DECISION

IN THE MATTER OF a Review of Issues Related to the Development Period for Enbridge Gas New Brunswick Limited Partnership

December 1, 2009

New Brunswick Energy and Utilities Board

REGISTERED PARTIES:	REPRESENTED BY:
Enbridge Gas New Brunswick Inc. ---	Mr. David MacDougall
Atlantic Wallboard Ltd ---	Mr. Christopher Stewart
Department of Energy---	Mr. Patrick Ervin
Flakeboard Company Limited--	Mr. Gary Lawson
Public Intervenor--	Mr. Daniel Theriault
NB Energy and Utilities Board--	Ms. Ellen Desmond

	Panel:
Chairman:	Mr. Ray Gorman, Q.C.
Vice-Chairman	Mr. Cyril Johnston
Members:	Mr. Don Barnett
	Mr. Edward McLean
	Mr. Robert Radford, Q.C.
Board Secretary:	Ms. Lorraine Légère

Introduction

The Board has recognized the concept of a Development Period since the very first days of the regulation of natural gas distribution in New Brunswick. In the first decision on rates, dated June 23, 2000, the Board said the Development Period is a term used to describe the amount of time required to move from a "greenfield" situation to a more established natural gas industry. In that decision the Board found that the Development Period should last until December 31, 2005.

Enbridge Gas New Brunswick Limited Partnership (EGNBLP) applied on October 8, 2004 for approval to extend the Development Period until December 31, 2010. The Board's decision of January 21, 2005 approved an extension of the Development Period until December 31, 2010. The decision stated that any further request to extend the Development Period beyond 2010 must be done by application and demonstrate the need for the extension. In the January 21, 2005 decision the Board stated that the Development Period is a time during which the utility cannot be expected to operate in a mature manner while its infrastructure and customer base are being developed.

In 2008, with the scheduled end of the Development Period approaching, the Board directed that a hearing take place to establish the criteria which will enable it to determine when the Development Period should end. In a decision on matters related to the end of the Development Period, issued March 20, 2009, the Board stated that how the Development Period is defined and when it ends will have an impact on many other matters. For that reason, the Board decided to conduct the public proceeding that has led to this decision. The public notice for this proceeding identified the following issues:

> What are the essential elements that define the development period?
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> Can the approved Return on Equity be altered prior to the end of the development period?
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> Can the development period end for one customer class without it ending for all customer classes?
>
> What are the criteria for ending the development period and how should those criteria be measured?

A pre-hearing conference was held on July 13, 2009 at which time the process for filing evidence and information requests was established. The public hearing was held in Fredericton on October 14, 15, 16 and 19, 2009 and in Saint John on October 23, 2009. The following parties registered as formal intervenors:

Atlantic Wallboard Limited ("AWL")
Department of Energy ("Energy")
Flakeboard Company Limited ("FCL")
The Public Intervenor ("PI")

The following witnesses testified at the hearing:

On behalf of EGNBLP:	Dave Charleson and Jamie Leblanc
On behalf of AWL and FCL:	John Reed
On behalf of FCL:	Michael McAloon
On behalf of the PI:	Laurence Booth, Robert Knecht and Kurt Strunk

Each of the four issues identified in the public notice, as well as other matters, are discussed below.

Essential Elements that Define the Development Period

In order to determine the essential elements of the Development Period it is helpful to describe what a Development Period is.

The introduction of EGNBLP into a marketplace where there exists well established companies that offer energy services in competition with the services to be offered by EGNBLP presents unique challenges. In addition, EGNBLP has significant start-up costs that cannot be recovered from its customers in the initial years.

In recognition of the circumstances it faces, EGNBLP must offer rates that will encourage the potential customers to become actual customers. The rates must offer overall benefits to potential customers in relation to their alternatives. In this fashion, EGNBLP can develop its business to the point where it can operate as a more mature utility. The period of time during which EGNBLP is establishing its business to the point where it can operate as a more mature utility is its Development Period. The Development Period is something that applies to EGNBLP as a whole. It is not a concept that applies to an individual customer or customer class.

