New Brunswick Board of Commissioners of Public Utilities

Hearing June 23rd 2000

IN THE MATTER OF AN APPLICATION BY ENBRIDGE GAS NEW BRUNSWICK INC. DATED DECEMBER 31, 1999, FOR APPROVAL OF ITS RATES AND TARIFFS.

Henneberry Reporting Service

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IN THE MATTER OF AN APPLICATION BY ENBRIDGE GAS NEW BRUNSWICK INC. DATED DECEMBER 31, 1999, FOR APPROVAL OF ITS RATES AND TARIFFS.

Chairman: David C. Nicholson, Q.C.

Commissioner: Monika Zauhar

Commissioner: Robert Richardson

Commissioner: R. J. Lutes

Commissioner: Leonard Larocque

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CHAIRMAN: Good morning, ladies and gentlemen. This is the panel that sat on the rate and tariff application of

Enbridge Gas New Brunswick.

The Board is delivering an oral decision this morning. And the reason for that is that our decisions are always published in both official languages of the Province.

The Board has made inquiries of all those translating bureaus in this Province. And we find that it may take upwards of two months to complete translation in all that I'm going to attempt to read today. So I hope you brought your pillows with you.

Anyhow, as a result, the Board has decided we should

deliver an oral decision in reference to three different

matters this morning. One is in reference to the rates and tariff. The second is in reference to the construction application. And third is a tidy-up thing on the marketers.

And this tape that has been put in front of me will not last for the whole time that I'm going to read.

All right. I will begin on rates and tariffs. Development period. 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.

Currently there are no customers using natural gas in New Brunswick. For most people it is an entirely new product. And they will require time to become aware of its advantages.

It is expected that customers will switch from their current energy source to natural gas, but the number will initially be small. However, the cost of building the necessary infrastructure will be significant. And for several years costs will exceed revenues.

The suppliers of competing energy sources are expected to respond aggressively in an effort to retain their customers. Natural gas is a commodity which trades actively in several hubs in North America. There are many sources of and uses for natural gas. The price of natural

gas varies in response to market conditions and can rise or fall significantly over a short period of time.

For these reasons EGNB maintains that it requires the ability to quickly respond to conditions in order to develop a customer base. Further, it needs assurance that it will have a reasonable opportunity to recover any costs incurred in the first few years of the franchise.

These requirements suggest the use of a nontraditional regulatory framework during the development period. No party to the hearings suggested that this would inappropriate. The Board considers that a development period during which a nontraditional regulatory framework would be used is appropriate.

In its prefiled evidence EGNB estimated that the development period would be approximately eight years but stated the actual development period would need to be flexible, as it is impossible to predict this length accurately at this time.

It is clear that the precise length of the development period cannot be established now. The Board believes that it is the appropriate party to make the decision as to when the development period is over.

EGNB agrees with this as is shown by the following exchange between Mr. O'Connell and Mr. Marois, transcript page 296, question 590: "Would you agree with me that the

decision-maker as to when the development period is over is the Board?" Answer: "Definitely."

The Board wishes to minimize the uncertainty associated with the development period so that EGNB can proceed with confidence to develop its distribution system. The Board considers that the development period should last until December 31, 2005. Thereafter the onus will be on EGNB to annually prove that the development period should be extended for a further year.

There was considerable discussion about the criteria which should be used in determining the cessation of the development period. Customer attachments, rate of return on equity, ability to forecast accurately, volumes of gas flowing and the economic environment were mentioned as items that should be considered.

However, there were no specifics provided that could be used in examining each of these. The following discussion occurred between Mr. O'Connell and Mr. Lewis transcript, pages 299 to 30.

Question 595: "What about the idea of Enbridge Gas working with Board staff to develop some set of criteria that would give some certainty to the determination of when the development period ends? Is that a reasonable suggestion?"

Answer: "I think we have already pointed out that the

Board ultimately will decide when the development period is over. We have in place and put in front of the Board the criteria that we think are relevant for coming to that assessment. We are both starting from scratch with respect to this franchise so, you know, we are clearly open to working with the Board to develop those criteria to the Board's satisfaction so that it can make that decision with whatever information it feels is necessary. So we will, you know, clearly want to work with the Board to come to an agreement on those issues."

The Board considers it appropriate that Board staff in consultation with EGNB develop specific criteria that will be used to decide when the development period shall end.

When the written decision comes out by -- the next session will be target rates. But the Board has already given that as an oral decision. So I will not read it today.

Rate riders. EGNB requested the Board to approve the use of rate riders. A rate rider would be used to reduce the rate for a particular class of customers during a given year. The company asked that rate reductions be permitted for one or more classes and that more than one reduction be permitted in any given year.

