

DECISION

**NSUARB-NG-HG-COMP
2010 NSUARB 229**

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE GAS DISTRIBUTION ACT

- and -

IN THE MATTER OF AN INVESTIGATION by the **NOVA SCOTIA UTILITY AND REVIEW BOARD** of certain complaints and to determine whether **HERITAGE GAS LIMITED'S** marketing strategy to distribute natural gas is meeting its obligation to serve its franchise areas

BEFORE: Kulvinder S. Dhillon, P.Eng., Member
Murray E. Doehler, CA, P.Eng., Member

COMPLAINANTS: **PETER ALLEN**
On his own behalf

BALWANTRAY CHAUHAN
On his own behalf

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

INTERVENORS: **CONSUMER ADVOCATE**
William L. Mahody, LL.B.

HALIFAX REGIONAL MUNICIPALITY
Mary Ellen Donovan, Q.C.
Stephen Jedynek, LL.B.

LIBERAL CAUCUS OFFICE
Andrew Younger, MLA

NOVA SCOTIA DEPARTMENT OF ENERGY

Mark Rieksts, LL.B.

Bill O'Halloran

PICTOU REGIONAL DEVELOPMENT COMMISSION

Robert Funke

BOARD COUNSEL: Richard Melanson, LL.B.

HEARING DATE: October 5, 2010

**CLOSING
SUBMISSIONS:** October 21, 2010

**REBUTTAL
SUBMISSIONS:** October 29, 2010

DECISION DATE: **November 30, 2010**

DECISION: **Complaints dismissed, but conditions imposed on Heritage Gas Limited.**

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I INTRODUCTION

[1] This is a decision of the Nova Scotia Utility and Review Board (the “Board”) with respect to certain complaints against Heritage Gas Limited (“HG”) and to determine whether its marketing strategy to distribute natural gas is meeting its obligation to serve its franchise areas.

[2] The Board received complaints from Peter Allen and Balwantray Chauhan, both of Halifax, against HG for not providing access to natural gas in their area. Mr. Allen wrote to the Board on April 22, 2010 and HG responded on May 10, 2010. Mr. Chauhan’s letter to the Board was received on May 7, 2010 and HG responded on May 26, 2010.

[3] The Board reviewed both responses from HG and advised in a letter dated July 19, 2010 that a public hearing was required to investigate these specific complaints and HG’s overall policy of extending natural gas distribution mains in its franchise areas. An Order setting the public hearing on October 5, 2010 was issued by the Board on August 9, 2010. The Board amended the Order on September 15, 2010 to allow information requests from the Intervenor to HG without changing the hearing date.

[4] Those who participated at the hearing were: Peter Allen and Balwantray Chauhan (the “Complainants”); the Consumer Advocate (“CA”); Halifax Regional Municipality (“HRM”); Nova Scotia Department of Energy (“NSDOE”); Pictou Regional Development Commission (“PRDC”); and the Liberal Caucus Office (“Liberal”).

[5] HG was represented by John C. MacPherson, Q.C. as counsel, along with James Bracken, President; Chris Smith, Vice-President, Finance and Business Services; and Michael Howard, Director of Sales and Marketing.

[6] PRDC had letters of consent to represent the Regional Development Authorities (“Regionals”) in the franchise areas of East Hants and Colchester. Robert Funke, the spokesman for the group, was supported by Barry MacMillan, Gerald Gabriel and Paula Irving.

[7] The Board received closing submissions from the parties on October 21, 2010 and rebuttal to the closing submissions on October 29, 2010.

II BACKGROUND

[8] HG was awarded a franchise to distribute natural gas in certain parts of the Province in 2003. Since then it has purchased the assets of Sempra, the original franchisee, in Dartmouth, Nova Scotia and installed new distribution mains in the areas of Dartmouth, Halifax, Amherst and Halifax International Airport.

[9] HG applied for, and the Board approved, its first full rates and tariffs application in 2004, including the feasibility tests to be met by each gas main extension undertaken by HG. The Board also approved a deferral account called the Revenue Deficiency Account (“RDA”) to accommodate the early expansion of gas mains by balancing the deficit in the early years of the projects with surpluses in later years.

[10] The relevant legislative provision governing the expansion of the distribution system is found in s. 18 of the *Gas Distribution Act*. This section provides:

18(1) Where the Board finds such action necessary or desirable in the public interest, the Board may direct the holder of a franchise to extend or improve its gas delivery system if the Board finds that no undue burden will be placed on the holder of the franchise.

(2) Subsection (1) does not empower the Board to compel the holder of a franchise to deliver gas to additional customers if to do so would impose undue burden on its existing customers or impair its ability to render adequate service to its existing customers.

[Post-Hearing Submission of HG, p. 2]

[11] In the Board's decision [2004 NSUARB 72], the feasibility test in respect of main extension and service lines ("MFT") as proposed by HG was accepted:

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

[Post-Hearing Submission of HG, p. 5]

[12] HG explained the use of the MFT as follows:

Heritage Gas is proposing to use a two part feasibility test, in respect of main extensions and service lines, which employs first a net present value (NPV) determination, and second a point in time revenue to cost ratio.

