employment of local workers in the long run. Maritimes NRG will implement policies whereby goods and services are procured wherever possible from Nova Scotia businesses. The company has engaged in an extensive public information program promoting its plan to bring natural gas to Nova Scotia. Maritimes NRG provided a list of public information sessions which it held, and committed to continue information dissemination to various groups including First Nations communities. It also submitted information regarding consultation with community groups, as well as a Memorandum of Understanding with the Nova Scotia Community College to undertake various training programs. The applicant has proposed that local ownership of up to 20% of the company can be achieved through the creation of a voluntary co-operative, membership in which will be open to all customers of Maritimes NRG. The Board of Directors of Maritimes NRG will select one of the co-op Board Members to sit on the Maritimes NRG Board.

## **8.2 SEMPRA ATLANTIC**

Sempra Atlantic's approach to benefits was fairly similar to that of Maritimes NRG. It commissioned expert reports from consultants who reported on the potential economic, social, employment and environmental impacts of natural gas on the Province. Sempra Atlantic's benefits

plan is based on the construction and operation of a \$1.1 billion project, as well as related infrastructure improvements and the benefit of an alternate energy source. Sempra Atlantic plans to provide training and employment for Nova Scotia residents, and promises to procure goods and services from local sources wherever possible. It states that recruitment of non-Nova Scotians will occur only after all other alternatives are exhausted. Arrangements for the training of students interested in careers in the gas industry are currently being discussed with the Nova Scotia Community College. Sempra Atlantic will also provide safety training for fire and police officials, and proposes to operate under a Nova Scotia content regime which is similar to, but better than, that currently in place with the SOEP group.

Like Maritimes NRG, Sempra Atlantic has undertaken an extensive public consultation program including meetings with fuel oil dealers, appliance contractors, community groups, municipal officials and First Nations Groups.

Sempra Atlantic commits to employ approximately 350 people in its Halifax head office and across the Province in the operation of its system. It commits to locate a call centre in Cape Breton, as well as at least two regional offices in the Province. Sempra Atlantic also commits to a meaningful opportunity for up to 49% ownership by Nova Scotia residents, and states that specific Nova Scotia ownership details will be filed within 90 days of approval by the Governor in Council of the grant of franchise by the Board. Sempra Atlantic has already appointed a Board of Directors, the majority of whom are Nova Scotia residents.

### **8.3 FINDINGS**

It is the view of the Board that, since **GIC Regulation 5(c)(i)** requires a written undertaking that the applicant will take all reasonable measures to implement the benefits plan, it follows that an applicant must, at a minimum, make a clear commitment to Nova Scotians that the gas distribution system proposed will be constructed. As has been noted earlier in this decision, in several instances the evidence of Maritimes NRG makes it abundantly plain that the company is not providing an unequivocal commitment to build its base system. The company's plans are subject to economic conditions.

The Board finds that Maritimes NRG's application does not provide the requisite degree of certainty that residents of the Province will get the maximum benefit from their natural gas resource. If economic conditions are unfavourable, it is quite possible that elements of Maritimes NRG's base system will not be constructed. The Board is also concerned that Maritimes NRG's proposal for an annual review of its construction plans could be both onerous and divisive. The Board believes that this annual review would have the potential to degenerate into an annual conflict among various communities of the Province, pitting region against region in the competition for timely access to gas. Further, it is not clear to the Board what the outcome would be should the Board disagree with the annual plan submitted by Maritimes NRG.

As a result of Sempra Atlantic's unequivocal commitment to build-out the system for four full years, regardless of economic conditions (only after the fourth year can the regulatory adjustment mechanism be triggered), there is a better likelihood, in the Board's view, of maximizing the benefits of natural gas for Nova Scotia. The Board is satisfied that Sempra Atlantic's socio-economic impact statement and benefits plan meet the regulatory criteria set out at the beginning of this Section. Accordingly, the Board approves them, subject to the following modifications:

- a) Sempra Atlantic is directed to expand the definition of a Nova Scotian (only in respect of measurement of staffing levels for full time employment). Currently the definition is based on eligibility to vote (i.e., six month residency). The Board believes it should be expanded to include individuals who were born in Nova Scotia. The Board considers that it is important to not only provide employment opportunities to individuals who are currently residing in Nova Scotia, but to provide an opportunity to attract back to Nova Scotia former residents who have left to obtain employment outside of Nova Scotia.
- b) Sempra Atlantic is directed to file with the Board its plans to establish a call centre in Cape Breton and its plans to establish regional offices.
- c) The Board expects Sempra Atlantic to engage in aggressive public information/consultation efforts to promote the safe use of natural gas. Sempra is required to file a copy of all written information to be used by the company in the promotion of natural gas, such as advertisements, educational brochures, etc.

## **9.0 FINANCIAL CAPABILITY AND RELATED EXPERIENCE**

The relevant statutory provisions governing the Board's responsibility in making a determination on the issues of financial capability and experience are as follows:

**8 (2)** *Before granting a franchise, the Board shall be satisfied that the granting of the franchise is in the public interest and shall take into consideration ....*

*(d) the financial capability of the applicant;*

*(e) related experience of the applicant in the delivery of gas.*

## **9.1 MARITIMES NRG**

The information initially provided by Maritimes NRG concerning the financial capability of its sponsors consisted of the annual report of Westcoast Energy Inc., and a letter from Arthur Irving, President of Irving Oil Ltd., (Ex. A5-91(B)). The letter, dated June 21, 1999 reads in part as follows:

*I, Arthur Irving, am an authorized official of Irving Oil Limited, and represent the Sponsor in respect of Maritimes NRG (Nova Scotia) Limited (the "Applicant").*

*The Sponsor has read and understands Maritimes NRG's Application for a province-wide franchise to distribute natural gas in Nova Scotia, including all errata, responses to information requests, and rebuttal evidence made by the Applicant (collectively, the "Application").*

*As one of the sponsors of Maritimes NRG (Nova Scotia) Limited, Irving Oil Limited is committed to facilitate the implementation of Maritimes NRG's "Rollout Plan". Based upon the Application, Irving Oil Limited is highly confident that it will be able to arrange for funding to enable Maritimes NRG to develop the "Rollout Plan".*

Maritimes NRG also proposed to make available a \$10 million bank letter of credit to secure its obligations. Maritimes NRG refused to provide Irving Oil's financial statements to the Board. While the company did make some additional financial information concerning Irving Oil available on a confidential basis, the Board was told that Irving Oil is a privately held company whose financial statements have never been made public. Maritimes NRG argues that Irving Oil's

commitment and financial capability is demonstrated by its extensive corporate presence in Nova Scotia for more than 75 years.

## 9.2 SEMPRA ATLANTIC

Sempra Atlantic filed its parent company's (Sempra Energy) Annual Report for the year ending 1998, including financial statements. Sempra Atlantic's witnesses assured the Board that Sempra Energy has extensive borrowing capability and adequate resources to finance the project internally if necessary. In addition, a resolution of Sempra Energy's Board of Directors dated March 2, 1999 (Ex. A1-6) was filed which authorized the expenditure of \$703 million US (\$1.1 billion CDN) to construct a gas delivery system in accordance with the application as filed. The resolution reads as follows:

*WHEREAS, the officers of Sempra Atlantic Gas ("SAG"), a wholly owned subsidiary of Sempra Energy Utility Ventures ("SEUV"), a wholly owned intermediate subsidiary of this corporation, have prepared and filed an application for award of an exclusive franchise to the Nova Scotia Utilities and Review Board (the "Application") seeking award of a franchise to provide local natural gas distribution service to the Province of Nova Scotia, Canada (the "Franchise"), which Application and Franchise have been described to this Board of Directors; and*

*WHEREAS, the officers of SAG, in consultation with the officers of SEUV and the officers of this corporation, will negotiate the terms and conditions of the Franchise based on the Application and evidence adduced in public hearings on the Application memorializing the proposed terms of the Franchise;*

*RESOLVED, that the proposed terms and conditions of the Franchise set forth in the Application, as described to this Board of Directors, are fair and in the best interest of the corporation and the proper officers of the corporation are hereby, and each of them acting alone hereby is, authorized and directed to confer with the officers of SAG and SEUV to authorize them to execute and carry out the terms of the Franchise in the name of SAG, in a form and upon the terms substantially as described to this Board of Directors.*

*RESOLVED, that this corporation is hereby authorized to confer with the officers of SAG and SEUV, and authorize them to expend up to \$703 million to fund the construction and operation of the distribution service contemplated by the Franchise.*

*RESOLVED, that any and all prior actions taken by the officers of this corporation, and any one of them, in connection with the actions authorized by these resolutions are hereby ratified, confirmed and approved; and*

*RESOLVED, that the officers of this corporation, and any one of them, is hereby authorized and instructed to execute any and all documents and perform any and all additional acts which may be necessary or appropriate in order to carry out the forgoing resolutions.*

*Sempra Energy Board of Directors - March 2, 1999*

### **9.3 FINDINGS - FINANCIAL CAPABILITY**

The Board considers that in order to discharge its responsibility under the above-noted statutory requirement, it must have access to sufficiently detailed financial information about an applicant, or its sponsor. The Board has to form an opinion of the financial capability of the applicant in order to be satisfied that the applicant is able to undertake the construction and operation of the facilities outlined in the application.

The financial information from Westcoast became of limited relevance when the Board, during cross-examination of Maritimes NRG witnesses, learned that Irving Oil was to be the sole financial investor and shareholder in the project. The withdrawal of Westcoast as a financial sponsor of Maritimes NRG created an even greater onus on Irving Oil to ensure adequate financial information was made available.

