



REPORT

IN THE MATTER OF an Investigation into the necessity for the 3% increase in the New Brunswick Power Distribution and Customer Service Corporation's charges, rates and tolls which came into effect on June 1, 2010

July 12 , 2010

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

MINISTER OF ENERGY'S DIRECTIVE

On April 27, 2010, the New Brunswick Power Distribution and Customer Service Corporation ("Disco") notified the New Brunswick Energy and Utilities Board ("the Board") that Disco's Board of Directors had approved a three per cent rate increase, effective June 1, 2010. On that date all rate categories were increased by three per cent. The residential rates were adjusted to eliminate the declining block energy charge. The New Construction Energy Charge was eliminated and the residential monthly service charges were held at current levels.

The Electricity Act authorizes Disco to increase its rates without the approval of the Board as long as the increase does not exceed the greater of three per cent or the percentage change in the average consumer price index. Since the increase did not exceed these parameters, Disco was not required to provide information to the Board concerning the necessity for the increase.

The Minister of Energy ("the Minister") wrote to the Board on April 12, 2010, directing it, pursuant to subsection 24(1) of the Energy and Utilities Board Act ("the Act"), to investigate the necessity for an increase in the charges, rates and tolls. The Board has completed its investigation and this is its report.

Subsection 24(1) states:

"The Minister may direct the Board to make an investigation and report to the Minister upon any matter over which the Board has jurisdiction."

This limits the investigation to Disco and does not permit the Board to investigate the generating companies operated by NB Power.

PROCESS

The Board used an investigation process that differs from the process used for review of a rate increase by Disco of greater than three per cent. A rate hearing requires that an applicant's

evidence be rigorously examined and tested and must allow for full public participation. This process includes providing parties, other than Disco, with an opportunity to submit evidence and to fully cross examine Disco's witnesses. This is inherently a lengthy process. The time required from receipt of an application to release of the Board's decision can take many months.

The Board, when reviewing an application for approval of a change in rates, has the authority to approve the rates as requested or to approve such other rates as it finds to be just and reasonable. The Board also has the authority to make an interim order respecting rates where it considers it advisable to do so. These powers allow the Board to take the time necessary to complete a thorough review while at the same time setting rates at an appropriate level.

The Board cannot make any adjustments to rates that are the subject of an investigation. These rates are in place while the investigation is occurring and cannot be changed by the Board as a result of its investigation. If it is determined that rates are higher than necessary, the Board cannot order a refund to customers based on the time that the rates were in place nor can the Board order rates to be reduced.

For an investigation to have any value, the report must be made available to the Minister as quickly as possible. The timeframe for an investigation must therefore be considerably shorter than a full rate hearing. As a result, limits are placed on the participation of the other parties. Their opportunity to submit written questions is reduced, they are not able to submit their own evidence and their ability to cross examine Disco witnesses is limited. The review that is completed in an investigation process is therefore less thorough than one which occurs in reviewing an application for approval of a rate increase. The investigation process permits a reasonable review of Disco's information, but the degree of scrutiny is not as rigorous as that which occurs for a rate application.

The process used for the investigation was as follows:

1. Disco was directed to file and make available the information that justified their rate increase;
2. The public was invited to register and participate in the process;
3. Disco was directed to provide answers to written questions from registered participants and Board staff;
4. A financial consultant was retained by the Board to examine certain specific items; and
5. A Public Hearing was held.

The panel for the public hearing component of this investigation consisted of five members of the Board: Raymond Gorman, Chairman; Cyril Johnston, Vice-Chairman; and Members Roger McKenzie, Constance Morrison and Yvon Normandeau.

At the hearing on June 22, 2010, Darren Murphy, Chief Financial Officer for Disco; Angela Leaman, Finance Director for Disco; Neil Larlee, Director of Energy Supply and Contract Management for Disco; and Lori Clark, Managing Director of Finance for the New Brunswick Power Holding Corporation testified on behalf of Disco.

The following parties registered for the hearing:

- Canadian Manufacturers & Exporters
- Capital Management Engineering
- Emera Energy Inc.
- Gerard Daly
- Kurt Peacock
- Public Intervenor
- Voice of Real Poverty Inc.

