

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE GAS DISTRIBUTION ACT

- and -

IN THE MATTER OF HERITAGE GAS LIMITED having filed with the Nova Scotia Utility and Review Board a request for approval of the project economics associated with the expansion of the natural gas distribution system to Fairview, Clayton Park, Bayers Lake and Bedford, Halifax Regional Municipality, at a total cost of approximately \$30 Million.

BEFORE: Peter W. Gurnham, Q.C, Chair
Kulvinder S. Dhillon, P. Eng., Member
Murray E. Doehler, CA, P. Eng., Member

COUNSEL: **HERITAGE GAS LIMITED**
John C. MacPherson, Q.C.

NOVA SCOTIA DEPARTMENT OF ENERGY
Mark Rieksts, LL.B.
Bill O'Halloran

CONSUMER ADVOCATE
John P. Merrick, Q.C.
William L. Mahody, LL.B.

CANADIAN OIL HEAT ASSOCIATION
Mr. Rick Latimer

HALIFAX REGIONAL MUNICIPALITY
Mary Ellen Donovan, Q.C.
Julian Boyle

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

FINAL SUBMISSION: May 11, 2010

HEARING DATE: June 4, 2010

DECISION DATE: **June 11, 2010**

DECISION: **The Board approves the application: RDA model to be revised.**

I INTRODUCTION

[1] In its submission dated December 1, 2009 to the Nova Scotia Utility and Review Board (the "Board"), Heritage Gas Limited ("Heritage", the "Company") outlined its plans to expand its natural gas distribution system into the areas of Fairview, Clayton Park, Bayers Lake and Bedford (the "Project"). In particular, Heritage requested Board confirmation that it was appropriate to apply the Community Feasibility Test ("CFT"), rather than the Mains Feasibility Test ("MFT"), to provide economic justification for the Project.

[2] The Project consists of 9 kilometres of nominal pipe size 10 inch steel pipe ("NPS 10") including two district regulator stations to serve the Fairview/Clayton Park/Bayers Lake and Bedford areas. In addition, 22 kilometres of polyethylene ("PE") pipe is proposed to serve the Fairview/Clayton Park/Bayers Lake areas and 33 kilometres of PE pipeline to serve Bedford West and Bedford South developments and Hammonds Plains commercial customers. It also includes associated customer service lines and metering equipment, all at a total cost of \$30,419,000 spread over the 2010 to 2015 time frame. Most of the cost would be incurred in the first year.

[3] Heritage expects to have an in-service date of September 1, 2010 and the Project is expected to be serving a minimum of 1,100 customers by 2015.

[4] Heritage's submission provided evidence that the Project's CFT parameters and contribution to the Revenue Deficiency Account ("RDA") are all positive over time, including a year 7 profitability ratio of 1.45:1 and a positive net present value. In addition,

the Company has secured with executed Distribution Service Agreements, customer commitments representing \$1.8 million of annualized revenue.

[5] In a January 26, 2010 letter to Heritage, the Board stated its agreement in principle with the application of the CFT to the Project, but noted that Heritage would need to demonstrate that the underlying economic assumptions were robust, and that there would be minimal negative impact on the RDA.

[6] In its April 8, 2010 submission which is the subject of this Decision, Heritage provided a review of the Project along with the CFT results including a discussion of the underlying assumptions.

[7] The Board decided that the matter warranted an administrative hearing and accordingly issued an Order and Directions on Procedure on March 23, 2010. Four parties - the Consumer Advocate ("CA"), the Nova Scotia Department of Energy ("NSDOE"), the Canadian Oil Heat Association ("COHA"), and Halifax Regional Municipality ("HRM") registered as participants. Information Requests ("IRs") were issued to Heritage on April 16, 2010 to which Heritage responded on April 26, 2010. The CA, NSDOE and HRM provided submissions by May 4, 2010, and Heritage provided its reply submission on May 11, 2010. The Board received letters of support from Clayton Developments Limited, the Nova Scotia Natural Gas Association, Mount Saint Vincent University and Sackville Trenching Limited.