The Board understands the reluctance of a privately held firm to disclose confidential information. However, the process for awarding a natural gas franchise in Nova Scotia has been determined by legislation to be a public process. Fairness, openness, and transparency are important principles for the Board to observe so that it is clear to all that the details of each franchise application have been properly scrutinized in a full and thorough manner.

After a review of the Annual Report of Sempra Energy, and the evidence of Sempra Atlantic witnesses respecting the financial issues, the Board finds that Sempra Atlantic has satisfied the requirements of the **Act** relating to financial capability.

The Board panel, subsequent to the hearing, received and reviewed evidence

submitted by Maritimes NRG, on a confidential basis, concerning the financial capability of Irving Oil. The Board finds that the evidence, while somewhat helpful, is not sufficient to satisfy the requirements of Section 8(2) of the Act because it does not enable the Board to reach a conclusion as to Maritimes NRG's financial capability.

The Board wishes to make it clear that it is not disqualifying Maritimes NRG solely on this issue. Rather, the failure to disclose adequate financial information weighs against Maritimes NRG in the consideration of its overall application. Maritimes NRG has expended much time, effort, and expense in this proceeding, as have other parties and participants. The Board believes that in keeping with the principles of fairness, openness, and transparency, a reasoned decision with a full assessment of the merits of the various components of each application best serves the public interest.

#### **9.4 FINDINGS - EXPERTISE AND EXPERIENCE**

It is not necessary in the Board's view to summarize the evidence of the parties relating to expertise and experience. Both proponents stand unchallenged as having the requisite expertise and experience to build a gas distribution system in Nova Scotia. Accordingly, the Board is satisfied that both Maritimes NRG, through the experience of its staff, advisors, and Westcoast's commitment of technical expertise, and Sempra Atlantic, through its staff, advisors and sponsors, have the requisite experience and expertise to safely construct and operate a gas distribution system in Nova Scotia.

#### **10.0 SEPARATION OF DELIVERY AND SALES FUNCTIONS**

Both Maritimes NRG and Sempra Atlantic requested the ability to buy and sell natural gas under certain circumstances. Both parties' rate design mechanisms were developed to facilitate a saving in the delivered price of natural gas to customers relative to the price of fuel oil. However, only Sempra Atlantic requested a licence to sell natural gas to consumers so as to ensure that its rate plan would achieve a minimum 5% saving off the prevailing price of fuel oil.

The Board denies this request and directs Sempra Atlantic to conduct the purchase and sale of natural gas through a separate affiliate or subsidiary. The Board believes the introduction of a marketing affiliate will permit Sempra Atlantic to accomplish its pricing objectives, as well as send a clear message that the delivery and sales functions are indeed separate.

The Board's view is that 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. **Section 30** of the **Act** states as follows:

*Restriction on power to issue licences*

**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 licence 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 licence pursuant to this Part.*

Further, **GIC Regulations 5(e)** and **13(1)(j)** establish requirements which are designed to foster competition in the sale of natural gas:

**5** . . . . *the Board shall not grant a franchise over an area unless*

**(e)** *the applicant has provided commitments satisfactory to the Board to encourage competition among agents, marketers and brokers in the sale of gas within the proposed franchise area by specifying,*

**(i)** *in a code of conduct filed with the Board, the relationship between the applicant and any marketing affiliate and the degree of separation between the applicant and any marketing affiliate, and the steps the applicant proposes to take to ensure that its marketing*



*affiliate gains no competitive advantage as a result of its affiliation with the applicant, and*

- (ii) the availability to all affiliated and unaffiliated marketers of detailed market information including name, address, telephone number and energy usage of customers and potential customers in the proposed franchise areas; and*

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

- (i) 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;*

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 Sempra 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.

In directing Sempra Atlantic to fully separate its delivery and sales functions, the Board wishes to make it clear that there is no intent to frustrate the success of Sempra Atlantic's rate plan. The appropriate degree of separation between these activities, and the code of conduct governing Sempra Atlantic's relationship with its marketing affiliate, will be examined in greater detail in Phase II. In the Board's view, however, the code of conduct should not be used to frustrate

Sempra Atlantic's objective of providing savings to prospective natural gas customers nor should it impair Sempra Atlantic's ability to attract potential customers to its system and achieve its stated goal of exceeding the provincial access targets. The Board recognizes the immense capital investment that Sempra Atlantic will have to make in its distribution system and it has to be able to ensure that maximum efforts are being undertaken to obtain customer conversions. The Board expects that, as Sempra Atlantic's system build-out plan is achieved and a competitive natural gas market develops, there may be a need to re-examine the code of conduct.

Both Sempra Atlantic and Maritimes NRG filed proposed codes of conduct to govern their dealings with affiliates. While Maritimes NRG's code is more detailed than Sempra Atlantic's, the Board is satisfied that Sempra Atlantic's code is sufficient to ensure non-affiliated parties will be treated in the manner required by the **Act** and **GIC Regulations**.

The Board expects to hear additional evidence from interested parties regarding Sempra Atlantic's proposed code of conduct in Phase II of these proceedings. Irving Oil raised a concern respecting interaction between Sempra Atlantic and an affiliate marketer that could potentially restrict competition. Irving Oil fears that, since Sempra Atlantic's transportation rates are linked to changes in the price of fuel oil, a Sempra Atlantic marketing affiliate could undercut the price of natural gas without negatively impacting the Sempra group's overall bottom line. Irving Oil believes this creates the potential for unfair competition. It is the Board's view that the natural gas market in Canada and the United States has developed to the point where there is sufficient competition to force transparency in gas pricing. Irving Oil's concern has been noted, and the Board will be monitoring the natural gas market in Nova Scotia. In addition, the Board will closely monitor the operation of Sempra Atlantic's rate plan to ensure that all marketers are treated in a fair and equitable manner and will hear complaints concerning any cross-subsidization or other misapplication of the Sempra Atlantic rate plan.

## **11.0 CONCLUSIONS CONCERNING PROVINCE-WIDE FRANCHISE APPLICATIONS**

The Board has determined that Sempra Atlantic be granted a full regulation class

franchise for the Province of Nova Scotia, and that all other franchise applications be denied.

Sempra Atlantic's application was chosen over its principal competitor, Maritimes NRG, because:

1. Sempra Atlantic has provided an unequivocal commitment to build-out its planned distribution system for at least four full years. Maritimes NRG has refused to provide such a commitment, indicating that, each year, the following year's build-out plan is subject to an economic feasibility test. While Sempra Atlantic has requested that there be a regulatory adjustment mechanism which could be invoked to delay further construction if the price spread between fuel oil and gas falls below \$3.50/GJ, it would only become effective after four full years of system build-out during which time a significant portion of the transmission facilities will have been constructed.
2. Sempra Atlantic has committed to build a gas distribution system that will meet or exceed the provincial access targets in each of the 18 counties within seven years. Maritimes NRG, on the other hand, has indicated it will meet or exceed the provincial access targets in only five of the 18 counties (assuming growth in the number of households) within the seven year period. Consequently, Maritimes NRG has requested an exemption from complying with the required access targets, stating that it is not financially feasible to do so. Further, Maritimes NRG has not even committed to build its base system.

The Board is satisfied that Sempra Atlantic's proposal meets the access targets. Clearly, the intent of the **GIC Regulations** is that access to natural gas is to be provided in all counties. Maritimes NRG's plan does not provide any access in four of the counties, and does not meet the required access targets in another nine counties. The Board is not convinced that it would be in the public interest to grant Maritimes NRG's request to be exempted from the application of the access targets.

3. Maritimes NRG's application relies heavily on the M&NP lateral policy for purposes of constructing transmission facilities. Maritimes NRG argues that since the cost of these facilities will be rolled into the M&NP toll, pursuant to the lateral policy, Nova Scotia gas users will save approximately \$200 million, which costs will be absorbed by all shippers on the system, including M&NP's customers in New Brunswick and the United States.

The lateral policy was debated at great length during the hearing. However, the Board finds that insufficient evidence was presented on this issue by Maritimes NRG and the Board is not persuaded that the lateral policy can be relied upon to ensure the timely construction of transmission facilities in Nova Scotia.

4. Sempra Atlantic and Maritimes NRG arrived at different consumption estimates for purposes of calculating their revenue projections. While both parties have used reasonable methods to develop their estimates, the Board recognizes that there are likely to be inaccuracies in any estimates based on market analysis. Since these estimates directly affect revenue projections, the Board must be cognizant of its responsibility to protect customers from unnecessary risk.

In the case of Sempra Atlantic, the proposal to develop a gas distribution system is financed in total from corporate resources or corporate borrowing. No subsidy or other indirect financial assistance to build the system is sought or suggested. In the case of Maritimes NRG, while a subsidy is not sought as part of the application, losses incurred in building and operating the gas distribution system are proposed to be accumulated in what is called a revenue deficiency account. Maritime NRG's plan is subject to the condition that the company will be permitted to eventually recover, from future ratepayers, all accumulated losses tracked through this account so as to ensure a cumulative 11% rate of return on equity. The ratepayers, therefore, ultimately bear the risk of Maritimes NRG's losses, including those losses which occur as a result of lower than expected penetration rates or consumption levels.

Sempra Atlantic, on the other hand, does not assume a guaranteed recovery of revenue deficiencies, or losses. Losses incurred in building and operating the gas distribution system are at the risk of Sempra Atlantic, which seeks only the opportunity to recover such losses through the potential for higher returns in later years, which are by no means assured. The company has committed to construct its system as planned, regardless of losses, for the first four full years.