A mature utility is one that is in a position to have a reasonable opportunity to recover its full costs each year. The rates for a mature utility are set, based on forecasts of costs and sales volumes, so that the utility will have an opportunity to recover all of its annual costs, including a fair return on the money invested in the business. There is no guarantee, however, that a mature utility will recover all of its costs each and every year. If the actual results for the year are such that the utility has not recovered all of its costs, as approved by the regulator, the utility is not entitled to recover any such shortfall from customers in the future.

A utility that is not mature is, by definition, one that cannot be expected to recover its full costs of service on an ongoing basis. Its business has not developed to the point that its rates can be set with the objective of providing a reasonable opportunity for the utility to recover its full costs on an annual basis. In contrast to the mature utility, shortfalls in recovery of its full costs, in a given year, are permitted to be carried forward with the intention that the utility have a reasonable opportunity to recover the shortfall in future years.

There have been numerous recommendations concerning the essential elements of the Development Period such as low market share and high unit fixed costs. The Board finds that most of these are really characteristics or aspects that may be associated with a Development Period but are not essential elements of a Development Period.

The most significant difference between a utility company that is still developing and a mature utility company is that the mature utility company is expected to be able to recover its full costs on an annual basis and a utility that is still developing is not expected to be able to do so. The Board finds 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.

Criteria for Ending the Development Period and How to Measure the Criteria

In light of the Board's finding with respect to the essential elements of the Development Period, the criteria to be used must provide the information necessary to make a determination as to whether the revenues can recover the full costs and a further determination as to whether the recovery of the full costs would be sustainable on an annual basis.

Market share, infrastructure development, product awareness and ability of the market to provide natural gas and installation are legitimate considerations but by themselves are not determinative of when the Development Period is over.

Determining if revenues can recover full costs requires a comparison of the full costs to the revenues that are available from the current rates. If the costs are equal to or less than the revenues then the first test has been met.

The question then becomes whether those revenues are sustainable. This requires another test. It must be determined if the revenues, in total for all of the customer classes, will be equal to or greater than the full costs going forward.

The rates that would be charged must therefore be able to provide a reasonable opportunity for EGNBLP to recover its full costs on an annual basis. It is important to state that, in the phrase "full costs" used in this decision, the Board finds that this includes all costs that have been approved by the Board as part of the rate base for EGNBLP.

Given the nature of EGNBLP's business, the expectation for the future costs of natural gas and competing fuels then becomes the critical determinant. It is the relationship between these commodities that effectively establishes a cap on the rates that can be charged to customers.

With respect to determining the impact of market prices, both EGNBLP and Mr. Knecht discussed the importance of the relative pricing of competitive fuels and natural gas. Each proposes a test based on the use of historical information; however, current and potential customers will likely base their decisions on what they expect to happen to their costs rather than what has happened in the past. The prices to be used should reflect what is expected to happen in the future. Forecasts of future prices are, in fact, used in the current market-based method of setting rates.

It is likely that the prices of the commodities will continue to fluctuate in the future. It is the total cost over a particular future period that should be the appropriate consideration, as higher costs in some months would be offset by lower costs in other months. The use of projected prices over a reasonable period of time would be appropriate.

With respect to the appropriate period of time, the Board believes that use of a forecast period of two years is reasonable. The Board finds that the rates that could be charged on a sustainable basis are to be determined by using the approved rate setting method in force at the time of performing the test.

If the rates that can be sustained provide revenues equal to or greater than the full costs the second test is passed and EGNBLP’s Development Period would be over.

With respect to the sustainability of revenues, EGNBLP proposed a 95/5 test wherein no more than 5% of the customers would experience more than a 5% increase in rates when switching to cost-based rates. The current method of establishing rates is based on a “typical” customer and such rates have been used to attract and retain customers. The Board believes that properly designed rates will continue to be appropriate for a “typical” customer. The Board finds that the 95/5 test is not necessary for determining if the Development Period is over.

EGNBLP also proposed a loss of throughput test. The purpose of this test was to establish the robustness of the revenues by examining the impact on EGNBLP’s financial results of a loss of throughput. Calculation of sustainable rates, as discussed above, will identify if the necessary revenues can be sustained. If the determination is that they can be sustained, then the expectation would be that existing customers would remain on the system unless other factors are involved.

If other factors are involved, this would be a normal business risk to which all companies are exposed. The Board finds that the loss of throughput test is not necessary for determining if the Development Period is over.