[8] In its review of IR responses, the Board noted that the RDA forecast had increased substantially (CA - IR 8), compared to the forecast that was in Heritage's most

recent compliance filing of February 27, 2009. The Board decided to convene an oral hearing to explore the projected increase in the RDA.

[9] The hearing was held on June 4, 2010, with the CA, NSDOE and HRM participating. The panel that represented Heritage was Ray Ritcey, President and Chris Smith, CA, Vice-President Finance and Business Services.

II ISSUES

[10] NSDOE is generally supportive of the Project, but cautions that “to achieve the objectives highlighted in the Energy Strategy, the expansion of natural gas use in the province must be orderly and economic”¹ and notes that there is always a level of risk:

Ultimately, the actual results will vary from the projections put forward by HGL, and there will always be some degree of risk that these variations may be material. Whether or not this risk has been mitigated by the efforts HGL has put into developing these projections, and the amount of risk that is acceptable in order to take advantage of expanding into developing areas as HGL proposes, are questions of judgement. NSDOE has no strong position on this issue, other than to note that the provincial policy of supporting the continued expansion of cleaner-burning natural gas use in Nova Scotia should be a factor that is taken into account in determining the acceptable level of risk.

[NSDOE written submission, p.5]

[11] The CA is concerned about the Project’s impact on the RDA, and does not support approval of the Project without further information being made available by the company:

The Consumer Advocate has concerns regarding the potential impact of the expansion on the RDA. To the degree that the economic analysis fails to capture all associated costs, or includes revenues not directly tied to the expansion, there will be an impact on the RDA which may jeopardize adherence to the cross-over and elimination criteria previously set by the Board.

We urge the Board to withhold approval sought by Heritage Gas pending provision of the following information:

¹ NSDOE written submission, p. 2,3

- The CFT calculations in a working spreadsheet,
- An estimate of the customer additions that can be served on the existing system,
- A more realistic forecast of customer additions in the early years,
- A clear, consistent report and all internal reports, analyses and memoranda concerning completion of the loop and the future need for a second supply source.

Once this information is obtained the Board and stakeholders will be in a better position to assess whether Heritage has satisfactorily supported its proposed expansion.

[CA written submission, pp. 3-4]

[12] COHA expressed concerns about the Project's viability and also a perceived abuse of process:

In closing, we wish to express that as an energy competitor, we welcome competition (on a level playing field) from all energy sources and have no objection to the expansion of a natural gas infrastructure in our province and providing more energy choices to Nova Scotians. We are however, disappointed to see some of the tactics being applied by HGL and strongly object to, what we would consider, abuse of the process and "pressuring" the Board and Intervenors. The approved decision by HGL to involve local supplier networks and move forward with the project prior to the Board's review and ruling places undue pressure on the Board. The Board should be wary of rushing the process as a result of HGL's abuse of the timelines; considering that HGL is looking to spend 30 M\$ in its largest expansion project in Nova Scotia to date, ample time is needed to ensure that both the "Market Expansion" and the "New Community" projects are economically viable on their own merits, that both have a positive impact on the RDA and that the cross-over and elimination dates are not extended to ensure that more burden is not placed on HGL customers.

[COHA written submission, p. 3]

[13] The main issues which arose in regard to this matter are:

- is it appropriate to apply the CFT to the Project, rather than the MFT, and is it appropriate to apply the CFT to the entire Project;
- are the underlying economic assumptions reasonable;
- the Project's impact on the RDA;
- is the overall RDA being appropriately managed; and,
- is the overall RDA being appropriately used?

These issues will be discussed individually in the following sections.