The rationale provided was that EGNB needed this pricing flexibility to be able to respond to market

conditions. Rate riders would only be used if EGNB believed that the current price was not competitive and that further the price was likely to remain uncompetitive for some time.

The Board considers that the use of rate riders as proposed by EGNB is appropriate for the development period. The Board will require EGNB to file any proposed rate riders with it and with all marketers at least two weeks before the proposed effective date.

The Act requires the Board will approve all rate changes before the new price can be charged. The Board will therefore approve the rate rider as proposed unless there are exceptional circumstances. The Board will notify EGNB and the marketers of its decision at least one week before the proposed effective date.

Revenue to cost ratios. There was considerable discussion concerning revenue to cost ratios. Mr. Kumar recommended that the revenues and costs associated with each customer class be tracked separately. He also recommended that the revenue to cost ratio for a given class should not exceed 110 percent.

EGNB's position was that the cost of service studies were not appropriate in the early years of a greenfield development.

Ms. Duguay made the following statement, transcript

pages 555 to 556. "My opinion about the relevancy of a cost of service study in the initial year of a greenfield project such as the Enbridge Gas New Brunswick project is that the cost of service study has a very important practical limitation."

The Board agrees that the information which would be provided by a cost of service study in the initial years of a greenfield situation would be of limited value. The Board will not require EGNB to file cost of service studies at this time.

The Board does consider that the revenues provided by a given customer class should over time be reasonably close to the costs incurred to serve that class of customers. This will minimize the amount of cross subsidy and send the proper economic signals to customers. The Board intends to revisit this issue near the end of the development period.

Capital structure. The capital structure of a utility consists of the total of the funds that are contributed by the owners in the form of equity capital together with the funds that are obtained by borrowing. The relative portions of debt and equity in the capital structure are expressed in the form of the debt to equity ratio. Where debt and equity and contributing equal amounts the ratio is stated as being 50/50.

The "essential elements" indicated that the capital structure of EGNB would be on the basis of 50 percent debt and 50 percent equity or a 50/50 debt to equity ratio.

Mr. Marois stated in evidence as follows. "It is important to note that the capital structure we are seeking approval of are not deemed amounts but are based on what is expected to be the actual capital structure." Transcript page 71.

Ms. McShane did not give specific support to 50/50 debt to equity ratio other than to say that it would "Be virtually identical to that maintained by mature U.S. LDC's." EGNB evidence, exhibit C, page 10.

Ms. McShane also provided the capital structure ratios of major Canadian gas and electric utilities. The schedule indicates that the average debt to equity ratio for Canadian gas distributors is approximately 65/35 and that Enbridge Consumers Gas at September 1998 was approximately 71 to 29.

No objections to the proposed debt to equity ratio were expressed by any Interveners. Ms. McShane testified that if the Board were to accept the debt to equity ratio including a higher portion of debt than 50 percent, the risk for equity holders would be increased and a higher rate of return on equity would be required.

The Board has carefully considered the evidence and

finds that the debt to equity ratio during the development period will be based on the actual ratio of the utility but that the amount of equity is not to exceed 50 percent.

Expenses. The greenfield nature of the natural gas industry in New Brunswick makes it extremely difficult for EGNB to accurately forecast its revenues and costs for the first year of operation. The prices for the distribution of natural gas are to be market-based and must be responsive to the actions of competitors.

EGNB does not control the prices of all the components which make up the total delivered price of gas that customers will pay. EGNB must be able to respond to price changes in the components that it does not control. The target rates may therefore need to be reduced during the year.

The customer attachment rate may be significantly different than that included in EGNB's proposal to the provincial government. Many people in New Brunswick are unfamiliar with natural gas. And their response may be well above or below that anticipated.

The costs to be incurred in the first year depend heavily on the timing for installing the pipe. There is some uncertainty as to exactly when the construction, scheduled for the year 2000, will be completed.

In addition the fiscal year for EGNB may change. For

all these reasons the specific amounts presented by EGNB as forecasts of revenue, cost and deficiency for the first year of operation may be subject to considerable variation. The Board will use caution in comparing the actual results to these forecasts.

The Board will, as proposed by EGNB, conduct annual reviews of the company's actual results and forecasts. The first such review will be based on the results up to and including December 31, 2000. The specific information to be provided by EGNB for the review will be determined after discussions between EGNB and Board staff.

Interested parties will be given an opportunity to provide written comments on the information which is proposed to be filed. EGNB will be able to respond to any comments received. The Board expects that the list of information required will evolve over time as parties gain experience with the process.

The information filed will be available to the public. The Board will require EGNB to notify its customers annually by way of a bill stuffer that they can receive this information from the company and/or examine it at the Board's offices.

Interested parties will be given an opportunity to provide written comments. And EGNB will be able to respond to any comments received. The Board will then

make a determination as to the amount to be included in the deferral account.

