



DECISION

IN THE MATTER OF an Application by Enbridge Gas New Brunswick Limited Partnership to change its Small General Service, Mid-General Service, Large General Service, Contract General Service, Industrial Contract General Service and Off-Peak Service Distribution Rates and for approval of its 2013 Regulatory Financial Statements (Matter No. 253)

December 23, 2014

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

IN THE MATTER OF an Application by Enbridge Gas New Brunswick Limited Partnership to change its Small General Service, Mid-General Service, Large General Service, Contract General Service, Industrial Contract General Service and Off-Peak Service Distribution Rates **and** for approval of its 2013 Regulatory Financial Statements.

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

Chairman: Raymond Gorman, Q.C.

Vice-Chairperson: François M. Beaulieu

Member: Michael Costello

Counsel: Ellen Desmond

Chief Clerk: Kathleen Mitchell

APPLICANT

Enbridge Gas New Brunswick Limited Partnership: Len Hoyt, Q.C.

INTERVENERS

Public Intervenors: René Basque, Q.C.
Monica Barley

Flakeboard Company Limited: Christopher J. Stewart

Department of Energy and Mines: Sacha Patino

A. Introduction

- [1] Enbridge Gas New Brunswick Limited Partnership (EGNB or the utility) is a public utility having entered into a general franchise agreement with the Province of New Brunswick on the 31st day of August, 1999. The general franchise agreement authorizes EGNB to distribute natural gas and provide customer services in New Brunswick.
- [2] For the period ending on December 31, 2013, EGNB served approximately 12,170 customers. It had a total revenue of \$44,918,000 and a throughput of 6,552,585 Gigajoules (GJ).
- [3] The distribution of natural gas in New Brunswick is governed by the *Gas Distribution Act, 1999*, S.N.B. 1999, c. G-2.11 (GDA) and associated regulations under the GDA and the *Energy and Utilities Board Act*, S.N.B. 2006, c. E-9.18 (EUB Act) and associated regulations under the EUB Act.
- [4] On June 27, 2014, EGNB filed an application with the New Brunswick Energy and Utilities Board (Board) pursuant to Sections 52 and 56 of the GDA and Sections 60 and 64 of the EUB Act seeking changes to its distribution rates for Small General Service (SGS), Mid-General Service (MGS), Large General Service (LGS), Contract General Service (CGS), Industrial Contract General Service (ICGS), and Off-Peak Service (OPS). EGNB is also seeking approval of its 2013 Regulatory Financial Statements.
- [5] EGNB was required to publish notice of the application in various newspapers and on its website and to provide notice to all certified gas marketers. EGNB's Exhibit 2.01 satisfies the Board that EGNB has met all requirements of the Order.
- [6] Two parties registered as interveners, namely, the Public Intervener and Flakeboard Company Limited (Interveners). The Department of Energy and Mines participated in the proceeding as an observer.
- [7] At the pre-hearing conference EGNB and the Interveners were asked to make representations about the procedure to be followed, and any other matters relevant to this proceeding. The Board then established a hearing process culminating in a hearing which took place from November 5 to 7, 2014.

[8] The following witnesses testified at the hearing:

On behalf of EGNB:

- Mr. Gilles Volpé, General Manager;
- Ms. Lori A. Stickles, Manager, Corporate Services; and
- Dr. H. Edwin Overcast, Consultant, being qualified as an expert in the areas of development of utility cost of service studies and rate design.

On behalf of the Public Intervener:

- Mr. Robert D. Knecht, Consultant, being qualified as an expert in regulatory economics and rate making.

[9] The Board issued an oral decision on December 16, 2014. That decision was a partial decision and provided some of the findings that are now included in this written decision.

[10] If there are any discrepancies between the oral decision and the written decision, this written decision will supersede.

B. Issues

[11] In this decision, the Board will consider the following issues:

1. Approval of the 2013 Regulatory Financial Statements;
2. Approval of changes to distribution rates for 2015; and
3. Miscellaneous issues relating to flex rates, rate riders, the development period and regulatory deferral account, and minimum filing requirements.

C. Analysis

1. Approval of the 2013 Regulatory Financial Statements

- [12] The first issue to be considered is the approval of EGNB's 2013 Regulatory Financial Statements.
- [13] The Board has reviewed and approved EGNB's regulatory financial statements each year since the franchise was granted. In previous years the purpose of the annual review was to examine EGNB's spending to ensure such spending was prudent and to determine what amounts, if any, should be added to the regulatory deferral account. This review has also been useful in assessing expenditures that affect future rate base.
- [14] With the legislative changes in 2012 to the GDA and associated regulations, the regulatory deferral account is not currently recognized as a regulated asset. Although EGNB is not prohibited from adding to the regulatory deferral account, the Board is not allowed to permit EGNB to depreciate, amortize, earn a return on or otherwise consider the regulatory deferral account, except in the circumstances and in the manner prescribed by regulation. At the present time, there is no such regulation in force.
- [15] The approval of the 2013 Regulatory Financial Statements includes a retrospective review of the prudence of spending during the year. No evidence was filed on the record to rebut the presumption of prudence.
- [16] The Board notes that actual expenses in 2013 exceeded approved expenses by \$289,000. EGNB explained this variance in EGNB Exhibit 1.15. The primary reason was a higher than budgeted cost of debt. The Board accepts this explanation.
- [17] In a decision dated September 26, 2012, the Board approved the 2013 test year revenue requirement. Using the approved revenue requirement and forecast of throughput, the allowed operating and maintenance expenses amount to \$1.90 per GJ. EGNB Exhibit 1.13, at page 2, indicates that the actual cost was \$1.80 per GJ. No party took issue with this evidence. The Board is satisfied that EGNB has met the per GJ target for 2013.