5. Sempra Atlantic has guaranteed that the delivered cost of natural gas to customers will be at least 5% less than the price of fuel oil. While Maritimes NRG has indicated that the delivered cost of natural gas to customers will likely be 10% less than the price of fuel oil, it is not prepared to guarantee any particular level of savings. The Board finds that since Sempra Atlantic provides a guaranteed saving, customers face less exposure to risk under its plan.
6. The Board has also considered the issue of financial capability to undertake the project. The Board finds that, based on the evidence submitted, Sempra Atlantic has satisfied the requirements of the **Act** relating to financial capability. While Maritimes NRG did submit certain financial information, on a confidential basis, the Board finds that the evidence, while somewhat helpful, is not sufficient to satisfy the requirements of the **Act**, and does not enable the Board to reach a conclusion as to Maritimes NRG's financial capability.

In view of the above factors, and after considering all the issues set out in this decision, the Board finds that the public interest is best served by choosing Sempra Atlantic to be the Province's distributor of natural gas.

Accordingly, pursuant to Section 8 of the **Gas Distribution Act**, the Board grants a full regulation class franchise to Sempra Atlantic for a period of 25 years subject to the terms and conditions attached in Schedule 'A'. By virtue of Section 8(3) of the **Act**, this grant of franchise is subject to the approval of the Governor in Council.



## PART TWO

### MUNICIPAL AND CO-OPERATIVE APPLICATIONS

#### 12.0 INTRODUCTION

In response to this first public request for gas distribution franchises in Nova Scotia, six municipal or co-operative applications were filed. Subsequently, two applicants withdrew. The original applicants were:

- Antigonish Community Gas Co-operative Limited
- Central Annapolis Valley Natural Gas Co-operative
- Pictou County Joint Expenditure Board (**withdrawn**)
- Town of Annapolis Royal
- Town of Berwick
- Strait Area Gas (**withdrawn**)

Since Pictou and the Strait Area withdrew their applications, it is not necessary to comment specifically on them. However, in Section 12.5, the Board will make some general observations respecting the applications filed by municipalities and co-operatives, as well as on potential future applications by municipal and co-operative applicants.

It is important to bear in mind that three of the four remaining applicants, (the Town of Berwick, the Central Annapolis Valley Natural Gas Co-operative and the Town of Annapolis Royal), are unable to access natural gas until such time as the provincial franchisee constructs a transmission lateral to serve their specific franchise areas. On the other hand, the Point Tupper lateral, which will be in close proximity to Antigonish, has already been approved. It is reasonable to conclude that gas could be available to Antigonish prior to it being available in the Annapolis Valley.

The economic and financial consequences of the dependence of the three Valley applicants upon others to provide transmission service create two problems which were not

addressed in the applications. The first relates to the requirement for a single “postage stamp” gas transportation rate to consumers. Consumers in areas proposed to be served by these applicants would pay toll charges for use of the provincial distribution system as well as the local distributor’s charges. This potentially could result in a higher transportation rate for consumers in these areas. This would be in conflict with **GIC Regulation 16(1)** which, for ease of reference, is repeated here:

*16(1) The Board shall create a single provincial rate, toll or charge for gas transportation services to consumers.*

The second problem concerns the applicants’ compliance with the provincial access targets for the counties in which these franchises have been requested. These applicants have proposed construction programs which are spread out over a period of several years after gas is first available in their respective areas. This could result in the delivery of natural gas to their proposed customers well beyond the provincial access time frame of seven years. In addition, there is no guarantee in all cases that the limited area franchise will result in the access targets for the county being achieved.

## **12.1 TOWN OF BERWICK**

The Town of Berwick submitted an application for a full regulation class franchise to supply natural gas in the Town and to adjacent parts of Kings County for a term of 25 years. As part of its application, the Town provided a description of the proposed franchise area and its boundaries, which consists of that area of Kings County covering the floor of the Annapolis Valley bounded by the Cambridge Road to the east, Aylesford Road to the west, Prospect Road to the south and Highway 221 to the north.

Financial information filed by the applicant included projections of revenue and expenses; proposed rates and operating revenues; schedule of capital expenditures and debt servicing costs; projected capital fund balance sheet; and schedule of rate base and rate of return calculations. Other material filed included a report entitled “Natural Gas Distribution Report on Generic Issues” by Campbell Ryder Engineering Ltd. of Edmonton, Alberta, prepared for the Nova Scotia Regional



Development Authorities and the Union of Nova Scotia Municipalities, dated December 1998, as well as the financial statements for the Town of Berwick for the year ended March 31, 1998. The Campbell Ryder Study did not relate to a particular franchise area in Nova Scotia. No specific engineering studies were undertaken to support the application. The Town advises that it has a low debt ratio and can arrange financing for the system through the Nova Scotia Municipal Finance Corporation.

In addition, information was provided by this applicant through responses to information requests from various parties and by witnesses on cross-examination during the proceedings.

The Town's application outlines the potential market for the franchise area. This includes 2,500 housing units, 260 businesses, seven institutions and four industrial or processing plants. Gas consumption estimates for each class of customer were provided based on the experience of distributors in other jurisdictions and material received from the Petroleum Directorate.

The Town stated in its application that its distribution system will be connected, directly or indirectly, to the Maritimes & Northeast Pipeline and further stated, "It is assumed that gas is available at the commodity price plus or minus transmission tariffs . . . ." The Town intends to establish a separate agency to perform the gas seller function.

While the Town relies on the experience and administrative capacity of the electric utility which it operates, it acknowledges that it does not have any direct experience in gas delivery. The Town plans to hire an operations manager with gas experience and two other staff.

The Town's proposal involves connecting to the provincial distribution system at a pressure reduction station. The construction of the delivery system, which is proposed to provide access to most of the potential customers in the franchise area, is estimated to cost \$3,650,000 in 1998 dollars. A six year roll-out plan is proposed with construction in stages of 20% in each of the first two years and 15% per year thereafter.

The Town filed a socio-economic impact statement which outlines the benefits of natural gas to area residents, businesses and municipal government, as well as the potential for

negative impact on competing energy providers. Local contractors would be used in system construction and goods and services would be procured locally.

The Town's intention to apply for a franchise has been reported in local media and public information sessions have been held, including consultation with representatives of Annapolis Valley First Nations.

### **12.1.1 Findings**

The Board recognizes that the information presented by the applicant, both in filings and in response to written and oral questions, represents considerable time and effort on the part of the individuals involved.

The test for this applicant, as outlined in the **GIC Regulations**, is the same as the test for the provincial applicants in terms of meeting the requirements for a full regulation class franchise. While municipal and co-operative applicants were exempted by the **GIC Regulations** from the requirement to pay an application fee, it is important to note that the **GIC Regulations** governing the granting of a franchise make no such exemption in respect of the regulatory criteria to be met.

The following response to Information Request #4 from the Town of Berwick to Geostorage, an intervenor, is cause for concern to the Board:

*We have not developed load profiles on any time base. Our projections and Proforma statements are NOT based on detailed engineering work, market surveys, or rate design but rather on generic cost of construction numbers and assumed customer acceptance rates and consumption rates. It is impossible to provide these profiles in a meaningful way on this basis.*

Similar responses by the Town to questions by other parties, including responses given by its witnesses during the hearing, indicate that the applicant has not undertaken any independent, detailed analysis concerning many of the fundamental assumptions on which its application is based.

The Board finds that, at a minimum, applicants for a full regulation class franchise must demonstrate that they have undertaken a thorough examination of all of the key factors which

support the development of a safe and reliable natural gas delivery system. This can be done either through the applicant's own staff, or as is more likely the case in a greenfield situation, through the retention of external expertise. The practice of submitting expert reports and studies which assess and support key points in a utility's application is standard in electric and water utility applications to the Board, and there should be no difference in natural gas applications.

As demonstrated by the evidence, it is clear that the applicant did not undertake sufficient independent, detailed analysis to support its application in key areas such as engineering and operational design, demonstration of financial capability, market surveys and penetration studies.

Based on the material submitted by the Town of Berwick prior to the commencement of the proceeding, and in reviewing the responses by its witnesses at the hearing, the Board has concluded that the applicant has not demonstrated it has performed the necessary due diligence to support its application, or that it has the financial capability or expertise to undertake the construction and operation of a safe and reliable natural gas delivery system.

In particular, the Board is not satisfied that the applicant undertook sufficient study of the financial requirements to construct and operate the required natural gas delivery system. The applicant presented Keith Arthur, who has been involved in the construction and operation of rural community natural gas delivery systems in Manitoba. However, the evidence indicates that these systems were developed under a different regulatory environment and required significant government subsidies. Mr. Arthur's experience, while helpful in explaining the development of rural natural gas distribution in western Canada, cannot readily be applied to the existing regulatory and fiscal realities in this province.

At this time, there is no known commitment by the Province or the Federal Government to provide subsidies or other financial assistance for the development of natural gas infrastructure in Nova Scotia. It would not be prudent for the Board to assume that public funds will be available to assist communities in the development of a natural gas system. Indeed, one of the intervenors at the hearing, COHA, argued that no subsidies should be made available in view of their inherent unfairness to suppliers of other forms of energy.

The Board has an unanswered concern that the projected financial statements may not

reasonably reflect the costs to construct and operate the system as proposed. Therefore, the Board is concerned that the granting of a gas franchise to the Town of Berwick may result in subsidies being required to build the system infrastructure and to fund the operating losses which may occur during the initial years of operation. Further, as discussed above, the residential customer may well be required to pay a higher cost for gas delivery than other consumers in the Province.

Sempra Atlantic proposes to service the Town of Berwick in its build-out plan and, in the Board's view, the ratepayers in the proposed franchise area would be best served by the province-wide distributor. Accordingly, the Board denies the application by the Town of Berwick.