The acceptance criteria without customer contribution requirement is a NPV profitability ratio (NPV of the revenue stream for 25 years divided by the NPV of the revenue requirement stream for 25 years) of 1.00 or greater and a year seven profitability ratio (revenue divided by the revenue requirement) of 1.00 or greater. Utilizing the following criteria a net present value for the project will be calculated:

- An estimate of the total incremental capital costs of providing service;
- An estimate of the total annual incremental operating costs of providing service;
- The Board approved return on common equity, interest rates, amortization (depreciation) rates, income taxes and capital structure; and
- An estimate of the expected incremental net revenue that will result from the addition of the service.

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

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

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

[Post-Hearing Submission of HG, pp. 4-5]

[13] The Board understands that the result of a positive MFT can, in the earlier years, negatively impact RDA. The test, however, if properly applied, should start to reverse this negative impact after year seven and contribute positively thereafter. In recent rate applications the Board noted that HG has consistently failed to meet its revenue forecasts which has negatively impacted the accumulation of the RDA. In 2009 the Board became very concerned that the MFT appears to have not been properly applied for expansions and imposed additional conditions by an order as recommended by its consultant, Energy Consultants International Inc. ("ECI"):

[127] The Board is concerned that if the feasibility tests are not conducted properly, it will negatively impact ratepayers by increasing the RDA.

[128] The Board agrees with ECI's recommendation. Heritage is directed to provide details of the mains feasibility test along with its applications for permits to construct when it expands into the areas of Fairview, Clayton Park and Bayers Lake.

[129] The Board further directs Heritage to continue to prepare community and mains feasibility test calculations for all new areas and all extension of its mains. The Board requires Heritage to include this information with its permit to construct applications.

[Post-Hearing Submission of HG, p. 5]

[14] In complying with this directive HG submitted several projects for approval which the Board determined needed further direction. Accordingly, on June 9, 2009, the Board issued a letter which stated, in part, as follows:

The Board has always understood that the mains feasibility test would be applied to each individual mains extension which could be a single pipe, or could include contiguous branches of a number of pipes. It would not normally include noncontiguous pipes, especially if they are geographically remote....

The Board directs that only such capital costs as those that meet a feasibility test be included in rate base at this time. As more customers are activated along the project, HG may include additional capital costs so long as the feasibility test results are met. At such time as HG includes a portion of the cost in rate base, it shall report to the Board the included cost, the remaining cost and the feasibility test result status.

[Exhibit H-15, pp. 1-2]

III COST FOR SERVICE IN THE COMPLAINANTS' AREA

[15] Mr. Allen in his opening remarks commented upon the desirability, from an economic and environmental view point, of using natural gas for residential properties, which is not disputed by HG. Mr. Allen further went on to say he does not expect HG to provide the service if it is unreasonable, stating:

... This is also on their document that they don't have to provide a service if it would be unreasonable. And certainly I don't want them to do anything unreasonable; I wish for Heritage Gas, you know, have plenty of profits and many decades of profitable service in this industry. I don't think moving into these residential areas will be unreasonable. ...

[Transcript, p. 15]

[16] The Complainants, who live in proximity to each other, are in an area that HG has determined does not meet the MFT, described by Mr. Allen as follows:

... So first of all I'm here to help promote the use of natural gas in this province. In particular I'm going to focus on this area in the south end portion of Halifax, which has been discussed in this submission.

I live in this area. It's ... this is not from my perspective an issue about where I live in the City of Halifax and getting natural gas to that portion of the city, I'm just using this area as indicative of a typical residential area in this province. ...

The area that we're looking at is this triangular area inside the red lines, where we have 466 single family homes; there may be a handful of multi unit residential there, maybe two or three units in the home, but generally, single family homes.

Heritage Gas has said that it will give out a \$4.5 million project or \$9700 per home to bring natural gas to this area. But the distribution to this residential area has been ruled out in spite of the fact that we have the mains in the area. The feasibility test was failed for this area.

...

So if it doesn't work here where we have natural gas available in the area at a couple of points with gas mains already there, three mains on the perimeter of this area already, then where in Nova Scotia would it be feasible.

[Transcript, pp. 12-14]

[17] The complainants' area was particularly explored by the Board with HG as follows:

- Q. ... So looking at Dalhousie and Saint Mary's and the feasibility test that was done there, if you had gone and allowed the area of the triangle to be part of that, would that whole area then been feasible?
- A. It almost certainly would have. I'm not sure that we've done the math on that but it almost certainly would have been feasible on an economic feasibility test basis by rolling it in with the benefit of something as large as Dalhousie. That doesn't mean to say, however, that it wouldn't, on an incremental basis, contribute to increasing the RDA.
- Q. In other words, just being restrictive, we may have caused a problem there, too. Not letting groups to go together.