- [18] Each year the Board also reviews the prudence of capital expenditures as part of its retrospective review process. This is carried out using a calculation referred to as the system expansion portfolio (SEP) test.
- [19] The results of the 2013 SEP test are found in EGNB Exhibit 1.13, at page 19. The SEP test compares the incremental revenues that EGNB has generated in 2013, to the incremental annual costs incurred in adding this revenue. In order to pass the SEP test and be considered prudent, the revenues should exceed incremental costs by at least 4%.
- [20] In 2013 the evidence demonstrates that the incremental revenues exceeded the incremental costs by 52%. No party took issue with this evidence. The Board finds that EGNB has passed the SEP test for 2013.
- [21] The Board is satisfied that the spending in 2013 was prudent and approves the regulatory financial statements, as filed.

2. Approval of Changes to the Distribution Rates for 2015

- [22] The Board will now consider the application for new rates for 2015.
- [23] As indicated above, the Board is governed by the GDA and associated regulations. Pursuant to Section 4 of the *Rates and Tariffs Regulation – Gas Distribution Act, 1999* (Regulation), the Board is required to:
- 1) Determine the cost of service rate for each class of customers;
 - 2) Determine the market based rate for each class of customers; and
 - 3) Use the lower of the resulting rates.
- [24] In 2012 and 2013, when the Board conducted this analysis, all rate classes, with the exception of the SGS class, had their rates set using the cost of service methodology. This was because, when conducting a comparison of both rates, the cost of service rate for all classes, except the SGS class, was less than the market based rate. For the purpose of this rate application, the Board will again conduct a review of both the cost of service rate and the market based rate for each class of customers.

a. Cost of Service Rates

[25] As in past proceedings, cost of service rates are fixed by determining a revenue requirement for a test year, in this case 2015. The revenue requirement is then divided among the classes of customers based on a cost allocation study. Once a revenue requirement is determined, rates for each class of customers are established based on forecasts of throughput.

[26] The revenue requirement is an estimate of the cost of running EGNB for the year. EGNB has presented its budget for 2015, including its return on rate base. The Board has carefully considered all of the expense items as presented and will comment on certain of those expenses in the following paragraphs.

i. O & M Expenses – New Corporate I.T. and Corporate Governance Allocations

[27] EGNB is proposing four new corporate IT allocations, namely, IT Infrastructure Shared Services (ISS) Security Operations, IT Application Operations, IT Enterprise Service Enterprise Content Management (ECM), and IT ISS Management. In addition, four new corporate governance allocations, namely, Enterprise Communications & Community Partners, Public, Government & Aboriginal Affairs, Enterprise Safety & Operational Reliability, and Enterprise Travel Procurement Card Program.

[28] A detailed description of the allocations and the benefits attributed to the ratepayers was provided by EGNB. No party took issue with these new corporate I.T. and corporate governance allocations. The Board is satisfied that these expenses are prudent and approves the eight new corporate allocations.

ii. O & M Expenses – Executive Risk Insurance

[29] Executive risk insurance is insurance which mitigates the personal liability of EGNB's directors and officers. EGNB is budgeting \$195,591 for 2015, which represents a corporate allocation from Enbridge Inc. based on the number of EGNB directors versus the total directors from the Enbridge companies being covered by the policy.

- [30] To support this allocation, EGNB submitted evidence prepared by Marsh Canada Limited (Marsh) in EGNB Exhibit 1.11. Marsh, an insurance broker, which also provides executive risk insurance to Enbridge Inc., was asked by EGNB to provide comments “...on the costs associated if Enbridge Gas New Brunswick L.P. and Enbridge Gas New Brunswick Inc. (“EGNB”)” were to purchase their own directors’ and officers’ liability insurance coverage similar to the existing coverage.
- [31] Marsh concluded that if EGNB was to purchase its own directors’ and officers’ liability policy with \$250 million of coverage, the annual premium would be approximately \$460,000.
- [32] The Public Intervener took issue with the usefulness of the Marsh estimate. In PI Exhibit 1.01, at page 5, Mr. Knecht stated “...it remains my understanding that EGNB’s revenue requirement is established based on reasonable costs it incurs, rather than the costs of a standalone operation.” Mr. Knecht noted that in the 2014 rate proceeding, the Board set the allowable costs at \$24,970. Mr. Knecht recommends that the allowable costs be set at the 2013 approved level of about \$25,000.
- [33] In his final argument Mr. Hoyt took issue with Mr. Knecht’s conclusion. He referred to the Board decision dated April 17, 2014, at page 9, which states:
- ... EGNB is required to demonstrate how these costs would be incurred if EGNB was a stand-alone operation and how these costs currently benefit ratepayers in New Brunswick.
- [34] While the Board does find the Marsh report informative, the purpose of the stand-alone test is to determine the necessity of the expense and not necessarily the reasonableness of the allocation method used by Enbridge Inc. A revenue requirement should be based on reasonable costs incurred. The question is whether or not this allocation, based on the number of directors, is appropriate.
- [35] EGNB has not provided any specific evidence in the hearing to justify the number of directors as a fair basis to allocate this cost. EGNB made a similar proposal in the last rate hearing and the Board rejected the proposal stating, at page 10 of the decision, “... one would expect that personal responsibility risk would be more related to the overall size of the business.” The Board finds no reason to find differently in this proceeding.

[36] The Board does, however, accept the evidence provided which suggests that executive risk insurance premiums are rising. In 2013, the Board allowed approximately 18.3% of the allocated amount and will do the same for 2015.

[37] The Board will therefore set the executive risk insurance cost for 2015 at \$35,793 which represents 18.3% of the 2015 forecasted allocation of \$195,591. As a result, the revenue requirement will be reduced by \$159,798.

iii. O & M Expenses – Capitalization of Sales and Marketing

[38] With respect to the capitalization of sales and marketing, the Board has, in past reviews, carefully considered expenditures on sales and marketing, as well as their capitalization rates.