## **12.2 CENTRAL ANNAPOLIS VALLEY NATURAL GAS CO-OPERATIVE**

The Central Annapolis Valley Natural Gas Co-operative, a member-owned co-operative, applied for a full regulation class franchise for the geographic area generally bounded by the Town of Berwick to the east, the Town of Middleton to the west, Highway 221 to the north, and Harmony Road to the south. The proposed franchise term is 25 years.

The application states that the potential market for natural gas consists of 4,500 housing units, 100 businesses, nine institutions and eight industrial or processing plants. The gas supply arrangements are identical to those outlined in Berwick's application, relying on an interconnection to the M&NP (direct or indirect) and on the assumption that "... being connected will make available to the system natural gas at the commodity price plus or minus transportation costs". The applicant proposes to finance the project by issuing debentures and members of the co-op will participate in the enterprise through share capital. With no in-house experience in gas delivery, the applicant plans to hire an operations manager with gas distribution experience as well as two utility operators.

The applicant estimates the cost of the construction of the delivery system to be \$5,772,405 in 1999 dollars. The construction schedule is the same as for Berwick - commencing with the construction of the main pipeline through the Annapolis Valley and extending for six years thereafter with 20% of the system being constructed in each of the first two years and 15% in each year thereafter.

A socio-economic impact statement was filed which was very similar to the one described in Berwick's evidence. Additional information regarding the inherent benefits of co-op ownership was also provided, including the unique accountability of management to membership which is characteristic of co-operatives. The application states that "This co-operative rejects special privileges from government or other agencies which will make it difficult for us to become self-sufficient".

The application briefly describes a code of conduct and refers to local media reports on the co-op's proposal, as well as public information sessions held.

Other information filed included pro forma financial statements; listing of potential customers by class; consumption forecasts; balance sheet; statement of income; capital investment summary and rate of return; revenue base assumptions and capital expenditures. Further, the Co-operative relied upon the Campbell Ryder generic study filed by the Town of Berwick. As was the case with the Town of Berwick, no specific engineering studies were undertaken in support of the application. The applicant provided additional comments on its application through the information request process and during its appearance before the Board.

### **12.2.1 Findings**

The Board recognizes the time and effort the applicant has invested in this process. While it appears that the applicant undertook some assessment of the potential market to be served, the level of examination was rather cursory and, therefore, may be subject to considerable error. Given the potential financial risk to the applicant resulting from errors in estimating market demand, the Board is not satisfied the applicant would be able to provide the requested service as anticipated in its franchise application.

Further, one of the fundamental risks and challenges for a successful natural gas franchise in Nova Scotia, which was discussed at considerable length during the hearing, is the ability of natural gas to compete with existing energy sources such as fuel oil. The applicant, in response to Board Information Request 10(c), indicated that this vital factor was not examined in the detail which the Board believes necessary, nor was it considered in the establishment of the delivery

rates. In its response, the applicant stated as follows:

*Forecasting the price of natural gas is beyond the scope of this application. Natural gas is assumed to be priced competitively to allow for projected market penetration. Profiting from the purchase and resale of natural gas was not part of the Co-Op's application.*

This provides the Board with no reasonable assurances that customers in the franchise area will be motivated to convert to natural gas.

The Board has an unanswered concern that the projected financial statements may not reasonably reflect the costs to construct and operate the system as proposed and the Board is not satisfied that the applicant has the financial capability to construct and operate the system. Accordingly, the Board is concerned that the granting of a gas franchise to Central Annapolis Valley Natural Gas Co-operative may result in subsidies being required to build the system infrastructure and to fund the operating losses which may occur during the initial years of operation. Further, as noted earlier, the residential customer could potentially pay a higher cost for gas delivery than other consumers in the Province.

This applicant's filings respecting capital and operating costs and the level of staffing required for the safe and reliable operation of its distribution system are inadequate, in the Board's view, to satisfy the **GIC Regulations**. While there may be a desire by communities to own and operate gas delivery systems, this goal should not be realized at the risk of the area's residents being unable to access natural gas in a reasonable time frame and at a competitive price.

Accordingly, the Board denies the application of Central Annapolis Valley Natural Gas Co-operative. The Board notes that Sempra Atlantic, in its build-out plan, is scheduled to service the geographic area included in this franchise application more quickly than this applicant proposes, and at a price for natural gas guaranteed to be a minimum of 5% lower than fuel oil, with the risk that the system will not be successful being borne by Sempra Atlantic.

## **12.3 TOWN OF ANNAPOLIS ROYAL**

The Town of Annapolis Royal applied for a full regulation class franchise to distribute natural gas within the town boundaries for a term of 25 years. The Town described the potential market for natural gas as consisting of approximately 340 housing units and 45 industrial, commercial and institutional locations. The Town relies on a connection to the M&NP system, directly or indirectly, and assumes that gas will be available at the commodity price plus or minus transmission tariffs. The Town proposes that the gas utility will be established as a separate entity and that another agency will act as a gas seller. The Town proposes to obtain financing through the Municipal Finance Corporation.

Access to gas delivery service is proposed for 100% of the franchise area. The cost of the system is estimated to be \$523,224 in 1998 dollars. The system will be constructed over a six year period in co-ordination with the arrival of the main pipeline. Since the Town has no direct gas experience, it intends to hire an experienced gas operations manager and a utility operator. The Town will rely on its water utility experience for the administrative side of the gas utility's operations. No specific studies were carried out in support of the Town's application.

A brief statement on the socio-economic impact of natural gas is included in the application, along with an outline of local media reports concerning the application, and a report on a public meeting held with respect thereto.

The Town filed financial information consisting of pro forma financial statements which include a capital fund balance sheet; proposed rates and projected operating revenue; rate base/rate of return calculations; proposed statement of revenue and expenses; schedule of capital expenditures and debt servicing costs.

### **12.3.1 Findings**

The Board's findings in respect of the application by the Town of Annapolis Royal are very similar to its findings in respect of the other municipal and co-operative applicants. The Board recognizes the time and effort the applicant has invested in this process.

Along with the engineering, physical construction and operational challenges of a

natural gas distribution system, there is also the requirement for adequate financial capability in order to undertake the ongoing development and operation of the distribution system. The Board is not satisfied that the applicant has met the regulatory criteria in any of these key areas and, therefore, must deny the franchise application. The Mayor clearly conveyed to the Board and participants at the public hearing that the process was not conducive to municipal applicants with limited funds. While there may be merit in this view, the process is simply the mechanism by which the Board evaluates applications under the **Act** and **GIC Regulations** established by the Province. The Province did not exempt municipal applicants with limited funds from meeting the regulatory criteria for a gas franchise. In the case of an applicant with no in-house experience, meeting the criteria necessarily involves the expense of retaining external expertise. This expertise is not only necessary in order to satisfy the Board that the requirements have been met, but is essential for the applicant in terms of having the best possible advice for purposes of determining whether it is feasible to make an application in the first place. No studies were undertaken to support the application and accordingly, the Town did not have benefit of this expert advice.

The Board has an unanswered concern that the projected financial statements may not reasonably reflect the costs to construct and operate the system as proposed. Consequently, the Board is concerned that the granting of a gas franchise to the Town of Annapolis Royal may result in subsidies being required to build the system infrastructure and to fund the operating losses which may occur during the initial years of operation. Further, as discussed above, the residential customer may well be required to pay higher cost for gas delivery than other consumers in the Province. Accordingly, the Board denies the application by the Town of Annapolis Royal.

The Board wishes to indicate its willingness to consider a subsequent franchise application by the Town of Annapolis Royal if a satisfactory service arrangement cannot be made with Sempra Atlantic, since the Town is not currently included in Sempra Atlantic's proposed build-out plan. However, any subsequent application made by the Town must address the deficiencies in its current application.



## **12.4 ANTIGONISH COMMUNITY GAS CO-OPERATIVE LIMITED**

The Antigonish Community Gas Co-operative Limited (ACGCL) was established to provide natural gas lines, gas and services to members in the Town and County of Antigonish. The applicant has applied for a full regulation class franchise for a term of 25 years. Unlike the other three franchise applicants, predecessor groups in Antigonish undertook two independent analyses, including a natural gas feasibility study relating to natural gas utility development and a study on conversion to natural gas which surveyed households in the Town and County. While ACGCL objected to the release of these studies, and argued that the financial analysis in the Campbell Ryder Study was not reflective of ACGCL's application and therefore not relevant, these studies are part of the evidence before the Board. This applicant has the advantage of having several individuals in the Co-operative who have been active in promoting the education and active participation of local communities in the development of natural gas in Nova Scotia.

ACGCL proposes a franchise area which consists of the entire County of Antigonish and intends to serve all economically feasible areas within the Town and County. Potential markets were identified by physical count, surveys, interviews and other data. An estimated seven year, 40% penetration rate is projected. A total of 1,305 customers were categorized by usage. Gas supply is assumed to be available from the capacity secured by the Province under the Memorandum of Understanding of December, 1997. The gas requirements of ACGCL are estimated at 1,000 MMBtu per day which is not significant given the available capacity. ACGCL indicates that it may take service off the Point Tupper Lateral.

The Town and County of Antigonish both operate water utilities and the Town also operates an electric utility. The applicant plans to draw on this experience for service, management and billing purposes. ACGCL also intends to utilize the resources of the Federation of Alberta Gas Co-ops for training and operations manuals.

The proposal is designed around a 10-year plan which may or may not involve constructing a 25.5 km steel transmission pipeline to connect to the Point Tupper Lateral. The requirement for construction of this transmission lateral depends on the outcome of negotiations with M&NP, and the application of the lateral policy. The applicant, in testimony, referred to the

possibility of a future co-generation facility which, depending on its location, could result in ACGCL connecting directly to the mainline. Build-out will occur over the first seven years of operation with roughly equal amounts of construction each year. Total capital cost of construction is estimated to be approximately \$7,800,000 within the first 10 years, not including the cost of the transmission pipeline. The applicant proposes a delivered rate for gas that is at least 15% below the cost of fuel oil.