[Transcript, p. 236]

a) MFT Calculations

[18] HG provided different scenarios and calculated the MFT for each one. The first scenario was done on the revenue and cost to service the nine residential customers, including the Complainants, who had signed Distribution Service Agreements ("DSAs"). This calculation showed a profitability ratio of 0.10:1:

Feasibility Test Based on Current Commitments	
Number of committed residential customers	9
Capital required:	
Mains	\$ 187,500
Service lines @ \$5,000/average	<u>45,000</u>
Total	<u>\$ 232,500</u>
Feasibility Test result	0.10:1
Minimum required result	1:1

[Exhibit H-6, p. 10]

[19] To improve the profitability ratio, the Company then did a calculation assuming that all 57 residences along the route of the mains would be connected. This calculation resulted in a profitability ratio of 0.5:1:

Feasibility Test Based on 100% Customer Commitment	
Number of possible residential properties	57
Capital required:	
Mains	\$ 187,500
Service lines @ \$5,000/average	<u>285,000</u>
Total	<u>\$ 472,500</u>
Feasibility Test result	0.50:1
Minimum Required Result	1:1

[Exhibit H-6, p. 11]

[20] Subsequently, in response to an information request, HG calculated the MFT for the area bound by Robie Street; South Street; and Beaufort Avenue, defined as the “triangular area”. The result of this calculation is as follows:

Feasibility Test Based on 100% Customer Commitment	
Number of possible residential properties	466
Capital required:	
Mains	\$ 2,139,000
Service lines @ \$5,000/average	<u>2,330,000</u>
Total	<u>\$ 4,469,000</u>
Feasibility Test result	0.47:1
Minimum Required Result	1:1

[Exhibit H-7, PA-IR-7, p. 13]

[21] HG confirmed that the MFT for the whole triangular area indicated it was un-economic to service.

[22] The relationship of the RDA and the MFT was explained:

Q. I think then coming back to it, the question I was asking you about the RDA and the feasibility test maybe we restricted the terms of the feasibility test too tightly to not allow that type of creative ... how to lump things together. Because of the concern of the RDA?

A. ... not being able to lump things together does make it much harder to serve a residential neighborhood. ...

[Transcript, p. 215]

Q. ... So what I am saying is that the big load doesn't have to reside in the residential area to get them service, ultimately.

A. Well, we understand that it does. And, again, we're going by our interpretation of the Board's letter, as recently as in June of 2009, where we aren't allowed to take a large load in one area and, as part of that project, broaden the scope of that to include residential areas that aren't directly on that line. We've tried to do that in the past and the Board has denied that approach.

[Transcript, p. 226]

[23] Mr. Allen in his pre-filed Evidence [Exhibit N-9] developed a financial analysis of the MFT. In particular, he found that this test is very sensitive to three parameters: return on equity (13%), return on debt (8.75%), and the inclusion of income taxes. He then recalculated the MFT, first changing the parameters of equity and debt return from the approved rates, to 10.0% and 7.0% using the scenario that all homes along the route for the two Complainants would take service (57 residences). This analysis indicated that the MFT requirement of profitability in year seven is not met; however it is met over a 25 year period. Next he did the same test as above, but excluded income taxes. This second analysis shows that the MFT for the 57 homes is met in both cases, i.e., 7 years and 25 years.

[24] He summarized his analysis as follows:

Heritage Gas chose to perform feasibility tests using 100% participation. The revised analyses that are included in this submission also assumed 100% anticipation. Over a 25-year period it is highly probable that there will eventually be close to 100% participation. A more thorough and detailed analysis should ramp up participation from a low percentage (e.g., 25%) to 90%. The financial analyses should be positive at the rates of participation in the 80 – 90% range, given the higher rates of fuel consumption and reduced capital costs as noted above. Submission deadlines preclude these analyses being included in this document by the Complainant.

[Exhibit H-9, pp. 14-15]

[25] The parameters of the MFT that Mr. Allen has concerns about were the natural gas consumption, installation costs, and cost of equity and debt. These are analyzed in the following sections.

(i) Natural Gas Consumption

[26] Mr. Allen questioned HG's assumption of the average energy consumption by residential customer and stated:

... For example, here I'm using a home which uses 3500 litres a year, which is 128 gigajoules. Heritage Gas uses a figure of 91. Well, I've been involved in the energy business for 30 years, I've analyzed hundreds of homes, there are many homes where 3500 litres a year is low. So I believe it's middle of the road, especially for the subject area in south end Halifax where we have those 466 homes.

[Transcript, p. 20]

[27] HG responded:

Acknowledging the fact that there are certain large homes on Oakland Road in particular that would probably be higher than 91 GJs, but the vast majority of the homes within that triangular area are very similar to the size of homes in Dartmouth where we have significant experience.

[[Transcript, pp. 157-158]

[28] In his closing submission Mr. Allen did a further analysis on the energy load and costs of service and whether the increased load made a difference or not and concluded:

The feasibility test is dependent on the magnitude of the gas consumed (annual GJ's), however, there is a small variance associated with this parameter. Whether the load is 90 or 120 GJ/year/home will not move the feasibility test result from a 0.50 to the required 1.00.