[39] EGNB has submitted evidence for the 2015 test year forecasting sales expenses at \$547,993, reduced from a total of \$624,115 forecast for 2014. Marketing expenses for the 2015 test year is set at \$617,596, down from \$1,002,256 in the 2014 forecast. Capitalization rates are set at 88.8% and 94%, respectively, the same values approved in the 2014 application.

[40] Mr. Knecht submits that capitalizing such expenses reduces EGNB's economic incentive to minimize them. Although he proposes that all sales and marketing expenses in the 2015 test year should be expensed, he acknowledged that capitalizing these expenses produces a smaller revenue requirement for 2015.

[41] In his rebuttal evidence in EGNB Exhibit 4.02, at page 2, Mr. Volpé stated that "... EGNB absolutely does have an economic incentive to consider all expenditures, regardless of the accounting treatment of the expenses (expensed or capitalized)." The argument is made that EGNB is now self-funding and "... so all expenditures are assessed to ensure they provide overall economic benefit to the business." It was also noted that the expenditures on marketing were dramatically reduced from their 2014 forecast levels.

[42] Due to the differing nature of the expenditures, the Board will deal with sales separately from marketing.

[43] With respect to sales, the Board reiterates its finding in the decision of April 17, 2014, that sales staff are involved in attaching new customers and as such are directly involved in creating future revenue. The Board therefore approves the level of sales expenses and their capitalization rate of 88.8% for 2015. If EGNB wishes to continue using this capitalization rate, the Board will require more robust evidence supporting the use of this capitalization rate in future hearings.

[44] Capitalization for marketing was also addressed in the decision of April 17, 2014, which stated, at page 13:

Recognizing that EGNB is attempting to develop a new long term marketing strategy in 2014, both the amount and the level of capitalization for marketing is approved. The Board would not anticipate that such a significant marketing expense would be capitalized at these levels on an ongoing basis.

[45] The Board acknowledges that the 2015 test year marketing expenses are significantly lower than those forecasted in 2014. EGNB has satisfied the Board of the need to spend funds on marketing activities to improve brand reputation and promote the use of natural gas in New Brunswick. However, EGNB has not satisfied the Board that all of these costs should be capitalized.

[46] For the 2015 test year, the Board disallows the capitalization of the amounts budgeted for market research, sponsorships, and other operating and administrative expenses in the amount of \$175,000. The Board is not satisfied that there is a direct link between these expenses and future revenues. The remainder of marketing expenses, primarily advertising, will be permitted to be capitalized at the requested rate of 94% for the 2015 year only.

[47] In future hearings, the Board will require that EGNB clearly establish a direct link between marketing costs and future revenue in order to justify capitalization of these expenses. In addition, the Board notes that EGNB is amortizing these expenses for a period of 41 years which is the same term for the amortization of distribution mains. The Board has concerns about this type of expense being amortized over 41 years and will also require EGNB to submit evidence to support the amortization period for these expenses.

iv. Contract Demand Revenue

[48] For the CGS and ICGS classes, EGNB invoices customers a contract demand charge. This is generally an amount which represents a customer's maximum daily usage, essentially a commitment by the customer to use a certain portion of EGNB's pipeline capacity.

[49] If a customer exceeds this contract demand at any time during the year, EGNB's tariff enables the application of a "ratchet" provision. This means that the customer will be charged at the higher demand level for the entire contract year. If the customer uses below its contract demand levels there is no reduction in the contract demand charge during the year.

[50] Mr. Knecht disagrees with the contract levels forecast for the CGS and ICGS classes. He refers to evidence provided in a previous hearing by a Mr. Reed, and states, in PI Exhibit 1.01, at page 7:

Based on these results, I conclude that Mr. Reed was correct that EGNB's billing demand forecast methodology was, and remains, unduly conservative. Even if all the customers who continue to take CGS and ICGS service remain at their current contract demand levels in 2015 and there are no upward ratchet adjustments, EGNB's revenues will increase by more than \$300,000.

I therefore recommend that the Board direct EGNB to present an updated forecast of billing demand for the 2015 FTY. EGNB should justify any claimed reductions in contract billing demands from 2014 levels, and reflect a reasonable estimate of the effect of the ratchet on actual 2015 billing demands based on its historical experience.

[51] During Mr. Stewart's cross-examination of Ms. Stickles, she outlined the process used to forecast contract demand levels for the 2015 test year. At page 36 of the transcript, she stated:

... so in April we did a mini review of contract demands, if a customer's contract demand goes up at that point, there is the ratchet that takes place, and then that would be in effect the contract demand that we would use for the budget for 2015. If the contract demand was assessed to go down, the customer would remain at the existing contract demand, and the contract demand would not go down until the 2015 budget -- or sorry, till November 1st when the actual review is done, but it would it have been used -- the lower CD would have been used in the 2015 budget.

[52] In a decision dated April 17, 2014, the Board expressed concern with the inconsistent practice that had developed in the calculation of the contract demand charge. The Board noted that failing to review the contract demand in a consistent fashion results in a less reliable forecast of throughput and a less reliable budget.

[53] The Board is satisfied that EGNB has responded to the Board's concern. The process used by EGNB for the 2015 test year, which uses actual customer consumption analyzed after the winter period, is one which should result in a more reliable forecast. The Board approves the 2015 contract demand forecast as submitted. The Board will closely examine the 2015 actual contract demand to ensure reliability of this forecast process in the next rate hearing.

v. Miscellaneous Revenues

[54] Miscellaneous revenues include revenue not related to throughput, predominantly representing revenue generated by agent billing and collections (ABC) and late payment fees. They also include categories such as interest income, transactional services, and red-lock fees.

[55] ABC is a service provided to gas marketers who wish to have EGNB perform their billing and collections services. EGNB is proposing to increase these rates by 1.9% in 2015 as detailed in EGNB Exhibit 1.02, at page 6. This increase equates to the stated cost of living increase used throughout the application.