A socio-economic impact statement was filed by the applicant outlining anticipated person years of employment over the seven year construction schedule and other benefits of access to natural gas. Also, details of the rather extensive public information program which was conducted by the applicant were filed with the Board as well as supporting financial information.

More specifically, the applicant filed a description of the franchise application and its boundaries; a study by Ian Spencer, Professor of Marketing at St. Francis Xavier University relating to a survey of households in Antigonish Town and County with respect to their intentions to convert to natural gas; a feasibility study for development of a natural gas utility to serve the Town and County of Antigonish by Campbell Ryder Engineering Ltd.; and pro forma financial statements. These include a statement of revenue and expenses; balance sheet; annual capital expenditures; rates and utility income; rate base; rate of return; capital assets and amortization; annual cash flows; and operating expenses.

Further information on the application was obtained through information requests from the Board and other participants, as well as through cross-examination of ACGCL witnesses at the hearing.

#### **12.4.1 Findings**

The Board recognizes that the application by ACGCL represents a good deal of time and effort on the part of the applicant. Although ACGCL filed a more comprehensive application than the other three municipal and co-operative applicants, the evidence contained in its financial statements poses a significant problem in terms of compliance with the regulatory requirement to demonstrate financial capability. This is further complicated by the uncertainty surrounding

ACGCL's connection to the M&NP system.

The financial statements indicate significant losses, and these losses occur throughout the 10 year period covered by the statements. The negative financial situation is worsened by the possibility that the applicant may also have to finance a transmission lateral. This cost is not included in the present financial statements and, according to the testimony at the hearing, the estimated cost of such a transmission lateral ranges from \$3 million to \$7 million. The Board, in Section 7 of this decision, has commented on the concerns it has regarding the application of the M&NP lateral policy to additional areas of the Province. There is no substantive evidence before the Board of the likelihood of a co-generation plant which could facilitate ACGCL's connection to the M&NP system. Therefore, there is a real possibility that the applicant would have to build the transmission line itself, thereby adding significantly to its debt and to its operating losses.

The Board is not satisfied that ACGCL has demonstrated the ability to finance the construction of the required facilities, nor is the Board persuaded by ACGCL's arguments that financial institutions will be willing to finance a project under these circumstances.

The Campbell Ryder study indicates that, in the longer term, a gas distribution system will be feasible for the Town and County of Antigonish. However, the study also concludes that at the time it was prepared (November, 1998), the delivered cost of natural gas to Antigonish would not be sufficiently competitive to support the development of a natural gas utility. Also, the Spencer marketing study raises concerns about the level of conversion to natural gas by potential customers and the challenges of convincing homeowners to convert. Other areas of concern are common to the other applicants and these are set out in the Board's general comments found in Section 12.5.

The Board has noted earlier that one of the major issues in the construction of a gas delivery system is the risk of lower than anticipated conversion rates and the impact this will have on transportation rates and the viability of the utility. Given the financial results contained in the pro forma financial statements provided by the applicant, and the conclusions and observations contained in the Campbell Ryder and Spencer studies, the Board is not satisfied ACGCL has the financial capability to mitigate this risk.

For these reasons, the Board denies the application of ACGCL.

## 12.5 CONCLUSIONS – MUNICIPAL AND CO-OPERATIVE APPLICANTS

Certain general conclusions can be drawn after reviewing the municipal and co-operative franchise applications. In considering these applications, the Board finds it useful to refer to the Policy Statement entitled “Maximizing Benefits from Natural Gas Delivery” referred to earlier in this decision. This policy provides direction in terms of evaluating these applications against the Province’s objective of maximizing the benefits of natural gas through meeting the provincial access targets. The full text of the Policy Statement can be found in Schedule ‘D’.

At page 2 of the Policy Statement, under Section C, “Feasible Access to Gas Throughout Nova Scotia”, the following statement appears:

*The Government believes that initially the most economic and efficient delivery system should be developed and run as a single franchise. The benefits of doing so are as follows:*

- *Rate Levelling: The Government believes that all Nova Scotians should have access to gas at the same basic delivery cost (similar to the province-wide rates for access to electricity).*
- *Quality of Service: A single franchise holder can minimize overheads, and provide a consistent, high quality of service to all customers.*
- *Speed of Initial Build Out: Some areas of the Province will be more attractive to provide service due to population density or large commercial demand. Through a combination of regulated rates of return and providing incentive returns, less attractive areas will be developed quicker.*
- *Investment Leverage: A single firm will have more incentive to invest in programs such as Research and Development and Training and Development when the benefits will be directed to their firm rather than a number of competing firms.*

In reviewing the **Act, GIC Regulations** and Policy Statement, it appears the Nova

Scotia Government intended to establish a regulatory framework which would attract applicants from the private sector possessing the expertise and resources necessary to successfully develop an extensive gas distribution system in a greenfield environment. In this respect, it is vital that applicants demonstrate that they have the financial capability to undertake the financing, construction and operation of a gas delivery system.

The Board is not satisfied that the municipal and co-operative applicants have the financial capability to fully undertake the plans set out in their respective applications and to bear the risks associated with the possibility that forecasts might not be realized. In some cases, it appears that completion of the project would be dependent upon some level of government assistance. No example was provided to the Board by the applicants of a similar gas utility in Canada being developed without a subsidy. The Board does not believe it is in the public interest to award a franchise at this time to any applicant if it appears that subsidies may be required to enable it to construct and operate its system. This is especially true when there is a viable commercial alternative.

Furthermore, the Province has established requirements for the safe and reliable operation of a natural gas system by a franchisee. These applicants did not persuade the Board that they either had the necessary experience or that they had sufficiently anticipated the requirements to operate the delivery system in a manner that would meet the provincial requirements.

As discussed at the beginning of this Part, it appears that certain municipal and co-operative applicants have not addressed the requirement for a common “postage stamp” consumer rate for gas transportation service throughout Nova Scotia. This is particularly relevant in circumstances where the applicant is dependent upon the provincial franchisee to construct pipeline facilities to connect the applicant to the natural gas grid. In the Board’s view, the problem relating to the delivered price of natural gas to consumers, when gas delivery involves the utilization and costs of two natural gas distribution systems, was not adequately addressed by the applicants. The Board is faced with the prospect of gas consumers in these areas waiting longer for gas than consumers located in areas served by the provincial distributor and the potential that when gas is eventually available, it will be more expensive than elsewhere in the Province. Notwithstanding the

undeniable benefits of a community owned and operated gas utility, the risks associated with these applications are fundamentally unacceptable in the Board's view.

## 12.6 SUPPLEMENTAL FRANCHISES

The Policy Statement contains the following:

*The intent of awarding a Nova Scotia Franchise is to maximize the opportunity for the widest possible delivery system to be developed quickly for Nova Scotia. The Government anticipates that this will still leave some areas of the Province underserved or unserved by gas. These areas will continue to be served by other fuel sources such as oil, electricity, propane and wood.*

*A number of steps can be taken which provide options for customers which do [not] have access to gas as part of the Nova Scotia Franchise.*

- *Multiple Franchises: The Act and Regulations allow for more than one franchise to be awarded. Other private firms, municipalities and cooperatives are examples of entities which may seek Supplemental Franchises.*
- *Application Fees: The Government has directed that the UARB shall not impose an application fee on municipalities or cooperatives intending to distribute gas only to residents of the municipality or members of the cooperative.*

### 3. Timing:

*While a great many factors will drive the actual dates, the timing of issuing Supplemental Franchises may be shortened under two scenarios:*

- *the Nova Scotia Franchise holder agrees to forfeit rights to a particular geographic area to another party; or*
- *a specific application for an unserved area is*

*made to the UARB.*

*Such awards will be made based on the process, terms and conditions outlined in the Act, Regulations and this Policy.*

The Board views supplemental franchises as an alternative available to communities not served by the provincial distributor.

The Board recognizes, as contemplated in the Policy Statement, that certain geographic areas within Nova Scotia may be unserved by Sempra Atlantic even though its build-out meets the provincial access targets. The Board anticipates that municipalities in this situation, which believe there is potential for a viable natural gas system within their geographic boundaries, will work with Sempra Atlantic to determine if modifications to the Sempra Atlantic proposal are feasible.

If, however, by the time natural gas is within reach of these delivery areas, and an arrangement with Sempra Atlantic cannot be reached, applications can be made for a supplemental franchise as contemplated in the Policy Statement. It will be important for these applicants to bear in mind the concerns raised by the Board in this decision concerning the deficiencies contained in the municipal and co-operative applications.

## PART THREE

### OTHER ISSUES

#### 13.0 REGULATORY ENVIRONMENT

Both Maritimes NRG and Sempra Atlantic presented long term rate plans. Due to the greenfield nature of the Nova Scotia market and the challenging economics of this project, both applicants submitted that regulatory certainty is necessary to create a stable environment in which the franchisee can attract new customers and have an opportunity, over the life of the franchise, to earn a fair and adequate return on investment.

The Board must balance the need to ensure performance by the franchisee in conformity with the law and policy objectives with the need of the franchisee to operate in an effective and efficient manner in order to maximize access to gas while minimizing system costs.

As part of its acceptance of the province-wide franchise for natural gas distribution in Nova Scotia, Sempra Atlantic will be entering into a regulatory compact with the Province through its interactions with the Board, various government agencies, and its customers.