III ANALYSIS AND FINDINGS

Appropriateness of the CFT Instead of the MFT

[14] COHA objected to the use of the CFT for the entire Project:

HGL has stated that the feasibility of the subject project was justified using the Community Feasibility Test (CFT) rather than the Mains Feasibility Test (MFT). They note the size of the community and the significant capital investment to construct the 33 kilometers of pipe required to expand to Bedford as justification to consider Bedford as a "New Community" and therefore the application of the CFT guidelines in lieu of the MFT guidelines. While this might be stretching the intent of the CFT's use, COHA could accept the CFT argument for the Bedford portion of the project but clearly not for the Fairview, Clayton Park, Bayers Lake portions of the project.

[COHA Written Submission, p.1]

[15] The CA is concerned that the CFT includes revenues from customers who could be connected to the existing system without the Project proceeding:

The Company acknowledges that the CFT includes some potential customers from the Fairview area that could be served from the existing system if the proposed pipelines were not installed, but argues that the existing capacity is limited. (NSUARB-IR-5) The Company does not estimate the additional revenues potentially served by the existing system, as requested in NSUARB-IR-5, and it does not revise the CFT to remove the associated revenues, as requested by NSUARB-IR-6. Heritage's insistence that the "customer load expected for the entire Fairview, Clayton Park, Bayers Lake expansion cannot be sustained by the PE system that currently exists near Bayers Road and Rowe Avenue" simply avoids the issue.

[CA Written Submission, p.2]

[16] In its written response, Heritage argued that:

- a) The original development plan for the Halifax market related only to the Peninsula. The 2007 expansion to the Peninsula was evaluated utilizing the Community Feasibility Test.

It is acknowledged that the proposed expansion is within the HRM and is contiguous to the existing Halifax EP system. However, these contiguous markets are outside the original development area contemplated by the company. The size and scope of the markets are such that Fairview, Clayton Park, Bayer's Lake and Bedford collectively cannot be serviced without a significant investment in an elevated pressure steel pipeline to support the polyethylene (PE) systems.

As was the case in relation to the original expansion to Halifax, the project requires a significant investment in the first year of the project with the building of the EP steel pipeline. The PE system that is required (and which will ultimately attach the various customers to the system) will be developed over a longer period of time. Customers will be recruited and attached to the

system over several years. Therefore the attributes of the project are consistent with that of a Community.

Projects under the mains feasibility test typically are smaller in scale and do not include an investment in an elevated pressure steel pipeline as the backbone for the expansion. These projects are also typically started and completed within one year.

[Heritage Written Response, p.5]

[17] In its January 26, 2010 letter to Heritage, the Board said: "The Board agrees in principle that the CFT appears to be appropriate given the unique circumstances in this case." The Board cautioned that it would use additional criteria to evaluate the Project for robustness of underlying economic assumptions.

[18] The Board finds that it is not necessary to revisit this issue and confirms that it is appropriate to apply the CFT instead of the MFT to the entire Project.

Reasonableness of Underlying Economic Assumptions

[19] Heritage has a history of not achieving its revenue projections and has, in past submissions, provided rationale for the under-performance. Reasons included over-estimating customers' gas consumption due to weather, increased appliance and building efficiencies, and lower or delayed attachment rates in developed areas.

[20] In IRs, COHA, the CA and the Board all questioned the reliability of the assumptions in support of the economics of the Project. In its written submission, the CA suggests the revenue forecast, in particular, is optimistic:

Heritage's base case CFT assumes that 10% of the added residential customers, 35% of the RC1 customers, 79% of the RC2 customers and the single RC3 customer will be activated in the last four months of 2010 after the pipeline is put in service. The Submission does not provide the basis of the forecast, but it does provide a second version of the CFT with fewer

added customers in the early years of the analysis period (Submission, p. 7). The profitability ratio of Version 2 is much lower than the Base Case, that is, 1.13:1 versus 1.45:1.

