

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** requesting Expansion of its Natural Gas Distribution System to the Towns of New Glasgow and Stellarton, Pictou County

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.
Christopher H.C. Smith, C.A.

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

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

FINAL SUBMISSIONS: July 9, 2014

DECISION DATE: **August 5, 2014**

DECISION: **The Board approves the Application.**

1.0 INTRODUCTION

[1] In a May 5, 2014, submission to the Nova Scotia Utility and Review Board (“Board”), Heritage Gas Limited (“Heritage”) outlined its plans to expand its natural gas distribution system to the Towns of New Glasgow and Stellarton (“Towns”) in Pictou County, Nova Scotia (“Project”). Heritage’s submission included its proposal to apply the Board-approved Community Feasibility Test (“CFT”) to economically justify the Project, including the input assumptions and results.

[2] Additionally, Heritage proposed that the CFT would be applied to its entire expansion into Pictou County including Northern Pulp Nova Scotia Corporation (“Northern Pulp”) and Michelin North America (Canada) Inc. (“Michelin”).

[3] Heritage’s CFT results indicated a year 7 profitability ratio of 1.02 and net present value over 25 years of 1.11, thereby slightly exceeding the approved minimum thresholds. Heritage further noted that while the Project will initially have a negative impact on the Revenue Deficiency Account (“RDA”), overall the impact will be positive and there will be no negative impact on existing ratepayers.

[4] Heritage, in its submission, did not request Board approval of the Project economics. The Board considered that request to be implicit, given that if the Board did not find the economics acceptable, the Project could not proceed. The Board, therefore, proceeded to review the matter in its usual process.

[5] The Board notified interested parties and invited participation in accordance with the following timetable (as amended):

Notices of Intervention	Wednesday, June 4, 2014
Information Requests (IRs) to Heritage	Friday, June 6, 2014
Responses to IRs from Heritage	Friday, June 13, 2014
Submissions from Interested Parties	Thursday, July 3, 2014
Reply Submission by Heritage	Wednesday, July 9, 2014

[6] The Consumer Advocate (“CA”) and Board Counsel’s consultant, Energy Consultants International Inc. (“ECI”), submitted Information Requests (“IR’s”) to Heritage and made submissions to which Heritage responded.

2.0 ISSUES AND FINDINGS

[7] By letter dated July 22, 2014, the Board advised Heritage that the Project was approved and a decision with reasons would follow. This was to facilitate an early start of construction. This Decision contains the reasons.

[8] There was general agreement among the parties on several issues. ECI and the CA agreed that the expansion should be allowed to proceed. The CA stated:

In conclusion, there also is little doubt that if the Phase III expansion were a stand-alone project, it would not be profitable within a reasonable period of time and should not be undertaken. When viewed in conjunction with the Phase I/II expansion, however, the Consumer Advocate is of the view that the Phase III expansion should be undertaken. Phase III will not significantly affect the RDA and will not change the date by which the RDA would end. Immediately after the RDA ends, Phase III would provide a positive cash flow to Heritage Gas. Within 10 years after the RDA ends, Phase III would be consistently providing an annual surplus -- even if no new customers connect to the system in the Phase III service area after 2019.

[Exhibit H-5, p.3]

[9] ECI was of a similar opinion:

As a single project, ECI finds that the expansion of gas service to Northern Pulp, Michelin, and the Towns is supported by the Board’s approved test for economic expansion, the Community Feasibility Test.

[Exhibit H-4, p.15]

[10] The CA and ECI also agreed that proceeding with the Project would be unlikely to harm existing ratepayers. Their respective statements were:

As with any analysis of this type, we do not know what the future will bring. It appears however that, under a reasonable set of assumptions with appropriate sensitivity analyses, the expansion to the towns will not harm other customers.

[Exhibit H-5, p.3]

Heritage has an obligation to serve customers in its franchised areas where it is economic to do so. Heritage has structured the expansion project to serve Pictou County in such a way that it will not result in subsidization by Heritage’s other customers in HRM,

Oxford, and Amherst. While there is a small cross-subsidy from Northern Pulp and Michelin in order to make the expansion to the Towns economic, both customers recently agreed to gas service on the tariffs and rates presented by Heritage and approved by the Board. Heritage is not proposing a rate increase to these customers in order to facilitate expansion to the Towns. As such, neither Northern Pulp, Michelin, or Heritage's other customers are worse off as a result of the expansion.

[Exhibit H-4, p.15]

[11] Additionally, in its evidence, ECI concluded that Heritage's projections of revenue and capital costs were reasonable. ECI also agreed with Heritage that it would be prudent to locate two distribution technicians in Pictou County so that in the event of an emergency there could be a timely response.

[12] Both the CA and ECI agreed that the Project's impact on the RDA would be slight and acceptable.

[13] ECI stated that the operating cost assumptions were reasonable but suggested that the CFT should include costs associated with the Maritimes & Northeast Pipeline Custody Transfer Station and property taxes. Heritage did not agree:

Heritage Gas has reviewed the items identified by ECI and is of the view that it is not appropriate for these costs to be included in the feasibility test.

- M&NP Operating Costs for the Custody Transfer Station – these costs were correctly excluded because they are recovered by Heritage Gas in its Gas Cost Recovery Rate ("GCRR").
- HGL Property Tax – Station Site – these costs were correctly excluded because they are recovered by Heritage Gas in its Rate Rider B.