The Board retained the services of Mr. Andrew Logan, CA, of Teed Saunders Doyle, as a financial consultant to review Disco's forecasted Purchased Power Expense and the PDVSA Settlement Deferral Account. Mr. Logan's review was conducted in accordance with the Canadian Institute of Chartered Accountants Assurance Handbook. Details on the process used by Mr. Logan are described in his report.

Mr. Logan provided a report on his findings to the Board on June 11, 2010. This report was made available to the public on the Board's website at www.nbeub.ca. Mr. Logan testified at the public hearing and answered questions concerning his findings. His conclusions are presented later in this report.

At the conclusion of the hearing, the parties were provided with the opportunity to submit comments. The Board believes that the concerns expressed by the parties, such as the impact of the cost of electricity on the poor, should be read in their entirety. The parties' complete comments can be found in the hearing transcripts at pages 175-182 for June 22 and pages 199-211 for June 23. The transcripts are available on the Board's website at www.nbeub.ca.

REVIEW OF THE 2010/2011 FORECAST

Revenues

The revenue forecast is based upon the load forecast. Concerns were raised over the possibility that Disco's load forecast may be overestimated in light of the history of actual sales as compared to forecast sales for a number of past years. Particular concerns were expressed with respect to both the forecast for residential and industrial transmission sales.

Disco stated that the forecasts were the best that they could produce and noted that should sales be lower than forecast the result would be a negative impact on their net earnings. The Board accepts Disco's forecast of revenues for 2010/2011.

Fuel and Purchased Power Expense

Purchased Power expense for 2010/2011 was forecasted to be \$1,031.8 million which represents 78.5% of Disco's total expenses. For the previous year this expense was estimated to be \$1,092.2 million. The forecast for 2010/2011 is \$60.4 million less than for the previous year which is a decrease of more than 5.5% year over year.

Mr. Logan, who reviewed Disco's forecasted purchased power expense, made the following conclusion at page 21 of his report:

“Based on the review procedures conducted and the results obtained, nothing has come to our attention that would cause us to believe that DISCO's forecasted purchased power expense for the fiscal year ended March 31, 2011 is materially misstated. Further, the amount forecasted appears reasonable and plausible based on the results of our work.”

The Board accepts Mr. Logan's conclusion concerning Disco's purchased power expense.

Mr. Logan also reviewed the calculations associated with the Petroleos De Venezuela, S.A. (PDVSA) Settlement Deferral Account. The PDVSA account was created to ensure that the benefits from the settlement concerning the use of Orimulsion are properly shared with Disco's customers. With respect to the PDVSA account Mr. Logan concluded at page 25:

“Our review of the PDVSA Settlement Deferral account indicated that all Board orders have been properly implemented. Our review produced no evidence that would indicate that the assumptions used and the methodologies implemented are not reasonable. We would conclude that the levelized benefit included in the forecast for 2010/11 is plausible in the circumstances, except for the interest error identified in the preceding paragraph. We would also note that the error favours the DISCO customer”.

The Board accepts Disco's calculations related to the PDVSA account.

Other Expenses

Transmission, Operations, Maintenance & Administration (OM&A), Amortization, Taxes, Interest and Special payments in lieu of income taxes (PILT) make up Disco's other expenses. OM&A is forecast to be \$123.3 million for 2010/2011, an increase of \$2.8 million (2.3%) over 2009/2010. This category represents approximately 44% of the total of the other expenses.

During the public hearing, various parties raised concerns with the increase in the OM&A budget. Questions were raised about the necessity to increase staff, the forecasted increase in wages and benefits, the Conservation and Education Program and the benefits to be achieved from the staff reduction program.

For 2010/2011, the reduction in staff that will occur as a result of the staff reduction program will be largely offset by the hiring of 12 lineman trainees who are needed to replace linemen that are expected to retire in the next few years. Disco, however, estimates that the payback period for the costs associated with the staff reduction program will be 1.4 years. Disco's budget for 2010/2011 does not include any cost of living increase for its non-union staff. A two year wage freeze for non-union staff will commence in February 2011.

Disco stated that the forecasted costs were necessary in order to be able to provide reliable, safe and environmentally responsible service.