[CA written submission, p.2]

[21] In its April 8, 2010 submission, Heritage went to some lengths to demonstrate that their consumption assumptions are realistic or even conservative. Heritage further argued, in its written response dated May 11, 2010:

Heritage Gas has taken a number of steps to address the concerns which have been raised with regard to the reliability of its forecasts:

- Heritage Gas has sought information from third party developers in regard to proposed new developments. These development companies, with an established record of success in HRM, have provided information and data concerning their development plans. To ensure a conservative forecast, Heritage Gas reduced the developer forecast factors by approximately 30%. The conservative view was utilized within the base Community Feasibility Test.
- Heritage Gas now has the benefit of experience in building out its system in areas of new development such as Russell Lake, Portland Hills and Dartmouth Crossing.
- As noted in various IR Responses, Heritage Gas has used more conservative consumption figures for retro-fit markets based on its actual experiences in those markets.

Similarly, with regard to "penetration rates", Heritage Gas has the actual experience of construction in both new residential and commercial areas (Russell Lake, Portland Hills and Dartmouth Crossing) and in a "retrofit" market (Halifax and Dartmouth). The penetration rate assumptions are described in detail at pages 5 to 8 of the letter from Heritage Gas to the Board of December 1,2009.

[Heritage Written Response, pp. 5-6]

[22] The reliability of the projections was emphasized during the hearing. As stated by Mr. Ritcey upon questioning from the CA:

A. (Ritcey) Mr. Merrick, it's our best estimate of the future at this point in time and we remain clearly focused on the RDA being recovered by the end of 2018/2019. We look at, I'd say, six factors that we believe contribute to improved accuracy of our forecast and I'd just like to provide those to you.

The first is, as you mentioned in your question, we have an additional two years of history, of experience on our systems, we do know our customers better today than we did when we last appeared before the Board, and we understand not only how those customers use our product but also the efforts that are required to attach the customers that we ultimately need to come to our system. We have a much better understanding than ever before.

The second area why our forecast today in long term planning 2010 -- we have greater access to new developments built into that plan which will result in higher uptake and ultimately penetration and it represents a lower cost of service.

The third element that factored into our long term plan was that we utilized developers' projections, we took information available from third parties and factored that information into our forecast and at the same time making some assumptions to reduce certain class of customers. We put in lower numbers than what were provided by the customer.

So, we believe that utilizing that information and the history of those developers and the success that they've had in the HRM will lead to better inputs on our part and better assumptions in developing a long term plan.

On average we lowered consumption levels across all classes of customers and we've targeted our infill customers along our line with specific strategies and tactics to basically improve our success rate of attaching customers along the line.

And, lastly, the government strategies that were announced, or government policies and government legislation that were announced in 2009 and again in April 2010 – there is a focus of the government in terms of increasing the use of natural gas in the province, and while the long term plan that we have in place hasn't factored any of those specific programs in place that we believe will ultimately come, we do recognize that certain customers will come to the system ultimately as the result of those policies and programs of the government.

So, that gives us, Mr. Merrick, increased confidence in terms of the assumptions that have been utilized in the forecast. Having said that, the forecast is not perfect. We know from history that forecasts are not perfect, assumptions change, some move in some ways and others move in different ways.

[Transcript pp. 16-18]

[23] The achievability was questioned by Board Counsel to Mr. Ritcey as follows:

Q. But there's a – forgive me, but there's a sense of déjà vu, because as I recall in 2008, in that case, the panel also expressed confidence in those projections and how their experience operating the system had led them to a more refined approach and that therefore these projections should be – those projections, I should say, should be more reliable than the past ones.

Has there been something – you've mentioned one factor. Is there anything else that's new since 2008?

A. (Ritcey) I think there's two other factors that – it's predominantly, you know, having the opportunity to – with pipes in front of new construction. That eases the customer attachment process. It also reduces the cost to bring those customers to the system.

We've also, with the eight years of history that we now have and the different types of customers that we have, we've factored that into the plan and we've reduced on average the amount of consumption that we had previously looked to into GT-08.

[Transcript pp. 56-58]

[24] The effect on the RDA and the confidence in the revenue projection were stated by Mr. Smith:

A. (Smith) But I appreciate the sentiment, that if we continue to miss on our forecasted customer additions we will have a larger RDA than what we have forecasted in this model.