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?

These tests, to determine if the Development Period has ended for EGNBLP, will be performed each year as part of the annual review process until the Development Period is over. When the Development Period is determined to be over, EGNBLP will no longer be permitted to add to the deferral account.

Can the Development Period End for One Customer Class Without It Ending for All Customer Classes

The Board, as stated above, finds that the Development Period is a concept that applies to EGNBLP and not to a particular customer class. Therefore the Development Period cannot end for one customer class; when it is over for EGNBLP it is over for all customer classes at the same time. This does not necessarily mean that the regulatory framework will remain the same throughout the Development Period.

Can the Approved Return on Equity be Altered Prior to the End of the Development Period

All parties were in agreement that the Board has the authority to review the allowed return on equity during the Development Period. A number of parties recommended that the review be expanded to include capital structure and cost of debt. The Board agrees that any review of the return on equity should also consider capital structure and the cost of debt because of their impact on the appropriate return on equity.

EGNBLP recommended that a review not occur at this time because of the extra work that would be required and the possibility that it might be necessary to consider two different returns – one for more traditional rate base items and one for the deferral account.

AWL, FCL, Energy and the PI all recommended that the review take place given the considerable length of time since the current allowed return on equity was set and the significant changes that have occurred during that time both in the financial markets and in the natural gas market in New Brunswick.

The Board finds that the return on equity, cost of debt and capital structure ("cost of capital items") can and should be reviewed during the Development Period. The process to be followed for this purpose will be discussed in the final section of this decision.

Development Period versus Regulatory Framework

It is important to distinguish between the Development Period and the regulatory framework. The regulatory framework includes, *inter alia*, the cost of capital items discussed above, the rate setting methodology and the system of reviews of EGNBLP's financial information.

As noted earlier, no party disputed the Board's authority to review the allowed return on equity prior to the end of the Development Period. This illustrates an important point. The existing regulatory framework does not define the Development Period, nor is the existing regulatory framework an essential element of the Development Period.

In some prior decisions a connection was made between the Development Period and the regulatory framework. The Board has always anticipated some changes to the regulatory framework at the end of the Development Period. The Board has not, however, limited its ability to modify any aspect of the regulatory framework during the Development Period or following the Development Period.

It is hoped that the clarification of the distinction between the Development Period and the regulatory framework will be of assistance to parties as the Board deals with other regulatory issues going forward. The Board retains the ability to modify any aspect of the current regulatory framework at anytime - including the rate-setting methodology. The Board will do so where there is a sufficient evidentiary basis to demonstrate the proposed change is appropriate.

Process to be Used Going Forward

EGNBLP has indicated that it will be in a position to file evidence on cost of service and rate design in January, 2010. The Board believes that a public review of such information should proceed as quickly as possible. The Board directs EGNBLP to file evidence on its cost of service, proposed customer classes, proposed rate design and the possible impacts of having different rate setting methods for different customer classes by January 15, 2010.

A related matter is the public review of the cost of capital items, as any changes to the existing parameters will affect the overall costs of EGNBLP. Recommendations were made that EGNBLP be required to provide forecasts for a number of future years. The Board finds that such forecasts would be of assistance in reviewing the appropriate cost of capital items and directs EGNBLP to file a 10-year forecast as part of the evidence to be filed in connection with a review of the cost of capital items. The forecast shall identify the number of customers and throughput for each class, the rates that EGNBLP expects to charge, the costs for each major expense category and all other relevant information. EGNBLP is to identify all key assumptions used in preparing the forecast.

The Board will hold a pre-hearing conference to establish the process to be used in the review of the cost of service and rate design. The Board, at that time, will also seek comments from interested parties as to the process to be used for the review of the cost of capital items and how best to incorporate the results from that review into the results of the review on cost of service and rate design.

To assist in these future reviews, the Board will consider all evidence filed as part of the hearing process related to this decision to be part of the record for the public reviews of cost of service and rate design and cost of capital items.

Dated at the City of Saint John, New Brunswick this 1st day of December, 2009.

Raymond Gorman, Q.C., Chairman

Cyril Johnston, Vice-Chairman

Don Barnett, Member

Edward McLean, Member

Robert Radford, Q.C., Member