As discussed above, an investigation does not permit as detailed an analysis as would occur with the review of an application for approval of a change to Disco's rates. The EUB has considered Disco's Information Package, Mr. Logan's report, Disco's responses to written questions and all of the comments made at the public hearing. Subject to the comments below, the Board finds that

Disco's forecasts for revenues, purchased power and other expenses for 2010/2011 are reasonable.

The total amount of Disco's expenses, including PILT, for 2010/2011 is forecast to be \$1,314.3 million. The total revenues forecasted for 2010/2011, after adjusting for the new rates coming into effect on June 1, 2010, is \$1,343.3 million. Disco believes that the full amount of revenue is necessary to allow Disco to cover all of its operating expenses for 2010/2011, to pay PILT and to have the amount of net earnings that Disco considers to be necessary.

The Board notes that the necessity to make a payment of PILT only arises when Disco has net earnings. The need for the full amount of the 3% increase therefore depends upon the requirement for and the amount of net earnings.

NET EARNINGS

Net earnings are the owner's profit after all expenses, including interest and PILT, have been paid. Net earnings and capital investment are the sources of equity. The purpose of equity is to provide the risk capital which can absorb fluctuations in financial results. Fluctuations in financial results can arise from the business risks to which a company may be exposed. Business risks include variations in demand from forecast levels, unanticipated operating cost increases, unfavourable weather conditions and changes in prices of major input commodities.

Disco believes that net earnings in 2010/2011 are necessary to enable it to withstand the variability and the inherent risk in its business. None of the registered parties stated that Disco should not have net earnings in 2010/2011.

The Board, in its February 22, 2008, decision on a rate application by Disco, stated:

“The Board finds that it is prudent for DISCO to have net income and to accumulate earnings towards its stated goal of self-sufficiency. The Board believes that the best method for determining net income is applying an allowable rate of return to equity. This,

however, is not possible as no equity injection has been made by the shareholder, and DISCO has only accumulated nominal retained earnings to this point. Consequently, the Board accepts DISCO's approach of using an interest coverage ratio to set income for the test year.”(page 24)

The Board considers that Disco is currently in a very similar situation and finds that it is prudent for Disco to have net earnings in 2010/2011 for the following reasons:

- Disco's access to debt markets is through the Province of New Brunswick and Disco's financial performance can influence the credit rating of the province.
- Failure to achieve a satisfactory financial performance could result, over time, in higher electricity rates.
- Sound financial performance facilitates the secure supply of electricity at reasonable rates.

Having found that it is necessary for Disco to have net earnings in 2010/2011 the issue then becomes was it necessary for Disco to increase its rates by 3% in order to have net earnings. Analysis of the information provided by Disco indicates to the Board that the 3% increase in rates was only necessary so that Disco would have net earnings in 2010/2011. The actual amount of the increase in rates that was necessary is therefore dependent upon the amount of net earnings that is necessary for 2010/2011.

The investigation, for the reasons discussed above, did not allow for a thorough examination of the topic of net earnings for Disco. The precise amount of net earnings that is necessary for 2010/2011 can only be determined after a careful analysis of all the relevant issues. These issues include matters such as the appropriate amount of equity in the capital structure and the appropriate rate of return on such equity. Such a review is best done in the context of a general rate application. Disco supports this approach as evidenced by the following comments made by Mr. Furey in his closing remarks:

“Forecast earnings in the current fiscal year will barely return Disco to a positive retained earnings situation of approximately \$7.8 million.

Disco requires not only this minimal level of retained earnings but a plan to build retained earnings to an appropriate level over time.

The issue of where that level should be is properly the subject of a fully informed Board decision in the context of a general rate hearing.”(page 191 of the transcript for June 23)

The necessity of the 3% increase, as stated earlier, is dependent upon the amount of net earnings that are necessary for 2010/2011. The amount of net earnings forecast for 2010/2011 is significantly larger than the amount approved by the Board in its February 22, 2008, decision for the 2007/2008 year. The determination of the necessary amount of net earnings for 2007/2008 was made after a thorough public review. As discussed above, this type of review did not occur as part of this investigation.

The Board is not convinced by the information provided by Disco that the precise amount of \$28.3 million of net earnings is necessary for 2010/2011 and for the reasons stated above is unable to make a determination as to the exact amount of net earnings that is necessary for 2010/2011.