[Post Hearing Submission by Complainant, p. 5]

(ii) Construction Cost

[29] The Complainants questioned assumptions used by HG to calculate the total cost of the project. In particular, they noted that the unit construction cost used by HG for their area to calculate the total cost is too high.

[30] HG responded to these issues and stated that:

...but we do have that on the record here that describes some of those programs and it can significantly reduce the cost of going into a neighborhood when we go in there on a shared basis with them. For the most part, that works best in brand new areas, so the cost of installations in brand new subdivisions is substantially lower.

...

...The problem with the HRM is that's it a very old city and particularly in Dartmouth and in Halifax, so you don't necessarily know what's underneath the streets and in a lot of cases Heritage Gas is ... is discovering, which benefits everybody in terms of what's underneath the streets of the HRM and those drawings and information are being shared with the HRM which will help future utilities in their expansion activities.

[Transcript, pp. 190-191]

[31] HG further compared the construction cost for gas mains in HRM to Amherst:

... we could actually do a little bit of a drill into the ground and then drag the pipe through, so we didn't have the same kind of cut that we'd have to have ... the trenching that we'd have to have in the HRM, so there were significant savings and speed of construction associated with it. ...

[Transcript, p. 193]

[32] HG explained the challenges it faces to serve the retrofit residential market:

... is that we recognize that there were challenges in terms of the retrofit market and so we are moving beyond that and that's why we have wherever there is an opportunity to provide service to residential customers ... in the greater Dartmouth area, which includes Russell Lake, Portland Hills, things of that nature and the whole opportunity that was presented because of Dartmouth Crossing, ...

[Transcript, pp. 185-186]

[33] Alternate ways to reduce the construction cost, using a "rock wheel", within the existing street was explored by the Board. HG responded:

A. It was absolutely cheaper because the width of the cut was basically the width of the pipe versus three feet, which is the typical size of the cut we have to do.

Q. So it'd be feasible to get one of those machines here and just ... why wouldn't we do that thing for all the cuts we're going to do now?

A. Well, I think that we would ... we would have propose to do some of that but the HRM was not interested in us utilizing that. And, in fairness to them, it was not ... to do a rock wheel-type process you need to know exactly what's underneath ... what's underneath the street and in a lot of the cases, the older parts of the HRM until we basically go in and stick our heads underneath the manhole covers and look underneath the street, we don't know what's there.

Q. So, that'd be the older parts of Dartmouth and Halifax. What about the places like the triangle? That's not necessarily all that old.

- A. I'm not sure that that's ... it's certainly something we can talk about with the HRM but I don't think that that is something that they would be interested in us utilizing on ... on a grand scale.

[Transcript, pp. 202-203]

[34] In response to the Board's questions, HG outlined other costs to install gas mains in the streets:

- Q. You have to pay a street opening fee, don't you, to HRM every time you cut it?

A. We paid a pave ... pavement reinstatement fee.

- Q. Is that very much? Is that very significant to the overall cost of doing this thing?

A. It is a ... it is a significant factor of our costs as well as the general permitting fees and we are in continuous negotiations with the HRM in terms of managing that.

[Transcript, pp. 203-204]

[35] HG explained the composition of each cost for a service line:

In reference to an individual service line installation, which is the \$5,000 specific, there is a specific cost per ... for every single one of those on a nominal basis. There's a fixed fee for a portion of each of those things and there's a variable component associated with the extension of the length of the service line. The same sort of consideration is whether it's in sod or whether it's in ... going across the customer's lawn or whether it's in asphalt.

[Transcript, p. 155]

[36] HG agreed that some savings could be achieved if there was a 100% sign-up by customers at the start of the project:

And I suppose that if it was presented to us in that format, here is 100 percent customer sign-up for 466 customers; could we negotiate a special rate, perhaps that would be something that we could ... we would be able to get some of economy of scale. But that is not something that we've ever contemplated.

[Transcript, p. 156]

[37] To which Mr. Allen in his closing submission stated as follows:

...There is a very high probability that there will be reductions in these costs as Mr. Smith suggested in his testimony, if a contractor were to be asked to submit a tender based on the installation of services for 57 or 200 or 300 or 466 homes in a single project.

[Post Hearing Submission by Complainant, p. 5]

(iii) Return on Equity and Debt

[38] Mr. Allen noted in his evidence that one of the main reasons the MFT is not met in his area is HG's return on equity and debt is too high compared to the current financial market conditions.

[39] Mr. Allen in his financial analysis used a lower return on equity and debt and stated:

It places an undue burden on them if they seek 13 percent on equity and 8.75 percent on debt. I do not agree with those figures. ...

I choose 10 percent because I referred to the documents of somebody who I believe is familiar to this Board, Kathleen McShane, and looked at her documents and find that 10 percent is quite reasonable for Utilities across the land.