The Board anticipates that the annual review of actual results will be separate from any review of proposed changes to the target rates. The precise timing will be determined by the Board after receiving comments from interested parties.

Administration fee. The quote "essential elements" indicated that EGNB might be reconstituted as a limited partnership.

Mr. Pleckaitis stated that a limited partnership would be established and that a draft offering memorandum had been prepared.

The memorandum indicates that the general partner will be Enbridge Gas New Brunswick Inc. And the partnership will be known as Enbridge Gas New Brunswick Limited Partnership, the partnership.

It also includes details of a service agreement between Enbridge Inc. and the partnership. Under the terms of the agreement, Enbridge will provide the partnership directly and through its affiliates, treasury and cash management, administrative, advisory, operating and other services.

All such services will be provided at a cost to the partnership "not less favorable than would be obtainable

in a comparable agreement with a person that is acting at arm's length with the partnership. In addition the partnership will also pay Enbridge an annual management fee in an amount equal to 1 percent of the partnership's expenditures in each fiscal period." Exhibit A-16, page 29.

The Board is of the opinion that it is appropriate that Enbridge Inc. and its affiliates be compensated for their efforts by charging market-based rates for all specific services provided. However, the Board orders EGNB to establish the market-based rates on conditions prevailing in the New Brunswick market in all cases where such services could be obtained from local suppliers.

Also the Board orders EGNB to file with it on an annual basis details of all services provided by affiliated companies together with the related cost of such services.

Enbridge Inc. and its affiliates will be compensated for all services provided. The Board does not consider it appropriate to require New Brunswick consumers to make any additional payments related to management of the utility. Accordingly the Board will not allow the deduction of the 1 percent management fee for regulatory purposes.

Depreciation of property, plant and equipment. In response to Board staff interrogatory number 34, EGNB

filed details of its classification of property, plant and equipment and its proposed rates of depreciation.

The evidence confirms that the classifications are in accordance with the gas distribution uniform accounting regulation. The Board approves of the company using the straight line method of depreciation and also of the proposed annual rates of depreciation.

Amortization of intangible assets. First the franchise fee. In response to Board staff interrogatory number 21, Enbridge Gas New Brunswick included the franchise fee, stated at an estimated cost of $2,926,065 in rate base.

In the forecast years from 2001 onwards, amortization is charged on the basis of a straight line charge over 20 years, which is the initial term of the general franchise agreement. The Board approves of the amortization of the fee over 20 years.

Franchise participation, rights, valuation, premium. The draft offering memorandum at page 43 discloses the payment of amounts by the partnership for all startup costs incurred by EGNB. The proposed costs include payment of a $4 million "franchise participation rights valuation premium."

The Board is of the opinion that this payment is strictly an arrangement between EGNB and the limited

partnership. It does not accept such payment as a reasonable charge to be recovered from the consumers of New Brunswick. Accordingly the Board orders EGNB to exclude this cost from rate base for regulatory purposes.

Other deferred costs. The Board recognizes that EGNB has incurred startup costs and it should be permitted to recover. EGNB has estimated its costs at $4,040,000. The Board will review these costs and permit EGNB to record all reasonable amounts as deferred charges. The Board will establish the amortization period for these costs at the time of the first review of EGNB's results.

Cost of debt. The cost of debt of a utility is the rate of interest charged by debtholders on the funds borrowed by the utility. The total cost of debt may also include other contributing factors such as costs incurred in the issuing of the debt and foreign exchange variations.

The "essential elements" indicated that the return on or cost of debt for EGNB will be the 10-year Government of Canada bond rate at the time the debt is incurred plus 2 1/2 percent.

In her evidence when addressing the issue of cost of debt, Ms. McShane stated as follows. "The debt will belong to Enbridge Gas New Brunswick via intercompany loans on terms and conditions that Enbridge Gas New

Brunswick would incur if it were to raise the debt on its own behalf in the public markets." Evidence exhibit C, page 10.

During the hearing, witnesses on behalf of the applicant consistently maintained that EGNB should be regulated as a "stand alone" entity without regard to the existence of its parent and affiliated companies.

Ms. McShane stated as follows. "The imputing of a stand-alone cost of debt to Enbridge Gas New Brunswick's operations based on Enbridge Gas New Brunswick's risk ensures there is no cross-subsidization between Enbridge Gas New Brunswick and its parent, i.e. that Enbridge Gas New Brunswick is not being subsidized by the customers of any of the parent's other operations regulated or unregulated." Evidence exhibit C, page 11.

The evidence established there is a very close relationship between EGNB and its parents and affiliated companies. Mr. Pleckaitis stated "It means that in the starting up of a corporation, one of the things that we benefit from is being able to draw people, experienced people from elsewhere in the corporation, to help them with certain aspects of starting up our company. These are people that already have existing skills in operating a regulated utility." Page 245 of the transcript.