The Board therefore finds that it cannot confirm that the full amount of the 3% increase taken by Disco on June 1, 2010, was necessary.

RELATED MATTERS

In its report of June 26, 2008, on the investigation into a 3% increase by Disco the Board stated:

“Given that DISCO’s rates this year have, in fact, been set using the consolidated figures for the NB Power Group, any future regulation of rates using DISCO only information would likely lack credibility.” (page 17)

It has been made clear in this investigation that the NB Power Group of Companies operates as a single entity with respect to determining the rates for electricity in New Brunswick. As such, all of the relevant costs should be examined before rates are increased.

Future regulation would therefore be more effective and have more relevance for customers if GENCO and NUCLEARCO were regulated in the same manner as DISCO and TRANSCO.”(page 19)

The nature of the operation of the NB Power group of companies is such that a very significant portion of the costs of the various companies are recovered by Disco through charges to its customers. In effect, Disco’s customers are required to contribute to the net earnings of the entire group. For this reason, it is in the public interest that the operations of the entire group be examined in order to determine the appropriate level of net earnings that customers in New Brunswick should be required to pay for through their electricity rates.

This issue was addressed by parties during the review. Mr. Peacock stated:

“I know that NB Power’s own management has made a proposal to essentially accept what is reality that this utility is still a vertically monopoly and it should be regulated as such. I think everyone in this room should encourage that that process of a full and complete regulation take place as soon as possible.

Until that point I think it is very difficult for the regulator to determine with any sort of confidence that this rate increase is necessary. We just don’t have all the facts in front of us.”(page 201 of the transcript for June 23)

The Public Intervenor, in closing comments, stated:

“Finally, I would suggest that the Board confirm with the Minister that there is a pressing need for regulatory examination of the prudence of Genco and Nuclearco’s

costs, and whether these costs are just and reasonable.” (page 211 of the transcript for June 23)

Mr. Murphy, on behalf of Disco, testified as follows:

“We have a process by which we have power purchase agreements whereby, you know, from a regulatory standpoint or from the public standpoint, it can be very frustrating in that it appears as if those costs, which represent a big chunk of rates, are not subject to, you know, a hearing process like this. And we certainly appreciate to be open and transparent that is important.

And we certainly support the notion that it should be included and we should be regulated, to be quite honest, at the holding company level, at least would be our recommendation, and not at the distribution company level, so that all of those costs could be evaluated and reviewed through a process like this that would ensure that all of those costs are prudent and are reasonable in terms of ratemaking.”(page 86 of the transcript for June 22)

CONCLUSIONS

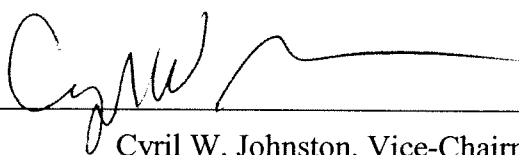
- All of the 3% increase in rates will go to providing net earnings for Disco.
- The Board has consistently taken the position that some level of net earnings for Disco is appropriate.
- To determine the appropriate level of net earnings for Disco would require a hearing that could take many months.
- Given the evidence that NB Power operates as a vertically integrated utility, the focus should be on the appropriate net earnings for the entire group of NB Power companies.
- Section 24(1) of the Act limits this investigation to matters over which the Board has jurisdiction.

- The Board does not have jurisdiction over either the NB Power generating companies or the NB Power holding company and therefore cannot make a determination regarding the appropriate level of net earnings for the NB Power group as a whole.
- Given the above, the Board cannot confirm that the 3% increase in rates was necessary.

Dated at the City of Saint John, New Brunswick this 12th day of July, 2009.



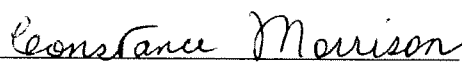
Raymond Gorman, Q.C., Chairman



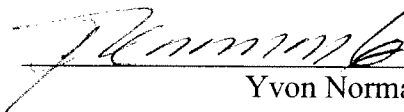
Cyril W. Johnston, Vice-Chairman



Roger McKenzie, Member



Constance Morrison, Member



Yvon Normandeau, Member