In granting the franchise to Sempra Atlantic and approving its rate plan, as described in this decision, the Board recognizes the need for a departure from the traditional regulatory cost of service model. The Board intends to monitor the construction, operations, rate plan, and implementation of Sempra Atlantic's benefits plan to ensure compliance with the **Act**, **GIC Regulations** and Policy Statement of the Province. While the Board agrees in principle with the appropriateness in the present case of a form of regulation different from the conventional regulatory regime, the Board retains full authority to ensure Sempra Atlantic complies with the **Act** and **GIC Regulations**, and fulfils its public commitment to the people of Nova Scotia. The Board's ongoing role is reflected in Sections 33(1) and (3) of the **Act**, which read as follows:

- 33     **(1)** *The Board may hold an inquiry as to whether any breach of a term or condition of a franchise has occurred.*



*(3) After an inquiry pursuant to this Section, the Board may, if it finds that a breach of a term or condition of a franchise has occurred, amend or cancel the franchise.*

The Board believes that in the proposed regulatory regime, reporting requirements take on added importance as an instrument to monitor compliance by Sempra Atlantic with its obligations. Sempra Atlantic, in its final submission to the Board, attached a proposed Regulatory Calendar. The Board has incorporated Sempra Atlantic's suggested filing schedules, with minor modifications, into the conditions of franchise award set out in Schedule 'A' of this decision.

#### **14.0 SINGLE END USER CLASS FRANCHISE**

The Board was surprised by the lack of participation in these proceedings by potential industrial users of natural gas. Natural gas development in the Maritimes has been portrayed as presenting a significant energy alternative to industry. Further, as the natural gas infrastructure develops in Nova Scotia, it is anticipated that additional opportunities to attract new industries to the Province will be created.

There was discussion at the hearing respecting the financial advantages of industrial customers being able to directly connect to the federally regulated system of M&NP, thus bypassing the provincial franchisee. It was suggested that Nova Scotia industrial companies would be disadvantaged by having to pay the franchisee's industrial rate as compared to industrial customers in New Brunswick and the United States Northeast who will have the ability to directly connect to M&NP. On the other hand, such conditions as demonstration of creditworthiness (which may require posting a letter of credit related to M&NP's monthly demand charges), and transmission rates which are set on the basis of a 100% load factor (shippers are required to commit to paying the transportation rate 100% of the time regardless if the capacity is fully used) are some of the significant impediments to direct connection.

In New Brunswick, industrial companies are permitted to directly connect to the M&NP system provided they apply for and receive a single end user franchise and pay a specified annual fee to the Province. Also, as a result of the NEB decision approving the M&NP project and

the postage stamp toll, natural gas customers in New Brunswick pay the same M&NP transmission rate as do gas customers in Nova Scotia (excluding the impact of any preferential Nova Scotia discounts). Natural gas customers on the U.S. portion of the M&NP system not only pay the same transmission rate as in Nova Scotia and New Brunswick, but also have to pay tolls for the U.S. system, the rate for which is comparable to the Canadian rate.

As part of Sempra Atlantic's proposal, it seeks the ability to negotiate the industrial rate down to a minimum level in order to enable it to attract industrial customers and to compete against competitive fuels and direct connections to the M&NP system. Sempra Atlantic also suggested that some of the M&NP terms and conditions for direct access to its system are onerous and that the distributor can offer various services which may better suit the needs of potential industrial customers.

Having examined the various positions presented, the Board finds that, upon acceptance of the provincial franchise by Sempra Atlantic, any industry in Nova Scotia wishing to directly connect to the M&NP mainline must first apply to the Board for a single end user class franchise. The Board believes it is in the public interest to require industrial customers seeking to bypass the provincial distribution system, to demonstrate their need to do so. The Board is not convinced that industrial customers should have the ability to unilaterally decide to bypass the provincial distribution system. Neither is the Board persuaded that this requirement will have a detrimental economic impact on industries in Nova Scotia as compared to New Brunswick (with its annual fee to be charged to a single end user franchise), and the US Northeast (with the additional M&NP transmission fee).

The Board expects Sempra Atlantic, as it has indicated during the proceedings, will vigorously pursue Nova Scotia industrial companies with a view to attracting them as customers. In the Board's view, the requirement to seek a franchise to bypass Sempra Atlantic's system will create a level playing field and will send the proper economic signals to all parties.

Single end user franchise applicants should be aware that, depending upon the nature of the application and the public interest shown therein, the Board may require a public hearing concerning the franchise application. Accordingly, the Board directs that an industrial company that

wishes to directly connect to the M&NP system must first file an application with the Board accompanied by the requisite fee.

## **15.0 MUNICIPAL FEES/TAXES**

Sempra Atlantic proposed in its final brief that it be given the right to surrender or amend its franchise in the event it is faced with the imposition of excessive municipal fees. It is instructive to note that the granting of natural gas franchises is not within the jurisdiction of municipal governments. Accordingly, any fees relating to the utilization of municipal rights-of-way or lands should not be considered to be “franchise fees”.

**GIC Regulation 13(4)** gives the Board final authority to determine the appropriateness of municipal fees:

*13(4) If pursuant to Section 78 of the Public Utilities Act, a municipality does not consent to the construction requested or gives consent that is unacceptable to the franchise holder, the matter shall be referred by the franchise holder to the Board.*

It is important that parties recognize that, for the development of a successful greenfield natural gas market in Nova Scotia, costs must be minimized. The Board expects municipalities to negotiate with Sempra Atlantic in good faith so that the municipal fees will be reasonable in light of the objective of the Province to have a viable natural gas delivery system for the benefit of Nova Scotia. The Board does not believe it is in the best interests of Nova Scotia to burden either Sempra Atlantic or its customers with excessive municipal fees or taxes.

## **PART FOUR**

### **SUMMARY OF BOARD FINDINGS AND CONCLUSIONS**

#### **1. GRANTING OF FRANCHISE**

Pursuant to Section 8 of the **Gas Distribution Act**, the Board grants a full regulation class franchise to Sempra Atlantic for a period of 25 years subject to the terms and conditions attached in Schedule 'A'. By virtue of Section 8(3) of the **Act**, this grant of franchise is subject to the approval of the Governor in Council. All other applications are denied.

#### **2. AVAILABILITY OF ADEQUATE SUPPLY**

The Board finds that both Sempra Atlantic and Maritimes NRG have met the criteria in the **Act** in respect of availability of adequate gas supply.

#### **3. EXISTENCE OF MARKETS**

The Board finds that the two provincial applicants have provided sufficient information, data and analysis to meet the requirements of the **Act** relating to the existence of actual and potential markets.

#### **4. CONSUMPTION ESTIMATES**

Both parties have used reasonable methods to develop their estimates. Since these estimates directly affect revenue projections, the Board must be cognizant of its responsibility to protect potential customers from unnecessary risk. The Board has concluded that since Sempra Atlantic, unlike Maritimes NRG, bears the financial risk in the event of lower than estimated consumption rates, there is a less risk to customers under the Sempra Atlantic plan.

## 5. RELIABILITY OF PRICE FORECASTS

The Board finds that both applicants provided reasonable estimates of the likely outlook for oil and natural gas prices, and has concluded that, since Sempra Atlantic guarantees a minimum saving of 5%, (except in circumstances where the regulatory adjustment mechanism is triggered - see section 5.3), and Maritimes NRG does not guarantee any level of saving, customers face less exposure to risk under the Sempra Atlantic proposal.

## 6. ACCESS TARGETS

The Board finds that Sempra Atlantic's projections of access to households under its distribution system meet the access targets prescribed in the **GIC Regulations**. The Board finds that Maritimes NRG's projections of access to households do not meet these targets. The Board will not agree to Maritimes NRG's request to be exempted from the application of the access targets.

## 7. PLANS FOR SERVICE

While Maritimes NRG filed a more detailed construction plan than did Sempra Atlantic, the Board finds that Sempra Atlantic has provided adequate estimates of its required facilities, and the costing of those facilities, in order to meet its plans for natural gas service throughout the Province. The Board expects Sempra Atlantic to comply with the requirements of the **Pipeline Act**, and to file more detailed engineering studies at the appropriate time.

The Board will require, as a condition of franchise award, that Sempra Atlantic undertake and fulfil its build-out plan subject only to *force majeure* and the regulatory adjustment mechanism.

## 8. RATE DESIGN

The Board finds that the Sempra Atlantic rate plan has more of the elements of a performance-based rate plan than does the plan of Maritimes NRG.

The Board finds that the rate plan put forth by Sempra Atlantic best serves the public

interest, and that it is in the public interest to approve the 20-year term for the rate plan as requested by Sempra Atlantic.

## **9. PROFIT SHARING AND RETURN ON EQUITY**

While it is reasonable for Sempra Atlantic to receive a return in proportion to the degree of risk it bears, the Board believes that a ceiling on any excess returns is necessary. As a condition of franchise award, Sempra Atlantic must accept the following modifications to its plan:

- a) For earnings in excess of an annual 20% return on equity but less than 30%, sharing will be on a 50/50 basis. Annual returns in excess of 30% will be shared on the basis of 75% to the credit of the ratepayer and 25% to the credit of Sempra Atlantic.
- b) If at any time during the initial 20 year rate plan Sempra Atlantic's cumulative average return on equity reaches 14%, Sempra shall file, within six months of its year end, a five year financial outlook.
- c) The Board accepts Sempra Atlantic's projected cumulative average rate of return of 15.2% as a reasonable rate of return on equity. However, the cumulative average return on equity cannot exceed 20% at any time during the 20 year term of the rate plan. If, prior to the end of the 20 year term, it appears that Sempra Atlantic may reach this limit, the Board reserves the right to call the company before the Board to review the issue of excess revenues and to make such amendments to the rate plan as the Board deems necessary to ensure that the cumulative average return on equity will not exceed 20% for the remainder of the term of the rate plan.