[56] No party filed evidence concerning this proposal nor objected to EGNB's proposed increase of 1.9% to the ABC rates. The Board finds that the proposed increase is reasonable and approves the rates for ABC as proposed.

[57] Miscellaneous revenues also included a nominal amount of \$6,000 for the remainder of the categories, including late payment fees, despite the fact that evidence submitted in Mr. Volpé's rebuttal evidence showed this amount to be substantial for the years 2011 to 2014. In EGNB Exhibit 3.02, at page 27, EGNB explained that "...when budgeting, EGNB does not have any certainty of fees from customers for late payment, red-locks etc."

[58] This subject of under-budgeting was addressed in PI Exhibit 1.01, at page 4, where Mr. Knecht states:

In the current filing, EGNB has continued its policy of assuming that it will not earn any miscellaneous revenues other than those from agent, billing and collection services and interest income. Most importantly, EGNB assumes that it will earn no late payment fees, despite a long history of actually earning those revenues.

[59] Table IEC-2 in the above-noted exhibit shows forecast, actual, and difference results for miscellaneous revenues from 2011 to 2015. Mr. Knecht proposes to take a simple arithmetic average of the difference totals for years 2012 and 2013 (i.e. \$268,000) and add this amount to the current 2015 forecast of \$190,000 for a recommended new forecast of \$458,000.

[60] EGNB disagrees with Mr. Knecht's proposal, stating in EGNB Exhibit 4.02, at page 7:

If the Board were to require EGNB to make an adjustment to Miscellaneous Revenues, it would only be appropriate to consider an amount for Late Payment Penalties, less the additional related unbudgeted costs, not the \$300K suggested by Mr. Knecht. ... If an average of Late Payment Penalties were to be considered, it would be most representative to consider the years 2011 and 2012. This would result in an average of \$178K for Late Payment Penalties.

[61] There are three issues to be considered with respect to miscellaneous revenues. The first issue is whether or not the Board believes that it is just and reasonable to adjust the miscellaneous revenues. The miscellaneous revenues in the previous four years ranged from \$345,000 to \$429,000. The Board finds that this is compelling evidence to make an adjustment and will do so.

[62] The second issue is whether or not the Board should take into consideration additional costs incurred to achieve the miscellaneous revenues. Although Mr. Knecht testified that he agreed with the premise that costs should increase if additional revenue is forecast, he concludes that EGNB has already increased costs substantially over its 2013 level, stating at page 299 of the transcript the following: "However, specifically in this case, I believe they have made an adjustment to the costs, and they have not made an adjustment to the revenues."

- [63] The Board finds insufficient evidence to support a further increase in costs beyond that which has already been forecasted. In future hearings, if EGNB believes that it has under-forecasted costs relating to miscellaneous revenues, then it should file evidence of those costs.
- [64] Finally, the third issue is the determination of the amount of the adjustment to be made to the miscellaneous revenues. Taking into consideration that there was evidence that 2013 and 2014 were colder than normal winters, the Board finds that 2011 and 2012 are the most appropriate years to consider to determine the additional forecast revenue. The average for these two years is \$245,000 and the Board orders that miscellaneous revenues be increased by this amount and EGNB is to provide supporting information for the allocation factors in making these adjustments.
- [65] The Board has carefully examined all of the projected expenses for 2015. Having considered all of the evidence and submissions by the parties, the Board accepts the expenses presented by EGNB with the exception of those items adjusted above.
- [66] Subject to the aforementioned changes, the Board approves the 2015 revenue requirement, as filed.

vi. Allocation of Costs

- [67] Having determined the revenue requirement, the next step is the allocation of costs. The revenue requirement must be allocated amongst the various classes of customers.
- [68] Section 3 of the Regulation establishes prescribed classes of customers for the purposes of Section 52 of the GDA as follows:
- Small General Service;
 - Mid-General Service;
 - Large General Service;
 - Contract General Service;

- Industrial Contract General Service;
- Off-Peak Service; and
- Contract Power Plant Service (No evidence has been filed for the Contract Power Plant Service class because there are currently no customers within this class).

[69] Subsection 4(1) of the Regulation directs the Board to adopt the cost of service method or technique for setting rates except where the market based method or technique would produce a lower rate.

[70] EGNB submitted a cost of service study updating the study filed with the Board in August, 2012. In EGNB Exhibit 1.23, at page 1, it is the utility's submission that they used "... the same cost of service principles and processes for the purpose of the 2015 COS study."

[71] During the cross-examination of Mr. Knecht by the Board's counsel, at pages 280-281 of the transcript, the following questions were asked on the issue of the cost of service study:

Q.76 - From your understanding, is there a change in the cost of service study this year from previous years?

A. I did not pursue it in detail or look at it extremely carefully, but based on the examples that you put in front of Dr. Overcast yesterday, it does appear that the company has modified its methodology from one in which demand costs -- the mains costs are being assigned to the SGS class to a methodology in which they are not. This may relate to the go round we had in the cost allocation proceeding in terms of switching from a two inch main for the purposes of the minimum system to a one-and-a-quarter inch main for the minimum system. Under the two inch main I believe it was Dr. Overcast's philosophy that there would be no demand costs assigned to the SGS class. When we switch to the one-and-a-quarter inch main, I believe that he modified his methodology and the Board accepted a method in which demand costs for mains are allocated to the rate SGS class. And based on just a brief review of the exhibits you presented yesterday, it appears that they zeroed out the allocation of demand -- mains related demand costs to the SGS class.

Q.77 - In your opinion, Mr. Knecht, is that a reasonable change and what, if any impact, that change -- what would it be?

A. I have not evaluated the impact, and I believe as you know, the methodology that Dr. Overcast has espoused, and the Board adopted, is different from the one

that I recommended. In this context I don't believe either the methodology that has been approved or the modification that was either -- it was presumably accidentally adopted in the current filing are unreasonable.

