

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE GAS DISTRIBUTION ACT

- and -

IN THE MATTER OF AN APPLICATION by **HERITAGE GAS LIMITED** for approval of its Inter-Affiliate Code of Conduct

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

APPLICANT: **HERITAGE GAS LIMITED**
John C. MacPherson, Q.C.
Jim Bracken, President
Christopher H.C. Smith, C.A.

PARTIES: **CONSUMER ADVOCATE**
William L. Mahody, LL.B.
NOVA SCOTIA DEPARTMENT OF ENERGY
Mark V. Rieksts, LL.B.

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

DECISION DATE: **September 17, 2012**

DECISION: **The draft Inter-Affiliate Code of Conduct is approved as revised by this Decision.**

I INTRODUCTION

[1] In its most recent general rate application, Heritage Gas Limited (“Heritage”) identified expenses related to operational and financial market services provided by an affiliate company, AltaGas Utility Group Inc. (“AUGI”).

[2] The Board in its Decision stated that:

AUGI, an affiliate of Heritage, is providing operational and financial services to Heritage as per the agreement between them. The Board’s concern is the reasonableness of these costs and whether an outside agency can provide the same services more economically to its customers. Heritage has agreed to draft an Affiliate Code of Conduct for approval by the Board. The Board orders Heritage to provide in the Compliance Filing a proposed timetable of milestones leading to Board approval of the Affiliate Code of Conduct.

[Decision 2011 NSUARB 183]

[3] Heritage filed its draft Inter-Affiliate Code of Conduct (the “Code”) on March 1, 2012. The Board notified interested parties and invited participation in accordance with this timetable:

Notice of Intention to Participate	-	March 23, 2012
Information Requests to Heritage	-	March 30, 2012
Responses to Information Requests from Heritage	-	April 13, 2012
Comments from Interested Parties	-	April 27, 2012
Response by Heritage	-	May 11, 2012

[Board letter, March 9, 2012]

[4] The Consumer Advocate (the “CA”) and the Nova Scotia Department of Energy (the “Province”) expressed interest in the matter. Only the Board and the CA issued Information Requests (“IRs”) and filed submissions. Heritage responded to the CA’s written submission.

II OBSERVATIONS AND FINDINGS

[5] The Board has reviewed the Code, the IRs and final submissions. Below are the observations and the Board's findings about the various issues raised with reference to the applicable sections of the Code.

1. Purpose and Objectives of the Code

[6] In s. 1.1 the Code proposes that the standard test for acceptable affiliate transactions is to keep "ratepayers unharmed by the actions of Heritage Gas with respect to dealing with its affiliates." [emphasis added] In IRs, both the CA and Board staff questioned whether Heritage should consider a higher standard that would require that an affiliate transaction provides a benefit to ratepayers, compared to alternatives.

In its submission, the CA argued:

Unfortunately, Heritage Gas has submitted a Draft Affiliate Code of Conduct that contains an unreasonably low standard. Specifically, Heritage Gas has proposed that affiliate transactions be permitted so long as ratepayers are "unharm

ed by the actions of Heritage Gas". Ratepayers maintain that Heritage Gas should only be permitted to enter affiliate transactions when such transactions are reasonably expected to produce demonstrable benefit to Heritage Gas customers. In addition, Heritage Gas must engage in an active and detailed comparison of the affiliate transactions with all other available options.

...

On the record in this proceeding, the Consumer Advocate is unable to identify any evidence that establishes why Heritage Gas ought not to be held to a reasonable standard in evaluating affiliate transactions. This reasonable standard would include that affiliate transactions only occur where the intended transaction has been demonstrated through sound, documented analysis to be the best available option for Heritage Gas customers. The Consumer Advocate would respectfully urge the Board to mandate the adoption of this reasonable standard.

[Exhibit H-4, pp. 2-3]

[7] In its reply submission, Heritage provided examples from several Alberta regulated utilities whose approved Codes of Conduct use a standard of review similar to that proposed in the Heritage draft Code. Heritage noted that Nova Scotia Power Inc. is

required to meet the more stringent standard, but also conducts many affiliate transactions with a high total value. Heritage concluded:

Heritage Gas anticipates, based on its experience to date, a more narrow range of transactions with a much lower overall value. [compared to Nova Scotia Power Inc.]

Heritage Gas therefore submits that the "standard" proposed by the Consumer Advocate is both too stringent for the type of inter-affiliate transaction which will be undertaken by Heritage Gas and not in accordance with the norms for such standards in other provinces for this type of business.