## **10. DISCOUNTS AND RATE CAP**

The Board is not prepared to make a final determination, at this time, as to whether Sempra Atlantic's initial rate cap should take into account the two discounts on transmission tolls which may be available to Nova Scotia. The Board directs Sempra Atlantic to undertake a review of the application of these discounts with the appropriate parties and file with the Board, prior to the commencement of delivery of natural gas to customers in Nova Scotia, its recommendations as to

the appropriateness of including discounts in the determination of its rate cap, as well as its recommendations concerning the use of the discounts in relation to its rate plan to ensure, at a minimum, a 5% discount off the current price of oil.

The Board accepts the change in the headroom factor from 10% to 15% in the calculation of Sempra Atlantic's rate cap.

## **11. M&NP LATERAL POLICY**

The Board finds little substantive evidence before it as to the potential use of the lateral policy beyond the existing laterals to Point Tupper, Halifax, and Saint John. The Board is not persuaded that the NEB will accept the proposition that a shipper or group of shippers on M&NP in a particular region will be subsidized by other shippers to the extent that has been suggested by Maritimes NRG. The Board finds that insufficient evidence on this issue was presented by Maritimes NRG, the only province-wide applicant at the hearing advocating the use of the lateral policy, to convince the Board that the lateral policy is a reliable and effective means of constructing transmission lines in Nova Scotia at this time.

## **12. SOCIO-ECONOMIC IMPACT STATEMENT AND BENEFITS PLAN**

The Board finds that Maritimes NRG's application does not provide the requisite degree of certainty that residents of Nova Scotia will get the maximum benefit from their natural gas resource. If economic conditions are unfavourable, it is quite possible that elements of Maritimes NRG's base system will not be constructed.

The Board approves Sempra Atlantic's socio-economic impact statement and benefits plan, subject to the following comments and directions:

- a) Sempra Atlantic is directed to expand the definition of a Nova Scotian (only in respect of measurement of staffing levels for full time employment). Currently the definition is based on eligibility to vote (i.e. six month residency). The Board believes it should be expanded to include individuals who were born in Nova Scotia. The Board considers that it is important to not only provide employment opportunities to individuals who are currently residing in Nova

Scotia, but to provide an opportunity to attract back to Nova Scotia former residents who have left to obtain employment outside of Nova Scotia.

- b) Sempra Atlantic is directed to file with the Board its plans to establish a call centre in Cape Breton and its plans to establish regional offices.
- c) The Board expects Sempra Atlantic to engage in aggressive public information/consultation efforts to promote the safe use of natural gas. Sempra is required to file a copy of all written information to be used by the company in the promotion of natural gas, such as advertisements, educational brochures, etc.

### **13. FINANCIAL CAPABILITY AND RELATED EXPERIENCE**

The Board finds that Sempra Atlantic has satisfied the requirements of the **Act** relating to financial capability. The Board finds that the evidence submitted by Maritimes NRG, on a confidential basis, concerning the financial capability of Irving Oil, while somewhat helpful, is not sufficient to satisfy the requirements of Section 8(2) of the **Act** because it does not enable the Board to reach a conclusion as to Maritimes NRG's financial capability.

The Board is satisfied that both Maritimes NRG, through the experience of its staff, advisors, and Westcoast's commitment of technical expertise, and Sempra Atlantic, through its staff, advisors and sponsors, have the requisite experience and expertise to safely construct and operate a gas distribution system in Nova Scotia.

### **14. SEPARATION OF DELIVERY AND GAS FUNCTIONS**

The Board denies the request of Sempra Atlantic that it be permitted to have a licence to sell natural gas to consumers. The Board directs Sempra Atlantic to conduct the purchase and sale of natural gas through a separate affiliate or subsidiary.

In directing Sempra Atlantic to fully separate its delivery and sales function, the Board wishes to make it clear that there is no intent to frustrate the success of Sempra Atlantic's rate plan. The appropriate degree of separation between these activities, and the code of conduct



governing Sempra Atlantic's relationship with its marketing affiliate, will be examined in greater detail in Phase II. In the Board's view, however, the code of conduct should not be used to frustrate Sempra Atlantic's objective of providing savings to prospective natural gas customers nor should it impair Sempra Atlantic's ability to attract potential customers to its system and achieve its stated goal of exceeding the provincial access targets. The Board is satisfied that Sempra Atlantic's code of conduct is sufficient to ensure non-affiliated parties will be treated in the manner required by the **Act** and **GIC Regulations**.

## **15. MUNICIPAL AND CO-OPERATIVE APPLICATIONS**

The Board is not satisfied that the municipal and co-operative applicants have the financial capability to fully undertake the plans set out in their respective applications and to bear the risks associated with the possibility that forecasts might not be realized. The Board does not believe it is in the public interest to award a franchise at this time to any applicant if it appears that subsidies may be required to construct and operate its system. This is especially true when there is a viable commercial alternative.

## **16. SUPPLEMENTAL FRANCHISES**

The Board views supplemental franchises as an alternative available to communities not served by the provincial distributor. Municipalities, not so served will be able to apply for a supplemental franchise, bearing in mind, however, the concerns raised by the Board in this decision respecting the deficiencies contained in the municipal and co-operative applications.

## **17. REGULATORY ENVIRONMENT**

In granting the franchise to Sempra Atlantic and approving its rate plan, as described in this decision, the Board recognizes the need for a departure from the traditional regulatory cost of service model. The Board intends to monitor the construction, operations, rate plan, and implementation of Sempra Atlantic's benefit plan to ensure compliance with the **Act**, **GIC**

**Regulations** and Policy Statement of the Province. While the Board agrees in principle with the appropriateness in the present case of a form of regulation different from the conventional regulatory regime, the Board retains full authority to ensure Sempra Atlantic complies with the **Act** and **GIC Regulations**, and fulfills its public commitment to the people of Nova Scotia.

## **18. SINGLE END USER CLASS FRANCHISE**

The Board directs that, upon acceptance of the provincial franchise by Sempra Atlantic, any industrial company in Nova Scotia wishing to directly connect to the M&NP system must first apply to the Board for a single end user class franchise. Such application is to be accompanied by the requisite fee.

## **19. MUNICIPAL FEES AND TAXES**

Pursuant to **GIC Regulation 13(4)**, the Board has the final authority to determine the appropriateness of municipal fees. The Board expects municipalities to negotiate with Sempra Atlantic in good faith so that municipal fees will be reasonable. The Board does not believe it is in the best interests of Nova Scotia to burden either Sempra Atlantic or its customers with excessive municipal fees or taxes.

## **20. CONDITIONS OF FRANCHISE AWARD**

The Board in granting the province-wide franchise to Sempra Atlantic has established Terms and Conditions of Franchise Award. These Conditions are set out in Schedule 'A' to this decision.

An Order will issue accordingly.

**DATED** at Halifax, Nova Scotia, this 16<sup>th</sup> day of November, 1999.

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John A. Morash, C.A., Chair

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Margaret A.M. Shears, Vice-chair

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John L. Harris, Q.C., Member

## SCHEDULE 'A'

### TERMS AND CONDITIONS OF FRANCHISE AWARD

The Board imposes the following terms and conditions on the grant of franchise to Sempra Atlantic.

1. The terms and conditions set out below are in addition to the terms and conditions contained in the **Act** and **GIC Regulations**.
2. Unless the Board otherwise directs, the full regulation class franchise granted by the Board, subject to Governor in Council approval, shall be held and operated by Sempra Atlantic.
3. Sempra Atlantic shall implement or cause to be implemented its plan for the construction of its natural gas delivery system and shall meet or exceed the required access targets as prescribed in the **GIC Regulations**.
4. Sempra Atlantic shall take all reasonable measures to implement or cause to be implemented all of the commitments, policies and practices set out in its socio-economic impact statement and benefits plan included in or referred to in its application, and as adduced in evidence before the Board in this proceeding.
5. Sempra Atlantic shall take all reasonable measures to implement or cause to be implemented all of the commitments, policies and practices set out in its rate plan, as modified herein by the Board, included in or referred to in its application, and as adduced in evidence before the Board in this proceeding. The Board's modifications are as follows:
  - I. Profit Sharing

For earnings in excess of an annual 20% return on equity but less than 30%, sharing will be on a 50/50 basis. Annual returns in excess of 30% will be shared on the basis of 75% to the credit of the ratepayer and 25% to the credit of Sempra Atlantic.

## II. Cumulative Return on Equity

- (a) If at any time during the initial 20 year rate plan Sempra Atlantic's cumulative average return on equity reaches 14%, Sempra Atlantic shall file, within six months of its year end, a five year financial outlook.
- (b) The Board accepts Sempra Atlantic's projected cumulative average rate of return of 15.2% as a reasonable rate of return on equity. However, the cumulative average return on equity cannot exceed 20% at any time during the 20 year term of the rate plan. If, prior to the end of the 20 year term, it appears that Sempra Atlantic may reach this limit, the Board reserves the right to call the company before the Board to review the issue of excess revenues and to make such amendments to the rate plan as the Board deems necessary to ensure that the cumulative average return on equity will not exceed 20% for the remaining term of the rate plan.

## III. Rate Cap Setting Mechanism

In determining the initial rate cap, Sempra Atlantic shall not include in its calculations the transportation discounts for Nova Scotians from Maritimes & Northeast Pipeline and the Nova Scotia Gas Market Development Initiative. Sempra Atlantic shall review the application of the discounts and present its recommendations to the Board prior to the commencement of the delivery of natural gas to customers.