[72] The Board has carefully reviewed all the evidence relating to the cost of service study. The change in methodology outlined above has had little impact on the outcome and according to Mr. Knecht, it is not unreasonable. The Board approves the cost of service study, as filed.

vii. Determination of Cost of Service Rates

[73] Having approved the revenue requirement and the cost of service study, it is now necessary to establish the average revenue per GJ that will be required to meet the revenue requirement for each class of customers.

[74] The rates are calculated by dividing the total cost allocated to each class of customers by the forecasted throughput for each class. No party took issue with the throughput forecast for the 2015 test year. The Board accepts the throughput forecast, as filed.

[75] EGNB filed its estimated cost of service rates in EGNB Exhibit 1.02, at page 4. These rates must now be compared with the market based rates described below.

b. Market Based Rates

[76] Pursuant to Section 4 of the Regulation, the Board is directed to determine the market based rate for each class of customers. The market based rates system is described in the Board decision dated April 17, 2014.

[77] In EGNB Exhibit 1.17, the utility has filed its calculation showing the market based rates for each prescribed class of customers. This calculation is consistent with the methodology used in past rate hearings.

[78] There is, however, a significant change proposed regarding the composition of the SGS and MGS classes. This proposal was made in response to a Board decision dated April 17, 2014, which stated, at pages 21-22:

In addition, EGNB is directed to re-examine how the SGS rate will be set in the future. Clearly the composition of the members in this class creates a difficulty in accomplishing the stated legislative and regulatory objective. Several alternatives were discussed during the hearing process. The most practical solution would be to subdivide the customers in the SGS class into two sub-classes, so to permit the Board to apply two different rate designs. The subclasses will, in turn, be more homogeneous. The evidence provided in the hearing did not provide sufficient data for the Board to fully develop this option. As a result, EGNB is directed to develop a proposal, reflecting a division of the SGS class into sub-classes, so that this issue can be resolved. In the event EGNB wishes to propose an alternative solution, in addition to the one described herein, the Board will consider the same.

[79] In response to the Board's directive, EGNB submitted a proposal to remove all non-residential customers from the SGS class rather than divide the class into two sub-classes. The rationale for this proposal was explained by Dr. Overcast in his opening statement. At pages 32-33 of the transcript, he stated:

There are a variety of constraints related to the pricing of delivery service and EGNB's efforts to remain an economically viable service provider. Each rate case brings new challenges and new issues to address. In this case, there continues to be issues relative to basing rates for all customer classes on the cost of service resulting in discounts from cost of service for some customers and the recovery of more than full cost of service from other classes. The market constraint is most pronounced for residential customers. As a result, EGNB has elected to limit the small general service rate to residential customers only.

[80] The proposal submitted by EGNB leaves only residential customers in the SGS class. EGNB submits in EGNB Exhibit 1.02 at page 2 that this will "...create a more homogenous SGS class" which provides for a better alignment to the residential electricity rate and the target savings contemplated by Subsection 4(2) of the Regulation.

[81] EGNB's proposal would see all non-residential customers previously in the SGS class transferred to the MGS class. With the introduction of smaller non-residential customers into the MGS class, EGNB is proposing to establish two rate tiers based on throughput. This transfer of customers will result in a greater number of customers being charged cost of service rates.

[82] In his evidence, Mr. Knecht stated that the EGNB proposal to alter the SGS class and MGS class is reasonable and generally consistent with his recommendation in Matter 225. At page 244 of the transcript, he believes that this proposal is going to resolve "...

the complex set of interrelated issues that we all wrestled with in the 2014 general rate application.”

- [83] No party took issue with EGNB’s proposal to transfer non-residential customers from the SGS class to the MGS class.
- [84] The transfer of non-residential customers to the MGS class is the most practical solution to the issue concerning the composition of the SGS class raised in Matter 225. The Board directs EGNB to transfer all non-residential customers from the SGS class to the MGS class and to advise the non-residential customers accordingly.
- [85] The rates arising from the application of the market based method or technique for all rate classes can be found in EGNB Exhibit 1.02. The rates of the SGS and MGS classes were calculated reflecting the above changes to class composition.

i. Updating the Enbridge Utility Gas Price Forecast

- [86] In a decision dated May 26, 2009, the Board approved a market based formula together with a step by step procedure for calculating a market based delivery rate for each of the class of customers. The formula included a number of data inputs for the SGS class including electricity prices, typical customer usage, and the cost of the natural gas commodity, namely, the Enbridge Utility Gas (EUG) price forecast.
- [87] The EUG price forecast and other inputs were determined at the time of the filing of this application in June. The Public Intervener argued that the most recent EUG price forecast should be presented and considered by the Board at the time of the hearing. As a result of an undertaking given at the hearing in November, EGNB provided an updated EUG price forecast which differed from the forecast provided with the application.
- [88] The primary reason advocated by the Public Intervener for updating the EUG price forecast was related to the time elapsed between the date of the rate application and the effective date for new rates. This position was put forward by Mr. Knecht who encouraged the Board to consider updated information if it was material. During questioning from the Board, Mr. Knecht testified that the change was not material and stated at pages 295-296 of the transcript “... So for the perspective of this proceeding, I

don't see I need to make a change. I updated the numbers to show you what the impact would be primarily to say I don't think that's a -- that it is worth it in this case.”

[89] The Board agrees with Mr. Knecht’s conclusion that the change was not material.

[90] Despite Mr. Knecht’s evidence, the Public Intervener argued that the Board should use the updated EUG price forecast in its calculation of the market based rates.

[91] EGNB opposed updating the EUG price forecast. Ms. Stickles provided some rationale for that position, testifying at pages 96-97 of the transcript:

... at some point in time you need to pick the data set that you are going to use. You need to set your assumptions, which we did. And, of course, now we have got the benefit of months that have gone by, and we know things that we didn't know when we did the budget, but we still stand by this budget. We believe the revenue requirement is reflective. ... So it's a constant refinement of the process, but I don't believe that it warrants stopping the whole process and refiling a brand new rate application.