[Exhibit H-5, p.2]

[8] The Board accepts that the number and value of Heritage transactions will likely continue to be a relatively small component of its total business. Imposing a higher standard of review than that proposed in the Code would be unlikely to make a material difference to rates, providing Heritage applies the proposed standard rigorously. As Heritage notes in its submission, the Board has some experience with imposing a higher standard and will do so if it is not satisfied in future that the objective of "keeping ratepayers unharmed" is being met.

[9] The Board will not impose the higher standard at this time.

2. Affiliated Party Transaction Summary

[10] The CA questioned the definition in s. 2.1(b):

Is Heritage prepared to report annually to the Board the following information:

- (a) A detailed listing of all assets, services and products provided to and from Heritage and each of its affiliated companies.
- (b) Each item on the listing should indicate the price received or paid and, as appropriate, the relevant fully allocated costs or market values.
- (c) Where fair market value is used, an explanation should be provided as to how the value was determined, including the comparative source for the value.
- (d) Where cost allocations are involved, a description of the cost allocators and methods used to make the allocations should be included.

- (e) A summary of corporate services and the methodology for ensuring fair allocations of these costs.

[Exhibit H-2, IR-6, p.1]

[11] Heritage responded:

Yes. The definition of "Affiliated Party Transaction Summary" will be updated to include reference to points (a)-(e) in the question.

[Exhibit H-2, IR-6, p.2]

[12] The Board directs that the final Code reflect the above change agreed to by Heritage.

3. Cost Recovery Basis

[13] In s. 2.1(i)(v) any "...transfer of equipment, plant inventory, spare parts or similar assets..." is to be done at net book value. The Board questioned whether this should be at the lower of market or net book value. Heritage responded:

... Heritage Gas does not agree. Affiliates should not realize a gain or incur a loss in the transfer of an asset between them. Any transfer of assets to, or from, Heritage Gas will need to meet the standard of keeping ratepayers unharmed.

[Exhibit H-3, IR-4, p. 2]

[14] The Board does not agree, and does not accept that Heritage should transfer such assets at a higher cost than the cost of acquiring it in the market. This does not keep ratepayers unharmed. At the same time, if Heritage transfers such assets at less than net book value, the prudence of the company incurring such costs is called into question.

[15] The Board directs that any such transfers be at the lower of market or net book value.

4. Fair Market Value

[16] In s. 2.1(j) “Fair Market Value” is defined as “the price reached in an open and unrestricted market between informed and prudent parties, acting at arm’s length and under no compulsion to act.” In s. 4.5, “Determination of Fair Market Value”, several methods to determine fair market value are listed. In its submission, the CA proposes that fair market value should always be determined by competitive tendering or quotes, where practical. Heritage, in its reply, notes that the language in the Code is very similar to that in the other Codes of Conduct mentioned above, and also points out that, in any case, the onus is on Heritage to demonstrate that an appropriate method was used.

[17] While the Board agrees with the CA that competitive tendering or quotes would provide greater certainty and is generally preferable, it also appreciates that this method could be difficult to accomplish in some situations. The Board’s view is that it is acceptable for Heritage to select what it considers to be the most appropriate method, depending on the individual circumstances. The Board notes that the Code obliges Heritage to demonstrate that it made the right choice.

[18] Given this requirement of the Code, the Board directs that for all transactions requiring determination of fair market value, an analysis of how each such determination was made is to be added to the list of items to be included in the Compliance Report per s. 7.5 of the Code. Where competitive tendering or quotes were not used, the analysis is to include the rationale for not using them.

5. Services Agreement

[19] In NSUARB-IR-6, the Board asked in regard to s. 2.1(p), "...should it be specified that a Services Agreement shall be in writing and signed by the parties?". To which Heritage responded, "Heritage Gas agrees that a Services Agreement should be in writing and should be signed by the parties. The Draft Code of Conduct will be amended to include reference to this requirement."

[20] The Board directs that the final Code reflect the above change agreed to by Heritage.

[21] Section 3.3.7 of the Code reads: "Heritage Gas shall enter into a Services Agreement with respect to any Shared Services and Shared Core Corporate Services it provides to, or acquires from, an Affiliate."

[22] In the Board's view, Services Agreements are a core element in establishing and maintaining affiliates' compliance with the Code. Therefore, the Board considers it appropriate that it be aware of the specifics of such agreements.