8.75 percent on debt is, I feel, excessive. I went with seven in my analyses. Enbridge Gas, New Brunswick, has lower. Alta Gas, the primary shareholder, they tap into money at five and six percent. Why should they tap into money at five and six percent and then charge the people of Nova Scotia 8.75?

[Transcript, p. 22]

[40] Mr. Allen, in both his post-hearing and reply submissions, emphasized that the use of the approved return on equity and debt by HG is standing in the way of serving residential customers. He takes exception to HG's insistence that these rates should not be considered at this hearing. He finds it "repugnant" that a franchise that

can serve "100,000 residential customers" is precluded from doing so because of these components of the MFT [Rebuttal Submission by Mr. Allen, p. 20].

[41] PRDC noted its concerns and stated:

While we agree that HGL should make a return, it is our contention that HGL does not deserve the generous rates of return built into the MFT [sic] when HGL incurs no risk.

[Post-Hearing Submission of PRDC, p. 9]

... One might get the perception that within HGL, these rates of return are sacrosanct and HGL is entitled to earn their full rates of return regardless of how the company is operated or the community benefit that it, as a monopoly, does or does not provide. During this October 5th Hearing, whenever there has been a discussion of how to make the MFT [sic] work for a project which has otherwise deemed to be "uneconomic", the responses from HGL executives invariably centre around customer price increases, subsidies or someone else finding more load - rarely if ever did they suggest that the rates of return could be fine tuned to make the MFT [sic] work.

[Post-Hearing Submission of PRDC, p. 14]

[42] The CA noted that:

As this Board is well aware, levels of return on capital are significant cost-driving factors in the implementation of the feasibility test. In considering these matters as part of the next general rate application, the Consumer Advocate encourages the Board to test the degree to which these components are serving as barriers to Heritage's obligation to serve.

[Post-Hearing Submission of CA, p. 3]

[43] HG responded to the CA's questions about Mr. Allen's assertion as follows:

- Q. ...do you take any issue with the nature of the calculations which he's made as far as the impact of the return on equity and the cost of debt has on the feasibility analysis?
- A. No, I don't think so. I mean, his math is accurate; he's used the same model that we've used, he's just plugged in different parameters. But I would point out that he has changed three things there. He has changed the return on equity. He's changed the debt rate and he has set aside taxes.

[Transcript, p. 160]

[44] HG was questioned by the CA about the return on equity and debt, as follows:

Q. Has Heritage given any consideration to altering the return on equity or the cost of debt percentages that are currently imbedded within the feasibility analysis?

A. No.

[Transcript, pp. 153-154]

[45] HG in its post-hearing submission noted how Mr. Allen had agreed that the private investors in a utility should be able to receive a return on investment, however, he had disagreed with the quantum. HG concluded:

...Heritage Gas respectfully submits that any such consideration would be beyond the appropriate scope of this hearing...

[Post-Hearing Submission of Heritage, p. 12]

Findings

[46] The Board accepts HG's evidence that a project with an MFT ratio of less than one will increase the RDA. The Board is mindful of the recently approved cap on the RDA and is reluctant to order an action which could significantly increase the balance. Regardless, the Board finds that the MFT is very sensitive to the return on equity and debt parameters. The Board also finds, in the circumstances presented in this complaint, that the values of these parameters is hindering the supply of natural gas to the retrofit residential markets. The Board, therefore, finds that the percentage return on equity and debt should be explored.

[47] The Board notes that the issues of this hearing did not include a review of the parameters for return on equity and debt. The Board in its decision on the latest

rate application [2009 NSUARB 15] has already ordered the review of these parameters in the rate hearing scheduled for 2011 for rates starting in 2012. Accordingly, the Board, at this time, makes no finding on the return on equity and debt parameters.

[48] The Board finds that for the retrofit residential market HG has not thoroughly investigated economies of scale. The Board orders that HG should review the ways it estimates costs for large specific areas using alternatives such as different installation techniques and the economics of a large scale installation and file a report with the Board no later than May 31, 2011.

[49] It appears to the Board that the use of street by-laws by HRM may be hindering HG's use of more cost effective installation methods. At the same time, HRM has expressed a desire to expand the natural gas service. HG should capitalize on HRM's desire to expand HG service in the Municipality to eliminate potential road blocks such as permit fees charged and by-law requirements.

[50] Finally, in light of all the evidence in this case, the Board finds that HG has applied the Board approved MFT appropriately. The Board finds that in the Complainants' area, the approved MFT is not met. As such the area does not qualify, at this time, for the extension of natural gas service. Therefore the complaints are dismissed. However, HG should revisit this area again, if and when any parameter in the MFT is amended by the Board or changed for any other reason.

b) Capital Cost Contribution by Residents

[51] HG, in its analysis for the feasibility test within the triangular area, looked at the possibility of a capital cost contribution from customers over and above their regular monthly bill. For instance, assuming all residents within the triangular area took up natural gas service, then each customer would have to pay about \$2,800 in order to meet the MFT and achieve a profitability ratio of slightly more than 1:1. Mr. Allen was questioned about this as a possible scenario:

- A. You know, I would expect that if we reviewed these feasibility tests and it's still found to be wanting, then certainly go to the homeowner and say, you know, we will put in the gas here but we need a \$500 or a \$1500 contribution from you.
- Q. Mm-hmm.
- A. It seems to me that is reasonable. Nobody is offering me that opportunity.