[92] The Board agrees with the approach used by EGNB in this application. The use of test years is a common practice within the regulatory environment and test years can be either historic or future. This application is based on a future test year where the revenue requirement is based on projected costs. It is conceivable that all inputs can change during the course of the hearing but it is not typical to change inputs unless errors have been discovered. No errors have been alleged in the calculation of the EUG price forecast at the time of filing.

[93] For all of the reasons set out above, the Board concludes that it is not necessary or appropriate to update the EUG price forecast for the purpose of setting the market based rates.

ii. Change in the Price of the Gas Variance Account

[94] In EGNB Exhibit 1.17, at page 1, EGNB discusses the methodology mandated by legislation and Board rulings regarding the calculation of market based rates. A key determinant in this calculation has been the EUG price forecast, which is provided at EGNB Exhibit 1.21.

- [95] In the calculation of the EUG price forecast EGNB relies on a Board approved methodology, which combines the uses of forecasts and actuals, and is in compliance with Subsections 4(1) and 4(2) of the *Gas Distributor Marketing Regulation – Gas Distribution Act, 1999*.
- [96] This approach has resulted in a two-month lag in the EUG price forecast, which has caused an increase in the time required to recover the price of the gas variance account (PGVA). To correct this inequity, EGNB is proposing a change in the calculation to use a forecast of the previous month's ending PGVA balance in the calculation of the monthly EUG price forecast. EGNB believes this will facilitate a more timely recovery of the shortfall in the PGVA and will also serve to provide better matching between those customers who contributed to the PGVA with those paying for its recovery.
- [97] In response to a question about this issue, EGNB provided an undertaking. The response to that undertaking is found in EGNB Exhibit 7.09, which explained the change as follows:

The difference between the current methodology of calculating the PGVA and the proposed methodology is that EGNB is proposing to begin recovering the PGVA balance one month earlier. This involves including a forecast of the previous month's PGVA ending balance. The actual difference between the estimated cost of purchasing and selling gas and the actual cost of purchasing and selling gas gets booked in the next month, as is currently done. Any variance is included in future forecasts. EGNB believes this is in compliance with Section 4(2) of the Gas Distributor Marketing Regulation.

- [98] The Board finds that the change to the PGVA calculation is reasonable and approves the proposal, as filed. EGNB is required to file with the Board its detailed monthly PGVA calculations.

c. Approval of Rates

i. Comparison of Market Based Rates and Cost of Service Rates

- [99] Having considered both the market based rates and the cost of service rates for each of the classes of customers prescribed by Section 3 of the Regulation, the Board is required to conduct a comparison of the resulting rates.

[100] The table found in EGNB Exhibit 1.02, at page 4, provides a comparison of the resulting rates as follows:

Rate Class	Market Based Rate (\$/GJ)	Cost of Service Study Rate (\$/GJ)
Small General Service	7.4045	24.7524
Mid-General Service	15.3435	12.7762
Large General Service	15.0374	4.8065
Contract General Service	9.6033	5.3068
Industrial Contract General Service	9.4689	2.7210
Off-Peak Service	11.5076	2.5294

[101] The Board notes that the cost of service rates in the above table are not exact because of adjustments to the revenue requirement arising from this decision. They cannot be determined until EGNB re-files its revenue requirement and makes those adjustments.

[102] That said, it is clear that the cost of service rates for all classes of customers, except the SGS class, will be lower than the comparative market based rates. Accordingly, cost of service rates will be used for all classes of customers, except the SGS class.

[103] It is important to note that the rates generated by the market based formula and the cost of service study both represent the total costs per GJ to customers. In the rate design process, these amounts will be allocated to customers' charges, demand charges, and delivery charges according to the rate design for each class of customers.

ii. Approval of the Rate Handbook

[104] The approved rates and rate design are compiled into a rate handbook which contains the terms and conditions regarding the services provided to each class of customers. The handbook makes available guidance to both EGNB staff and customers on items such as security deposits, disconnection notice, rate schedules, etc.

[105] The proposed rate schedules for the various classes of customers are found in EGNB Exhibit 1.27. The Board orders EGNB to revise Exhibit 1.27 with the amendments arising out of this proceeding and to file the amendments with the Board.

[106] In a decision dated September 20, 2012, at page 26, EGNB was directed "... to work with Board staff to modify the handbook and update the language contained therein to ensure that the new regulatory structure is being reflected." This process should continue.

d. Rate Design

i. Fixed Charges

[107] The EGNB rate design proposal includes an increased emphasis on fixed charges to recover fixed costs and includes changes to demand or customer charges to most classes of customers.

[108] The delivery charge has been held constant for ICGS customers with all of the increase being in demand charges. The demand charge for the CGS class will increase. For the MGS class, EGNB proposes graduated charges to accommodate the addition of small non-residential customers that previously were part of the SGS class. The monthly customer charge for the SGS class has been increased by \$2 coupled with a decrease in the delivery charge to ensure the target savings of 20% under the equivalent cost of electricity.

[109] No party took issue with the proposed rate design changes. The Board finds the changes to the fixed charges are just and reasonable and approves them, as filed.

ii. Revenue Smoothing Mechanism

[110] EGNB is proposing a new rate design tool, namely, a revenue smoothing mechanism (RSM), also known as, revenue decoupling. This tool is often used as a rate adjustment mechanism where it separates, or decouples, a utility's fixed cost recovery from the amount of gas the utility delivers. EGNB believes that this mechanism would help the utility achieve its 2015 revenue requirement and safeguard customers against EGNB over-earning as a result of events such as colder than forecasted weather.

[111] The proposed RSM would consist of adjusting the authorized rates upwards or downwards the following month in order to generate the authorized level of revenue per rate class of customers for the 2015 test year. This mechanism would be used only in the SGS, MGS, and LGS rate classes of customers. A more detailed explanation of the RSM can be found in EGNB Exhibit 1.26.