There are different – the reason I asked about different classes is different classes of customers have a different impact on the overall RDA and our assumptions around rate – as you go up in size our assumptions are – we have – there's fewer customers to analyze, the numbers, the – we know them better.

We – for example, Rate Class 3 customers, we have much better confidence when they would come on given our visits and one-on-one conversations with those customers. So, to apply a general – I understand what the point of the sensitivity analysis is but there are other mitigating factors that affect the growth of the company.

[Transcript pp. 66-67]

[25] The shortfall in the actual results compared to GTA-08 was explained by Mr. Ritcey:

A. (Ritcey) Mr. Merrick, the main reason why we are in the situation today with respect to the RDA really is directly attributable to the downturn in the economy in 2008 and 2009.

Clearly we had expectations of customer attachments in that time period that would ultimately significantly provide revenue to our system. That did not materialize as we had planned, and I believe we wouldn't be the only company that was impacted by the circumstances at that point in time.

Having said that, we've recognized that in the development of our new plan and we've gone through a very lengthy process in terms of looking at all the assumptions around all the factors that affect the RDA, we've built that into the long term plan and we're executing strategies and tactics basically to ensure that we get the revenue on that we're expecting.

[Transcript pp. 19-20]

[26] The achievement of the projections and the effect on the RDA are of concern to the shareholder. In response to a question from Board Counsel, Mr. Ritcey stated:

Q. Okay. I guess with the track record that we see in terms of the revenue projections you would certainly understand if stakeholders and the Board are skeptical of their reliability?

A. (Ritcey) Yes, I understand, Mr. Outhouse, and as I indicated in my opening remarks, it's clearly the focus of the attention of the management of Heritage Gas and the shareholder to do everything that we can to reduce that RDA in a orderly fashion.

[Transcript pp. 57-58]

[27] The Board finds that any shortfall in the revenue projections will directly impact the RDA. The Board accepts that Heritage strongly believes in the robustness in its present projections (identified as "LTP 2010" in the exhibits). The Board is concerned about its achievability.

Impact on the Revenue Deficiency Account

[28] In its Information Request CA-IR-8, the CA asked:

Please provide the Company's current projected annual RDA balances and the year of full depletion of the RDA, for the following cases:

- a) No expansion,
- b) Planned expansion without the loop around the Bedford Basin, and
- c) Planned expansion [without] the loop around the Bedford Basin.

[29] Heritage's response included the following table:

RDA Balance (\$ millions):	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
With Expansion	\$ 26.9	\$ 33.9	\$ 40.8	\$ 45.5	\$ 47.5	\$ 44.6	\$ 37.4	\$ 31.6	\$ 23.4	\$ 13.0	\$ 0.1	\$ -	\$ -
Without Expansion	26.9	33.9	40.2	44.7	47.9	47.8	44.8	38.8	33.9	28.2	21.1	12.5	2.3
Expansion reduces (increases)	\$ -	\$ -	\$ (0.6)	\$ (0.8)	\$ 0.4	\$ 3.2	\$ 7.4	\$ 7.2	\$ 10.5	\$ 15.2	\$ 21.0	\$ 12.5	\$ 2.3
RDA													
Note that 2008, 2009 are based on actual results.													

Taking the projections at face value, Heritage's evidence is that the effect of the Project on the RDA will be to reduce the peak in 2012 by \$400,000 and accelerate full recovery by about two years to 2018. In other words, the overall RDA picture will be improved if the project proceeds.

Management of the Overall Revenue Deficiency Account

[30] Heritage, in its March 8, 2004 General Tariff Application ("GTA-04"), proposed a deferred RDA, in conjunction with levelizing its forecast cost of service over a five year test period. Heritage forecast that the RDA balance would grow to a peak of approximately \$6 M, but would be fully recovered by 2008. In its Decision, [2004] NSUARB 72, the Board approved the RDA and five year test period but directed that Heritage report data annually to the Board on both an actual and weather normalized basis. The Board stated:

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

[Board Decision, 2004 NSUARB 72, p. 9]

[31] Before the end of the five year test period, Heritage submitted a new GTA-06 on September 1, 2006. Regarding the RDA, it stated: "Due to the slower than expected pace of development of the natural gas market, it is apparent the revenue deficiency account ("RDA") will not be fully recovered in 2008 and a longer period will be required."