[Transcript, pp. 58-59

Finding

[52] A possibility of a capital contribution from customers, in order for an MFT to have a ratio greater than one, was presented at the hearing and not before. This information should have been developed and shared with potential customers when service was requested. The Board finds that HG needs to develop a timely and better process to advise the potential customers about the possibility of a capital cost contribution to meet the MFT.

IV OTHER REQUESTS FOR SERVICE

a) Complainant's request - Balwantray Chauhan

[53] Mr. Chauhan in his opening statement explained that after an oil leak on his property he investigated alternatives for heating his home. He believed that natural gas would be a good alternative and thought his neighbours might agree. He circulated a letter to his neighbours outlining the problem he had with the oil leak and the possible solution of using natural gas.

So I have taken this letter to ... and I wished I'd kept copies of how many I delivered, but I would ... I would guess probably anywhere between 100 and 150, perhaps even more. So this is Bellevue Avenue, Marlborough, Inglis, Oakland, Ritchie Drive, and all the sort of surrounding areas where I am. And I thought I was being really a good salesman for Heritage Gas, because I thought I'd bring them lots of business.

And I waited for about six to eight weeks, and I had a lot of people who responded to me by phone, by email, and probably around ... again, I wish I'd kept copies, but maybe almost 100 perhaps of folks who delivered these expressions of interest, ...

So I had taken these forms to Heritage Gas in Dartmouth, plunked them on their desk and I said I hope we can do something about this, and several phone calls and emails afterwards, I was told that, you know, there wasn't sufficient interest. ...

[Transcript, pp. 62-63]

[54] Counsel for HG questioned Mr. Chauhan about the number of expressions of interest he had delivered to HG:

Q. ... I think it was in the letter that came back to you from Heritage Gas, that their records appear to indicate something in that general area plus or minus 25 as opposed to 100.

Do you have any explanation as to that variance in numbers?

A. No. I mean, I will simply disagree with you because I think the number was higher. Now it's possible that maybe all the folks who returned the forms didn't fill out every single part of the form that, you know, would qualify it as being, you know, a legitimate expression of interest. Perhaps they didn't put their address

in, perhaps they forgot to sign it, perhaps they left out some other form, but you'd have to take my word for it that it was more than 25. That certainly is not the case.

[Transcript, p. 66]

[55] This was further followed-up with Mr. Chauhan by the CA:

Q. ... or expressions of interest, were you contacted by anyone else from Heritage Gas?

A. No, absolutely not. ...

[Transcript, p. 68]

[56] The CA explored this further with HG:

Q. They tracked those hundred customers and now we're in a position that no one today can tell this Board how many applications Mr. Chauhan actually delivered to your company, nor how many have been tracked in your system?

A. ... There's obviously a disconnect, however, in terms of what we have in stated commitments, we've got 25 DSAs in that area that have committed to take natural gas. ...

[Transcript, pp. 148-149]

Finding

[57] The Board finds HG's handling of these applications/expressions of interest to be unsatisfactory. It shows disrespect to a private citizen who, of his own volition, undertook a marketing exercise on behalf of the company. The Board orders HG to review its procedures for handling and recording of any and all potential customer requests for service to ensure this situation does not arise again. HG should file its report on the changes with the Board no later than May 31, 2011.

b) Letters of comment

[58] The Board received three letters from persons and groups that are looking for natural gas service. One letter, from Carolyn Conde, commented on how she contacted HG in the fall of 2009 looking for service and was told her name would be added to a list of those in her area who are interested. She called again on August 26, 2010, asking about the status and was informed that her name was not on any list. This was raised at the hearing by the CA:

Q. Has anyone from Heritage Gas responded to Ms. Conde's letter of August 2010?

A. Not at this time.

[Transcript, p. 141]

[59] A letter from James Lorimer of Formac Publishing Company Limited ("Formac") in Halifax outlined its efforts to be supplied with natural gas. It appears that it could have been served if a proposed apartment building near it would also take service from the street. When the apartment building owner decided not to have a separate service for his new building, Formac was informed they would not be served unless they provided a contribution to the capital cost. The CA explored this with HG:

Q. Okay. Mr. Lorimer, though, continues to maintain in a ... in a letter to this Board that he has not been provided with sufficient information. But I take it the company's position is that they've provided all that they're willing to provide?

A. That's correct.

[Transcript, p. 145]

[60] The information requested by Formac was HG's analysis that was used for the MFT for this particular area and was explored at the hearing by Board counsel:

Q. And I thought I heard you say that you would not ordinarily share that ... the model result. I was wondering why.

A. Well, and I guess if it ... we've ... we've tried not to have our feasibility test out in circulation, I guess, and so we try to maintain that tact.