[112] In EGNB Exhibit 1.26, at page 6, the utility states that "... the likelihood that EGNB recovers its costs including a return of and on its investment is improved." In PI Exhibit 1.01, at page 14, Mr. Knecht takes issue with this mechanism because the proposed RSM is "... a very broad-based version of RSM, in which all (or virtually all) revenue fluctuations from budget are absorbed by ratepayers and none are absorbed by EGNB."

[113] Mr. Knecht has expressed six concerns regarding the proposed RSM in PI Exhibit 1.01, at pages 15-16, as follows:

First, the Company proposes to apply the mechanism on a total budget revenue basis, rather than a per customer revenue basis. This eliminates any incentive that EGNB has to attract new customers.... As I noted earlier, revenue decoupling mechanisms are often established on a per-customer basis, so as to give the utility an incentive to attract and retain customers.

Second, the Company proposes to recover the entire revenue difference for one particular month in a single month.... This approach can result in significant rate volatility.... Simply reviewing the Company's response to EGNB (NBEUB) IR-19(e) shows that SGS rates would fluctuate substantially, including a jump from \$5.17 per GJ to \$14.90 per GJ from one month to the next.

Third, for the reasons discussed earlier, granting EGNB a revenue variance mechanism for non-weather factors has inequitable aspects, in that ratepayers may be absorbing risk when they can least afford it, or because they have reasonably responded to the price signals provided by the utility....

Fourth, as proposed for the MGS and LGS classes, the Company's mechanism would recover the variance in the first block energy charge, with no recovery in the tail block charges.... In effect, in EGNB's proposal, the volatility of rates will be more pronounced for smaller customers within each rate class than for larger customers within the rate class, despite the fact that all customers contribute to the variances.

Fifth, the Company proposes to apply the RSM to the Rate LGS class, but not to the CGS or ICGS classes. While the Company's proposal in this regard is understandable, it creates the potential for a modest windfall in the particular circumstances for this application....

Finally, to state the obvious, a RSM is not consistent with the Rate Rider mechanism. If the Board adopts a rate rider for the SGS class (which I do not endorse), an RSM would be incompatible with that mechanism.

[114] In essence, it is Mr. Knecht's view that the proposed RSM goes too far in terms of shifting risk from shareholder to ratepayer. He submits in PI Exhibit 1.01, at page 14, that "... from a ratepayer perspective, it is questionable whether it is reasonable to increase rates to ratepayers when they have reasonably responded to price signals and reduced their consumption."

[115] Additionally, Mr. Knecht points out that there are two basic issues regarding the distortion of price signals related to recovery of historical variances with this type of mechanism. First, he mentions in PI Exhibit 1.01, at page 14, that "... rates are generally not matched with costs." Secondly, he states that "... these mechanisms tend to contribute to rate instability, as rates are often adjusted monthly or quarterly to recover variances."

[116] The introduction of the RSM is a new concept in natural gas regulation in New Brunswick. There was an abundance of evidence filed on this issue and considerable time was spent in exploring its merits during cross-examination. The Board appreciates the time and effort devoted by all parties in exploring the merits of this proposal.

[117] The Board has reviewed all of the evidence provided with respect to the proposed RSM and, although it agrees that revenue decoupling may be a useful tool in natural gas rate making in New Brunswick, it finds that the RSM proposed in this hearing should not be approved.

[118] The Board agrees with the concerns set forth by Mr. Knecht. In particular, the Board is concerned that this particular mechanism would produce higher rates to customers if throughput was to decrease from the forecast amount. These higher rates could result, for example, from a loss of customers. In that case, EGNB would appear to have a guarantee of revenue requirement recovery and not just a reasonable opportunity to earn its revenue requirement. There would be a shift of operational risk from the utility to customers.

[119] In addition, the Board is concerned as to whether the mechanism as proposed would be consistent with the requirements of the Regulation to provide a 20% target savings to

SGS customers. For the SGS class, the ratemaking objective established by Regulation is not a revenue requirement for the class, but is an obligation to set rates that ensure target savings. Any mechanism that may result in rates that are higher from the rate established in the rate proceeding may not comply with the Regulation.

[120] Although the Board does not approve the RSM as proposed, it is not opposed to the concept of revenue decoupling. EGNB may wish to evaluate and file a narrower form of revenue decoupling that addresses the issues raised by the Public Intervener and Mr. Knecht.

3. Miscellaneous Issues

a. Flex Rates

[121] An issue arose at the hearing concerning the option of creating flex rates. On this issue, Mr. Knecht stated in PI Exhibit 1.01, at page 17, as follows:

... EGNB and the Board may wish to formalize the Company's ability to offer negotiated "flex" rates below the regular tariff rate in order to meet competitive circumstances. Many natural gas distribution companies have that flexibility, generally subject to certain conditions that protect other ratepayers from being unduly discriminated against.

[122] In his rebuttal evidence in EGNB Exhibit 4.02, at page 4, Mr. Volpé responds to Mr. Knecht's recommendation as follows:

EGNB appreciates Mr. Knecht's suggestions and support regarding flex rates in competitive circumstances. EGNB reviews alternative energy pricing on a continuous basis and would apply to the Board for approval of such a rate if the situation presented itself.

[...]

EGNB will continue to monitor alternative energy prices going forward. Prior to its next annual rate application, EGNB will consider applying for a Board approved methodology to offer flex rates to customers subject to ex post Board review in order to benefit all ratepayers.

[123] Mr. Stewart argued that every competitive option should be employed by the utility to ensure the continued stability of the system, including the use of flex rates. He suggested

that it would be most appropriate for the Board, as a result of this proceeding, to at least amend the tariff or direct that the possibility of a flex rate be explored.