[32] In its Decision, [2006] NSUARB 142, the Board approved the extended duration and size of the RDA forecast subject to Heritage refiling "the projected RDA balances, and all the supporting schedules, for the next fifteen years reflecting the various elements of the decision". Heritage filed the revised tables on January 8, 2007, which indicated the RDA would grow to a peak of \$29.2 M in 2011 and be fully recovered by 2019.

[33] Just seven months later on July 9, 2007, Heritage submitted an annual filing as required by the 2006 decision, including a new forecast that the RDA would peak at \$38.8 M in 2011 but still be fully recovered in 2019.

[34] Heritage submitted GTA-08 on September 2, 2008 in which it requested Board approval of rate increases driven primarily by the desire not to exceed the RDA targets approved in the GTA-06 decision. The Board granted the rate increases in its Decision [2009] NSUARB 15, but included the following in its findings:

The Board shares the concerns of the intervenors as to whether the cross-over date of 2011 and the elimination date of 2019 of the Revenue Deficiency Account ("RDA") will be met by Heritage. It is to the benefit of ratepayers that the RDA be eliminated as soon as reasonably possible. To provide a cushion against any potential shortfall in revenue projections, and to help ensure that the cross-over and elimination of the RDA occurs within the timeframe outlined in the Application, the Board orders that depreciation charges be suspended for the test years 2009, 2010 and 2011. This suspension of depreciation charges will not alter the requested rates. The depreciation charges will resume in 2012, and beyond, unless the Board determines otherwise.

[35] Heritage's subsequent compliance filing on February 27, 2009 indicated a forecast RDA peak of \$30 M in 2009, with full recovery by 2018. The reduction in peak RDA can be attributed to the suspension of the depreciation charges for 2009 through 2011.

[36] As noted above [para. 8], in response to CA-IR-8, Heritage's current forecast for the RDA, not including this Project's contribution, indicates the peak will be \$47.9 M in 2012 and full recovery will now not occur until 2021. This large jump in the RDA forecast precipitated the Board's decision to conduct the oral hearing.

[37] The growth of the RDA forecast is directly linked to Heritage's lack of success in achieving its forecast number of customers and consumption rates. With each successive filing, Heritage acknowledged that the previous forecast had been optimistic,

but that the company had new knowledge based on actual customer acquisition rates and consumption and that the updated forecast should now be considered realistic. Until now, the Board accepted Heritage's forecasts and assumed that the RDA was being managed prudently.

[38] In its financial filing dated June 1, 2010 [Exhibit H-12], Heritage compared its actual December 31, 2009 results to the forecast which accompanied the GTA-08. Similar to previous forecasts, customer numbers and revenue projections in the GTA-08 proved to be very optimistic, with actual 2009 revenue being \$2.9 M, or 24.7% lower than forecast, and activated customers at the end of 2009 being 863 (26%) fewer than the forecast 3,298 total across all rate classes.

[39] In this regard, the following exchange between Board Counsel and Mr. Ritcey is instructive:

Q. Okay. All right. So, when we look back at that historical record you'd agree with me that Heritage has consistently failed to meet its various revenue projections by a very substantial margin, correct?

A. (Ritcey) Correct.

Q. And as a result of missing those revenue projections it's missed by a very substantial margin its RDA projections?

A. (Ritcey) They are directly linked to one another, yes, Mr. Outhouse.

Q. And you would agree with me that the failure to meet your revenue projections is far and away the primary driver which has caused the RDA to go from its original projection of \$6 million dollars in 2004 to the balance which we look at today at the end of 2009 of approximately \$34 million?