[Transcript, p. 197]

[61] HG's unwillingness to share this information with a customer was further explored by the Board:

Q. ...What part is confidential of this test?

A. ... In an individual customer residential service perspective, I would have to think about what's confidential about it. Obviously, we could withhold all the information about specific customers within it.

[Transcript, p. 223]

[62] It is interesting to the Board, as noted by HG, a property owner (i.e., the apartment building owner) can end up with a cheaper alternative which has negative consequences for supplying other potential customers on the same street.

[63] The third letter was from property owners in the 1700 block on Barrington Street. HG has been working with this group to provide natural gas service, however, they have some challenges. As explained by Mr. Bracken:

...We were trying to time that work around some of the HRM's road construction work. The petition that they filed and put in here is indication of some very strong interest. We're delighted to see that interest.

The challenge we're working with there is some of the design requirements of the City. Those are heritage properties. ...

[Transcript, pp. 212-213]

[64] The CA noted the importance of providing information to customers:

The Consumer Advocate submits that evidence submitted at this hearing demonstrates that improvement is required in Heritage's communication with potential customers, ...

[CA Closing Submission, p. 4]

[65] HG acknowledged the short-comings in its tracking system and stated:

... Heritage Gas is reviewing its tracking processes and will implement changes to correct any identified weaknesses.

[Reply Submission of Heritage Gas, p. 5]

Finding

[66] The Board finds that these instances are similar to the manner in which Mr. Allen was not fully informed about the option of a customer capital cost contribution. As noted in para. 57, HG is ordered to refine its communication strategy with potential customers.

V OTHER ISSUES

a) Franchise

[67] PRDC noted one of the conditions of the full franchise that had been granted to HG was:

3. Heritage Gas Limited shall implement or cause to be implemented, as modified by this decision or by future Orders of the Board, its gas delivery plan and financial plan as set out in its application for the construction of a natural gas delivery system in all or parts of Cumberland, Colchester, Pictou, Halifax, the District of East Hants, and in the Goldboro area of Guysborough County, in accordance with all federal, provincial, and municipal legislation.

[PRDC Closing Submission, p. 4]

[68] In its post-hearing submission, PRDC re-emphasized the concern that HG is only pursuing its financial plan to maximize its profits. HG is not pursuing the gas delivery plan which is a term of its franchise award. They also listed three sources of third party funding, mainly from the Province, used to help expand the distribution system. None of these were for the expansion of the system to the unserved franchise areas identified by the PRDC.

[69] PRDC in its opening remarks commented upon HG's marketing within Pictou County:

... While Heritage Gas claims their marketing and business development practices have been appropriate, we are left wondering what impact has the lack of adequate business plans, strategic objectives, tactical plans, and the matrix by Heritage Gas up to 2007 had on the expansion of the gas distribution network to currently unserved areas in the initial development plan, and what impact have these factors had on the growth of the revenue deficiency account. ...

[Transcript, p. 77]

[70] PRDC and Andrew Younger, MLA, on behalf of the Liberal Caucus suggested that HG may want to consider surrendering a portion of its franchise area.

As stated by Mr. Younger:

2. In franchise areas where Heritage Gas has no plans to provide service, and it appears unlikely that Heritage Gas will provide service within the remaining years of the franchise the board should consider whether those zones should be considered forfeited.

[Post-hearing Submission of Liberal Caucus, p. 1]

[71] PRDC went further in its submission stating that:

This could be done via some form of partnership with HG [sic] or a totally separate entity. It is not fair to the unserved markets for HG [sic] to say we don't want to serve you (i.e. we don't want to meet our obligations with respect to serving franchise areas) and we don't want anyone else to serve you either.

[PRDA Closing Submission, p. 25]

[72] HG, in both its post-hearing and reply submissions, emphasized the efforts it has have made to determine anchor “tenants” in all the franchise areas. HG has not actively marketed in these areas lately as some of the Regionals would like.

Mr. Bracken stated:

... The Heritage Gas approach has been refined over time to increase focus on the types of expansions which can be economically justified. We do not market directly to areas where we know the economics cannot be supported because to do so would simply create ... create demand we are not able to serve. ...

[Transcript, p. 115]

[73] In working with the Regionals, HG is willing to look at all possibilities, including other sources of funding. As explained by Mr. Bracken:

... we’re willing to explore all sorts of possibilities and opportunities. I am aware that in other jurisdictions, other provinces, in order to accelerate the expansion into serving more communities to serve more customers, residential customers in particular, there have been government programs where there’s a very high degree of, effectively, government subsidization of the infrastructure. ...

[Transcript, p. 173]

[74] HG responded to the PRDC’s suggestion of relinquishing its franchise rights in certain areas and stated:

... I mean you heard us say that we’re continuing to work with Pictou County. We’re not interested in surrendering the franchise. I don’t think anybody else could serve the franchise better than we can. We’re continuing to work with Pictou and others.