[124] EGNB and the Interveners all agreed that flex rates may benefit the system. The Board agrees that there is a potential benefit to the system and will entertain an application by EGNB either before or at the next rate hearing to develop a process and criteria on how such a rate design would work.

b. Rate Riders

[125] EGNB is requesting that the use of rate riders be discontinued. The use of rate riders was considered in a Board decision dated April 17, 2014, where it stated at page 28, “The use of rate riders has been an important part of the market based method or technique since the conception of the EGNB franchise.” They were “... developed to allow EGNB to adjust rates below the maximum approved rate to ensure that the target savings were maintained.” and “... providing EGNB with the flexibility to adjust to market conditions.”

[126] The decision also noted that “In the past, when a rate rider was put in place, any shortfall in revenue would be added to the deferral account. Now, without a functioning deferral account, the mechanism for recovery no longer exists.” The Board suspended the use of rate riders and stated that if the SGS class was redefined it may help to determine if natural gas is a competitive energy source and possibly eliminate the need for rate riders.

[127] EGNB puts forward its rationale for discontinuing rate riders in EGNB Exhibit 1.02, stating at pages 5-6:

Proposed changes to the EUG price calculation facilitate a more timely recovery of the Purchase Gas Variance Account. The EUG price used in this application to determine market based rates is more reflective of market pricing pressures historically seen in winter months, resulting in a slightly higher average EUG rate, and therefore lower market based rates. As a result of that change, together with the proposed changes to the SGS rate class composition, the creation of a residential only class, the elimination of the blended SGS rate class approach, and the Board’s decision to now require EGNB to make annual rate filings which ensures SGS rates are reassessed on an annual basis, EGNB believes that it has satisfied the Board’s concerns and is requesting that going forward the use of rate riders be discontinued.

[128] Mr. Knecht reviewed the EGNB evidence on rate riders and stated that he did not oppose their elimination, for the purposes of this proceeding, but did not support the exclusion of the rate rider from the tariff completely.

[129] The Board finds that it is appropriate to discontinue the use of rate riders. In coming to this conclusion, the Board considered the fact that changes approved to the EUG price calculation will result in a more timely market based rate during the potentially volatile winter months. In addition, the redefinition of the SGS class to residential only customers, provides more residential customers with the promised savings for this class. EGNB annual rate filings will also provide a more timely response to market changes.

c. Development Period and Regulatory Deferral Account

[130] During the hearing there was considerable debate by the parties as to whether or not EGNB is still in the development period. If it is determined that the development period is indeed over, the regulatory deferral account may no longer be used.

[131] The Board found in a decision dated December 1, 2009, at page 3, "... that the essential element that defines the Development Period is an inability to have a reasonable opportunity to recover the utility's full costs on a sustainable basis." In the same decision, at page 6, in order to determine if the development period is over, the Board developed a two-part test, as follows:

The Board finds that the appropriate criteria to be considered in determining if EGNBLP's Development Period is over are:

Are the full costs equal to or below the currently available revenues?

Are such revenues sustainable?

[132] Both the regulatory and legislative landscapes in New Brunswick have changed significantly since the last Board decision regarding the development period in 2009. As a result of legislation and a regulation that came into effect in 2012, the regulatory deferral account is no longer allowed to be recognized or considered as part of the regulated assets of a gas distributor, in approving and fixing just and reasonable rates and tariffs. Previously, EGNB was regulated using a market based method or technique to set

rates, whereas the primary method of setting rates currently is the cost of service rate system.

[133] For both the preceding and current year, all classes of customers, except the SGS class, have had their rate set on a cost of service basis. The Board has set rates that allow EGNB a reasonable opportunity to recover its approved revenue requirement. The elimination of rate riders in this decision removes uncertainty with respect to the rates set for the test year.

[134] Considering the above, it is apparent that the issue of whether or not EGNB still remains in the development period should be reexamined.

[135] The Board orders EGNB to file a new application, on or before June 1, 2015, for the determination as to whether or not the development period is over.

d. Minimum Filing Requirements

[136] Further to the Board decision dated April 17, 2014, the Board had ordered EGNB to propose minimum filing requirements to the Board at a date to be set by the Board.

[137] In PI Exhibit 1.01, at page 4, Mr. Knecht mentions that EGNB:

... has done an excellent job to include much of the information, that, in the earlier proceedings, I and other parties have requested in discovery or suggested be included in the minimum filing requirements. This effort has greatly simplified the discovery process, and should result in a shorter and more efficient proceeding. I thank the Company for its efforts.

[138] The Board acknowledges EGNB's proactive effort in putting together the documentary evidence required for this matter. The evidentiary package creates a precedent for the minimum filing requirements required for future rate hearings.

[139] In the event that additional information is required, the Board will advise the parties accordingly.

D. Conclusion

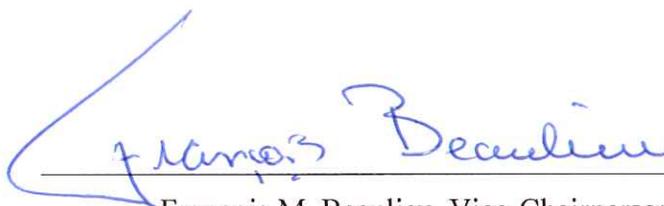
[140] The Board finds as follows:

- EGNB's 2013 Regulatory Financial Statements are approved as filed.
- EGNB's application for a change to its Distribution Rates is approved, subject to the modifications outlined in this decision. Once EGNB has filed the necessary additional information, the Board will issue an Order setting out the distribution rates for each customer class. The rates approved in this application will become effective January 1, 2015.

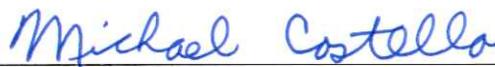
Dated at the City of Saint John, New Brunswick this 23 day of December, 2014.



Raymond Gorman, Q.C., Chairman



François M. Beaulieu, Vice-Chairperson



Michael Costello, Member