- 6. Sempra Atlantic shall file with the Board, in a timely manner, all required applications pursuant to the **Pipeline Act** and regulations, and any other applicable enactments, with respect to the construction, operation, maintenance and inspection of its gas delivery system.
- 7. Sempra Atlantic's duty to perform its obligations shall be temporarily suspended to

the extent that it is affected by a circumstance constituting a *Force Majeure Event*. In order for a circumstance to constitute a *Force Majeure Event*, Sempra Atlantic shall (i) promptly notify the Board of such event and its cause and confirm the same in writing within twenty-four (24) hours of its discovery, (ii) promptly supply such available information about the event and its cause as may be reasonably requested by the Board and (iii) immediately initiate reasonable efforts to remove the cause of the event or to lessen its effect. Suspension of Sempra Atlantic's performance obligation shall be of no greater scope and of no longer duration than that which is reasonably necessary in the judgment of the Board, and Sempra Atlantic shall use commercially reasonable diligence to remedy its inability to perform.

8. Subject to Section 19 of the **GIC Regulations**, Sempra Atlantic is entitled, without penalty of any kind, to surrender the franchise at any time if, upon application to the Board, it can demonstrate the occurrence of any one or more of the following specific circumstances:
- (a) Operational failure of the Sable offshore gas production facilities that would have a substantial negative impact on all, or a material part, of Sempra Atlantic's system;
  - (b) Failure of M&NP to build and operate all of the pipelines and other related facilities that are reasonably required by Sempra Atlantic to operate its system; or
  - (c) Failure by Sempra Atlantic to receive all reasonably required environmental or other governmental approvals in a timely manner, or receipt of any such permits and approvals which contain unreasonably burdensome or restrictive terms or conditions that

would have a substantial negative impact on all, or a material part, of Sempra Atlantic's system.

9. Sempra Atlantic may apply to the Board for amendment of its franchise pursuant to Sections 18 and 19 of the **GIC Regulations** if any of the circumstances set forth in the preceding paragraph occur and Sempra Atlantic nonetheless elects to proceed with an appropriately modified franchise.
10. Unless the Board otherwise directs, Sempra Atlantic shall follow the following Regulatory Calendar set out in Appendix F of Sempra Atlantic's closing argument, subject to minor modifications by the Board:

<b>I. <u>Annual: Filing Requirement</u></b>	<b><u>Filing Date</u></b>
1) Financial Reports	March 31 (for prior year)
2) Fuel Oil/Gas Price Forecast Report	March 31 (subsequent three year period)
3) Socio-Economic Report including the Pipeline Benefit Plan	March 31 (for prior year)
4) Access Target Progress Report	March 31 (for prior year)
5) Transportation Rate Cap Adjustment	November 1(effective 1/01)
6) Annual Monthly Customer Charge Adjustment	November 1(effective 01/01)
7) (Possible) Bid process for annual default gas supply service	September-October (effective 01/01)

**II. Monthly:**

- 1) Monthly transportation rate calculation (3 working days before prior month end).
- 2) Posting of the discounts to residential, small commercial, and small industrial classes of customers (3 working days before prior month end).
- 3) (Possible) Bid Process for default service:

Time line for Monthly Bid Process:

Bid package	8 working days before month end
Accept bids and post	5 working days before month end
Set monthly transportation rate	3 working days before month end

### **III. Semi-annual:**

Report on benefits plan every six months commencing 180 days from the date of Governor in Council approval of the grant of franchise by the Board, for first seven years of construction of system, with quarterly informal consultations with the Board.

### **IV. Periodic and/or Single Filing:**

- 1) Phase II filing on Sempra Atlantic's Code of Conduct.
- 2) Filing of Sempra Atlantic's initial full tariff, terms and conditions of service.
- 3) Revisions to tariff when required.
- 4) Sempra Atlantic has agreed to make up to 49% of its ownership of Sempra Atlantic available for equity investment by Nova Scotians within 10 years of Governor in Council approval of the franchise award. Sempra Atlantic is directed to file its public ownership plan within the 90 days of the approval by the Governor in Council of the grant of the franchise by the Board.
- 5) Suggested table of contents for the annual and semi-annual filing requirements within 180 days of GIC approval of the Board's grant of franchise.
- 6) Possible triggering of rate adjustment mechanism in Year 5 or later.
- 7) Recommended disposition of ratepayer portion of revenue sharing amounts.
- 8) (Possible) intra-month bid process for "supplier of last resort" service.
- 9) Report on attainment of access targets and benefits in socio-economic and benefits plan (90 days after seventh year of construction).

11. Sempra Atlantic shall not purchase and sell natural gas for sales to customers unless through a separate affiliate or subsidiary. Notwithstanding the foregoing, Sempra Atlantic may purchase and sell gas for the effective and efficient operations of its system as described by the Board in this decision as follows:

- 1) Line pack requirements.
- 2) Daily load balancing requirements.



- 3) Fuel requirements (if not available from alternative suppliers).
- 4) Other requirements as may be determined by the Board from time to time.

12. Unless the Board directs otherwise, Sempra Atlantic shall file a report on its plans to establish a call centre in Cape Breton and regional offices in the Province, such report to be filed within six months of the date of GIC approval of this grant of franchise.

**SCHEDULE ‘B’**  
**INTERVENORS**

Town of Amherst	Halifax Regional Development Agency
Gerald A. Amirault, C.A.	
Antigonish Regional Development Authority	Halifax Regional Homeowners Association
Municipality of the District of Argyle	Halifax Regional Municipality (HRM)
Assembly of Nova Scotia Mi’kmaq Chiefs	Hants Regional Development Authority
Atlantic Combustion Products Limited	Heating, Refrigeration and Air Conditioning Institute of Canada (HRAI)
BC Gas International Inc.	
Canadian Association of Petroleum Producers	Imperial Oil Resources
Canadian Oil Heat Association (COHA)	Intervention Coalition on Sable Gas Project
CanEnerco Limited	Municipality of the County of Inverness
Cape Breton Island Building and Construction Trades Council	Irving Oil Limited
Cape Breton Regional Municipality	Peter J. Kelly
Chamber of Mineral Resources	Kings County Natural Gas Committee
Coalition for Responsible Economic and Environmental Development (CREED)	Lunenburg-Queens Natural Gas Committee
Competition Bureau, Industry Canada	Maritime Electric Company, Limited
Cumberland Regional Economic Development Association (CREDA)	Maritimes & Northeast Pipeline Management Ltd. ( <i>withdrew</i> )
Engage Energy Canada, L.P.	Metropolitan Halifax Chamber of Commerce
Gasworks Installations Inc.	Town of Mulgrave
Geostorage Associates	Municipal Enterprises Limited
Greater Halifax Partnership	New Democratic Party Caucus Office
Municipality of the District of Guysborough	Nova Scotia Environmental Industry Association
Guysborough County Regional Development Authority (GCRDA)	Nova Scotia Home Builders’ Association
	Nova Scotia Petroleum Directorate
	Nova Scotia Power Inc. (NSPI)
	Offshore Technologies Association of N.S.

Pictou Regional Development Commission

Poly Cello

Town of Port Hawkesbury

Province of Prince Edward Island  
(Department of Development)

Progressive Conservative Caucus Office

Village of Pugwash

Municipality of the County of Richmond

Scotia Synfuels Limited

Municipality of the District of Shelburne

South West Shore Development Authority

Municipality of the District of St. Mary's

Strait Area Chamber of Commerce

Strait-Highlands Regional Development  
Agency

Turf Masters Landscaping Limited

U.A. Local 56

U.A. Local 244

Union of Nova Scotia Municipalities

Municipality of Victoria County

Voluntary Planning Energy Sector

Waldale Manufacturing Limited (*withdrew*)

Watershed Association Development  
Enterprises Limited

The Western Valley Gas Opportunities  
Committee

James J. White

Municipality of the District of Yarmouth

Town of Yarmouth

**SCHEDULE ‘C’**  
**ABBREVIATIONS**

<b>Access targets</b>	The distribution targets by number of households in each county specified in Schedule “A” to the <b>Gas Distribution Regulations (Nova Scotia)</b>
<b>Act</b>	<b>Gas Distribution Act</b> , S.N.S. 1997, c. 4
<b>Board</b>	Nova Scotia Utility and Review Board
<b>Board Regulations</b>	<b>Board Gas Distribution Regulations (Nova Scotia)</b> , November 24, 1998 (N.S. Reg. 93/98) made by the Board pursuant to s. 41(1) of the <b>Gas Distribution Act</b>
<b>Directions on Procedure</b>	Directions on Procedure - First Franchise Hearing, issued by the Board on November 30, 1998
<b>GIC Regulations</b>	<b>Gas Distribution Regulations (Nova Scotia)</b> , November 10, 1998 (N.S. Reg. 86/98) made by the Governor in Council pursuant to s.42(1) of the <b>Gas Distribution Act</b>
<b>GJ</b>	gigajoules
<b>Irving Oil</b>	Irving Oil Limited
<b>Lateral Policy</b>	M & NP lateral policy
<b>Maritimes NRG</b>	Maritimes NRG (Nova Scotia) Limited
<b>M&amp;NP</b>	Maritimes & Northeast Pipeline
<b>MMBtu</b>	million British thermal units
<b>NEB</b>	National Energy Board
<b>NB</b>	Province of New Brunswick
<b>NS or the Province</b>	Province of Nova Scotia
<b>Petroleum Directorate</b>	Province of Nova Scotia, Petroleum Directorate

<b>Policy Statement</b>	“Policy Statement on Maximizing Benefits from Natural Gas Delivery” being Schedule “B” to the <b>Gas Distribution Regulations (Nova Scotia)</b>
<b>Sempra Atlantic</b>	Sempra Atlantic Gas Incorporated
<b>SOEP</b>	Sable Offshore Energy Project
<b>Westcoast</b>	Westcoast Energy Incorporated