[Transcript, p. 176]

[75] HG stated that by being economically responsible they are properly meeting the terms and obligations of its franchise award:

... As an operating utility with processes and knowledgeable staff, Heritage Gas is in the best position to provide such service on an economically sound basis. ...

[Reply Submission of HG, p. 10]

Findings

[76] The Board reminds HG that they are responsible to meet all the terms of the franchise agreement. The Board, at this time, does not have sufficient information to determine if HG is properly, prudently, and actively meeting these terms. Accordingly, at this time, the Board will not consider recommending any amendments to the franchise award to the Province.

[77] As there appears to be some evidence that HG may not be properly pursuing all the terms of the franchise agreement, the Board intends to monitor the situation and may hold a hearing on the issue at some future date. In the meantime, HG is ordered to file annual reports with the Board starting no later than June 30, 2011 on the activities and plans to fulfill its mandate in the franchise award.

b) Economic test for Expansion

[78] The difficulty of managing all the parameters for expansion of natural gas was stated by Mr. Bracken:

Well, as I mentioned, we're continuing to work on it. We'll continue to try and find some solutions but I would simply say that as of today, given the economic feasibility test as it is, given the constraint of managing RDA appropriately, for the most part for in-fill residential neighbours or neighbourhoods, it's pretty much dependent on a reasonably large commercial load in the area.

[Transcript, p. 167]

[79] HG stated that it has a proper balance on marketing and economic responsibility for infill areas.

Heritage Gas submits that its marketing efforts in regard to infill expansion in established residential areas have been sufficient and appropriate, given the realities of the situation faced by Heritage Gas in regard to the economics of infill expansion in established neighbourhoods.

[Post-hearing Submission of HG, p. 18]

[80] The restriction on looking at alternate ways to determine an economic test was explained by HG:

... And so then we would, just as I'm suggesting today, we would have had to come up with a different mechanism by which to evaluate those projects and I think that will be the case eventually but it will not be that case until such time that the RDA is on it's way down versus increasing, right.

Q. And the RDA, correct me if I'm wrong, is not just a measure that protects the financial viability of the ... of the utility but it's also for protection for the ratepayer as well, is it not? The cap on the RDA.

A. Yes, that's right.

[Transcript, p. 201]

[81] HG further stated:

... As the RDA becomes under control and it's no longer increasing on an annual basis, there may be a opportunity for us to sit down with this Board and determine an alternate way to manage the feasibility test.

[Transcript, p. 183]

[82] The problems with the MFT, overall, were explored by HG in its post-hearing submissions. HG reiterated its position that little can be done until the RDA balance declines. The CA commented upon this as follows:

The determination of economically advantageous expansion has and should be the subject matter of continued review by this Board. It may be that the economic expansion

test, or the sample size over which the test is administered, or both, need to evolve as Heritage seeks to gain market share.

[Post-hearing Submission of CA, p. 2]

[83] HG, in its reply submission, expressed concern about changing the Feasibility Test at this time:

...Heritage Gas furthermore submits that the "bundling" of the projects reviewed in a Feasibility Test may not be appropriate and may create an undue burden on future rate payers, as they would be required to pay for these RDA increases through future rates. In the future, when the RDA balance is significantly reduced it may be appropriate to consider bundling projects or a portfolio approach, similar to what is used by more mature utilities.

[Reply Submission of HG, p. 2]

[84] As part of his evidence, Mr. Allen commented upon the different service model for residential customers in New Brunswick. In commenting on this, and the control over the RDA within HG, NSDOE stated as follows:

NSDOE appreciates the challenges faced by the Board in providing a regulatory framework within which are balanced the realities for Heritage as a greenfield utility in achieving expansion of service in accordance with the economic feasibility test, and the expectations of potential customers who are seeking greater distribution of natural gas services.

In approving the mains feasibility test and RDA, the Board has mapped a course for Heritage Gas to expand its service capabilities in a manner which is measured, economically sustainable, and which recognizes the need to limit the growth of the RDA, in the interests of preserving intergenerational equity.

NSDOE submits that in doing so, the Board has quite rightly established a regulatory framework which has steered Heritage away from the business model adopted by Enbridge Gas in New Brunswick, characterized by a much greater RDA which has led to higher distribution rates compared to those in Nova Scotia.

[Post-hearing Submission of NSDOE, p. 3]

[85] NSDOE made the following additional comment:

NSDOE submits that in certain circumstances it may be justified for Heritage to conduct further analysis of these assumptions as part of its economic feasibility test, both in terms of gas consumption per home and costs to provide service.

[Post-hearing Submission of NSDOE, p. 5]

Finding

[86] As has been noted earlier in this decision, the Board is cognizant of the interaction between the RDA and the MFT. Until the RDA balance is under control and no longer increasing, the Board finds that the MFT should be maintained. The Board does not support the application of the “New Brunswick” model.

[87] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 30th day of November, 2010.

Kulvinder S. Dhillon

Murray E. Doehler