[23] Accordingly, the Board directs that Services Agreements shall be filed with the Board for information. If confidentiality is requested, the request shall conform to the requirements of Rule 12 of the *Board Regulatory Rules*. Heritage is to amend s. 3.3.7 of the final Code to reflect this directive.

6. Exemptions

[24] In NSUARB-IR-9, the Board asked "...should the Board accept and consider applications for exemption from parties not regulated by the Board?". To which Heritage replied "Yes, the Board should accept and consider applications for

exemption from parties not regulated by the Board. At the present time none of Heritage Gas' affiliated companies are regulated by the Board.”

[25] The Board disagrees with Heritage on this point. It is not the Board's practice to accept applications for regulatory exemption from entities not regulated by the Board.

[26] The Board directs that Heritage is to make all such applications on behalf of its affiliates. Heritage is to amend s. 2.6 of the final Code accordingly.

7. Occasional Services Permitted

[27] In NSUARB-IR-15, the Board asked “...what process and benchmarks will Heritage use in determining if occasional services have become ‘material as to value, frequency or use of resources’?”

[28] In its response, Heritage stated:

In the event that Heritage Gas was utilizing, or providing, services to an affiliate on a recurring basis and at a deemed fully loaded value of \$50,000 or more per year, Heritage Gas would enter into a Services Agreement.

Recurring basis would be defined as more than once per year, in consecutive years, and was expected to continue to be provided, or required in future years.

Section 3.3.8 of the Draft Code of Conduct will be amended, as illustrated below, to reflect this clarification.

“Where Heritage Gas has otherwise acted prudently, it may receive, or provide, one-off, infrequent or occasional services (“Occasional Services”) to, or from, an Affiliate on a Cost Recovery Basis. In the event that Heritage Gas is utilizing, or providing, services to an affiliate on a recurring basis and at a deemed fully loaded value of \$50,000 or more per year, Heritage Gas shall enter into a Services Agreement. Recurring basis is defined as more than once per year, in consecutive years, and is expected to continue to be provided, or required in future years.”

[Exhibit H-3, IR-15, pp. 1-2]

[29] The Board agrees with the proposed amendment and directs that it be incorporated in s. 3.3.8 of the final Code.

8. Documents to be Provided to the Board upon Request

[30] Sections 7.6 and 7.7 of the Code state:

7.6 Documents to be Provided to the Board upon Request

If required by the Board, Heritage Gas shall provide the Board with a copy of any document referred to in a Compliance Report or other supporting records and material.

7.7 Compliance Records and Audit

The records required to be maintained by the Compliance Officer pursuant to section 7.4 hereof shall be retained for a period of at least six years. Compliance records shall be maintained in a manner sufficient to support a third party audit of the state of compliance with the Code by Heritage Gas, its directors, officers, employees, consultants, contractors and agents, and by Affiliates of Heritage Gas with respect to the interactions of the Affiliates with Heritage Gas. Subject to the confidentiality provisions of section 8.1 hereof, all such records shall be made available for inspection or audit as may be required by the Board from time to time.

[31] In its submission, the CA suggested:

...that the Code explicitly provide that affiliates, when engaging in transactions with Heritage Gas, make available all of the affiliates books and records as may, in the judgment of the Board, be necessary to carry out its audit powers.

[Exhibit H-4, p. 3]

[32] In reply, Heritage stated:

For the reasons noted in the Heritage Gas responses to the various Information Requests, it submits that access to "all. .. affiliates, books and records...", as requested by the Consumer Advocate, is not required to ensure compliance with the proposed Draft Code.

[Exhibit H-5, p. 3]

[33] The Board agrees with the CA that access to certain affiliate books and records will be necessary for a complete compliance audit. The Board considers that the wording of the two sections quoted above is not sufficiently clear as the Board would like. The Board directs that the following provision be appended to s. 7.6: "...including relevant affiliate records in possession or control of the affiliate as requested by the Board."

9. Minor Revisions

[34] The Board noted minor numbering and typographical errors in s.2.3, s.4.5, and s.8.3. Heritage agreed and will make the appropriate amendments.

III DECISION

[35] The draft Inter-Affiliate Code of Conduct is approved as revised by this Decision.

IV COMPLIANCE FILING

[36] Heritage is directed to file a final draft Inter-Affiliate Code of Conduct incorporating the required revisions by no later than September 28, 2012.

[37] An Order will issue following review of the final draft Code.

DATED at Halifax, Nova Scotia, this 17th day of September, 2012.

Peter W. Gurnham

Kulvinder S. Dhillon

Murray E. Doehler