A. (Ritcey) That would be correct.

Q. It's also true, isn't it, that the failure to meet the revenue projections in the compliance filing of February '09 and its projected failure to meet those same projections -- those 2009 projections in 2010 and 2011 is why we're now looking at an RDA somewhere in the range of \$47 - \$48 million, correct?

A. (Ritcey) That's correct.

[Transcript pp. 52-53]

[40] The RDA is a unique regulatory tool which the Board has made available to Heritage. A private unregulated company would not have the ability under generally accepted accounting principles, to use such an asset. It is an asset created by and through regulation.

[41] As noted above, the track record of Heritage in estimating both the size and duration of the RDA has been far from satisfactory. Indeed, the Board has, to a large extent, lost confidence in Heritage's ability to properly estimate the size and duration of the RDA. Much of the Board's concern relates to the fact that the present and future customers of Heritage will be paying the RDA of \$47 M. Inter-generational equity is a significant concern for the Board.

[42] The Board believes the time has come for Heritage to take off its rose-coloured glasses and put more discipline and reality into its financial projections. This discipline and reality is the responsibility of Heritage and its shareholder. To ensure that Heritage meets its financial projections, the Board has determined that it needs to change the RDA model so that Heritage's shareholder will bear more of the risk in relation to the RDA.

[43] Possible alternatives to do this, such as a cap on the RDA or controls on how assets come into rate base, are noted in the cross-examination of the Heritage panel by Board Counsel, and are summarized as follows:

- an overall cap on the RDA and possibly a cap on the RDA as it relates to the Project;
- allowing new assets into rate base when there are sufficient customers to justify the Project economically, and in the meantime, allowing only short-term interest rates;
- sharing the RDA risk above the forecast amount.

[44] The Board is concerned that changes to the RDA model be done in an efficient and effective way to achieve the Board's objectives while not causing unintended consequences to Heritage.

[45] In that regard, the Board has requested Board Counsel to facilitate a consultation with Heritage on how best to achieve the Board's objectives. A letter to Board Counsel is being issued with this Decision. The purpose of the consultation is not to determine whether this should be done. The Board has determined it will be done. Rather, the purpose of the consultation is to determine how best to achieve it. Board Counsel will be asked to report back in 60 days.

[46] The Board very much wants to see Heritage succeed. The Board believes the Project which it is approving in this Decision is critical to having Heritage succeed.

[47] However, the time has come for the Board to take steps to inject more rigor into the process to ensure the RDA is properly managed and that Heritage's projections are realistic.

Use of the RDA

[48] It became apparent during a review of Exhibit H-12 that Heritage was increasing operating and administrative expenses, over and above those approved in the last rate case (GTA-08), by substantially increasing staffing expenditures. It also became apparent that those additional expenditures, to the extent Heritage did not have a corresponding increase in revenue, were being added to the RDA.

[49] The purpose of the RDA is to assist Heritage to recover its test period expenditures and earn a reasonable return, to the extent those expenditures cannot be recovered through early year revenues.

[50] Based on the evidence before the Board, the Board believes it is an inappropriate use of the RDA to unilaterally, and without Board approval, increase test year expenditures, without a corresponding increase in revenues, and charge those amounts to the RDA. Heritage has 30 days to make additional submissions on this issue otherwise that practice by Heritage is to stop. As a rule, if Heritage needs to increase its operating and administrative expenses, and if revenues do not increase to allow that to happen, then Heritage's only alternative is to apply for rate relief. Heritage is free to discuss this issue with Board Counsel in the consultation.

IV APPROVAL

[51] The Board approves the economics of the Project.

[52] In the Board's view, by injecting more rigour into the management of the RDA as described above, it is more likely that Heritage's latest projections will be met. If not, Heritage's shareholder will share the risk.

[53] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 11th day of June, 2010.

Peter W. Gurnham

Kulvinder S. Dhillon

Murray E. Doehler