As neither of these items are direct costs of Heritage Gas, it would be inappropriate to include the costs in the Feasibility Test. Inclusion of these costs in feasibility tests as part of the previous Application for the Rate Class 4.1 was an oversight by Heritage Gas.

[Exhibit H-7, p.7]

[14] The Board concurs that the two items are not recovered through rate revenues and agrees with Heritage that they should not be included in the CFT calculation.

[15] ECI considered several different approaches to calculate the CFT with varying assumptions regarding inclusion of Northern Pulp and Michelin, and the rate at which potential new customers would be added. ECI summarized the CFT results for each of the scenarios in its evidence and concluded that examination of the various scenarios served to “provide a directional indication of the impact of possible additional customer attachments.” [Exhibit H-4, p.14]

[16] ECI went on to recommend:

...ECI recommends that the Board consider the Pictou County expansion as a single project, as Heritage’s existing ratepayers are not worse off as a result of the expansion. As a single project, ECI finds that the expansion of gas service to Northern Pulp, Michelin, and the Towns is supported by the Board’s approved test for economic expansion, the Community Feasibility Test.

[Exhibit H-4, p. 15]

[17] The Board agrees with ECI’s conclusion that the CFT should be applied to the Pictou County expansion in its entirety. In the Board’s view, it is acceptable to include larger anchor customers in the economics, because this allows the distribution system to be expanded to smaller customers for whom providing service could not otherwise be economically supported. Furthermore, existing ratepayers are not negatively impacted.

[18] In its evidence ECI suggested that Heritage had inappropriately considered effects of inflation in the CFT input parameters. ECI stated:

...In the feasibility test, ECI adjusted capital and operating costs downwards by Heritage’s assumed inflation rate of 2.25% per year. Sales rates for 2015 were extended over the duration of the study period. The resulting 7 year profitability ratio is 0.94, and the 25 year NPV ratio is 0.99, compared to 1.02 and 1.11 in the original filing.

[Exhibit H-4, p.16]

[19] While the Board agrees with ECI that there is an apparent impact on the CFT results due to inflation, the Board does not consider the magnitude of the impact sufficient to further examine at this time. Heritage Gas stated:

Heritage Gas acknowledges that the impact of inflation on the CFT is an appropriate matter for the Board's consideration. Heritage Gas submits that it is more appropriate to examine this issue during Heritage Gas' next General Rate Application. At that time, the Board will have the benefit of the context of a full proceeding within which to examine all evidence and submissions from interested parties in regard to this issue.

[Exhibit H-7, p.9]

[20] The Board agrees with this approach and anticipates the issue will be thoroughly reviewed during the next rate hearing.

[21] In conclusion, Heritage said:

Heritage Gas believes the proposed expansion into the Towns is prudent and should be evaluated using the proposed CFT (including Phases I, II and III). Based on the results of the CFT, the expansion does not harm existing ratepayers and will expand Heritage Gas' service area while also providing customers in Pictou County the opportunity to gain access to natural gas.

Heritage Gas therefore respectfully requests Board approval of the expansion economics into the Towns of New Glasgow and Stellarton, Pictou County.

[Exhibit H-7, pp.9-10]

[22] Having considered the evidence, and there being no objection from the parties, the Board finds it is appropriate to apply the CFT to Heritage's entire expansion into Pictou County including Northern Pulp and Michelin. The Board further finds that the Project is economically justified by the CFT results.

[23] The Board approves the economics as submitted by Heritage for expanding the distribution system to the Towns.

[24] In its analysis of the CFT Heritage, of necessity, made certain assumptions. There is always a risk that these assumptions may change over time. These risks include: the possibility that one or other of the large customers leave the system prematurely; customer connections and amount of gas consumed in each year may be less than assumed; or an overrun of capital costs. The ratios for this Project in the application of the CFT are close to one. Accordingly, the Board wants to monitor the progress of this Project. Heritage is therefore directed to file an updated "Phase III"

table (the table contained in the response to CA IR-2) six months from completion of construction. The updated table should include a full explanation of any variance.

3.0 TIMING OF APPROVALS

[25] Heritage filed the economic analysis and the request for permits to construct this Project contemporaneously. Heritage then asked the Board to approve the permits to construct in advance of a finding on the economic analysis. Heritage agreed to accept any construction risk associated with proceeding in this matter. This is something the Board had allowed in the past, thinking it would be the exception rather than the rule. In a letter dated June 27, 2014, the Board approved the permits but advised Heritage that it was not prepared to continue this practice.

[26] While the Board acknowledges Heritage was accepting the risk in proceeding in this manner, this is a public process. The Board invited interested parties to comment on Heritage's Project. The Board is concerned that it undermines confidence in the public process if Heritage is already building the system in a community before the Board has had an opportunity to make a decision whether the project is economic. That is particularly the case in this Project, where the economics are marginal. Accordingly, the Board directed Heritage to time its applications in future such that the economic analysis approval is in place before the permits to construct are approved and construction starts.

[27] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 5th day of August, 2014.

Peter W. Gurnham

Kulvinder S. Dhillon

Murray E. Doehler