Mr. Luison testified "And if I can just add to that,

the reason we do that is because there are certain skill sets and activities that have to be performed front end. We just staff up as is required at the front end." Transcript page 246.

Again quoting from the transcript. Question 467: "And Enbridge Gas New Brunswick has the benefit of being a wholly-owned subsidiary of Enbridge Consumers Energy Inc. with all the expertise and talent that goes with that?" Answer: "Right. And presumably that was one of the reasons that I guess we won the bidding process, was because we were able to establish to the government's satisfaction that we did have the know-how and the experience to carry on with this sort of a greenfield project."

Question 469: "You convinced the Province of New Brunswick that they weren't dealing with just Enbridge Gas New Brunswick but with the Enbridge group, with all the resources and talent and expertise that comes from a hundred years in this industry, correct?" Answer: "Yes. That's correct." Transcript page 247.

Ms. McShane testified, Question 223: "Do you know if the execution of the general franchise agreement by the Province of New Brunswick and Enbridge Gas New Brunswick had any impact on the bond rating of Enbridge Consumers Gas or Enbridge Inc.?" Transcript 670. Answer: "I doubt

it. It's not big enough."

Based upon the evidence, the Board is unable to accept the argument that EGNB should be considered as a "stand-alone" entity for purposes of establishing its cost of debt.

In establishing a fair cost of debt for the inter-company loans to EGNB by its parent, Enbridge Inc., the Board has considered the following evidence. Enbridge Inc. will be borrowing funds on the market at the rate of interest consistent with its bond rating.

In response to Province of New Brunswick interrogatory number 35, Ms McShane indicated that the then current yield on 10-year Government of Canada bonds was 6.2 percent and that Enbridge Inc. had raised debt in early March 2000 at 6.815 percent. She further indicated that this cost of debt represented a 67 basis point spread over the 10-year Canada benchmark.

Advancing funds to EGNB at 10-year Canada rates plus 2 1/2 percent results in a spread of approximately 1.8 percent over the cost to Enbridge Inc. The Board is of the opinion that this would provide a benefit to Enbridge Inc. which is excessive in the circumstances.

The Board understands that EGNB is entering a greenfield situation which inherently carries a risk that the market will not develop satisfactorily. Therefore

there must be a premium to compensate Enbridge Inc. for this risk. Accordingly, the Board orders that the cost of debt of EGNB be limited to the actual borrowing rate of the parent company plus 1 percent. This rate is to apply to both long-term and short-term borrowing. In addition, the Board orders EGNB to record all the information necessary regarding the borrowing cost of its parent company in support of its interest charges to EGNB.

Return on equity. The return on equity of a utility is the rate of return allowed to be earned on the capital invested by shareholders in the enterprise expressed as a percentage of such capital. The percentage is normally calculated by reference to the cost of "risk free" capital in the money markets, to which a premium is added, based upon the perceived risk of the particular enterprise. The latter component is known as the "risk premium".

The "Essential Elements" stated that the return on equity will be 13 percent during the development period. Ms. McShane expressed her opinion that the rate of return of 13 percent was reasonable and supported her opinion with an analysis of the forecast of long Canada yields and the required risk premium for Enbridge Gas New Brunswick.

Mr. Kumar gave no opinion on the appropriate return on equity. No Interveners objected to the rate of 13 percent established in the company's application and no proposed

alternative rate was developed.

The Board finds that the rate of 13 percent is to be the return on equity allowed during the development period. However, the Board orders EGNB, in the event of actual earnings exceeding 13 percent during the development period, to apply all such excess as a lump sum payment in the reduction of the deferral account.

Income taxes. The "Essential Elements" indicate that "In the event that EGNB is reconstituted as a legal partnership, applicable taxes will be deemed to be all those taxes which would have been payable by a corporation."

It is the Board's understanding that this section of the application means that when calculating the revenue requirement for a test year, the return on equity of 13 percent is to be calculated after a notional charge for corporate income taxes.

In response to Board Staff Interrogatory 10, Mr. Luison confirmed that the request that the taxes to be included in the cost of service are the taxes which would have been paid by a corporation.

The impact of income taxes is discussed in the Offering Memorandum, exhibit A-16, at pages 35 and 36 as follows:

"The return on equity of the Partnership increases

steadily from an initial annualized rate of 7.4 percent in 2000 to 24.5 percent in 2007. This reflects the gradual shift in the equity deployment of the Partnership from investments earning 6.3 percent to utility equity providing the pre-tax equivalent of 13 percent after tax. However, because of the tax deductions generated during the start-up of the Gas Distribution Utility, the cost-of-service regulatory regime does not recognize the payment of any deemed taxes by the Partnership, or their recovery as a cost-of-service, until 2005 and increasingly thereafter."

Ms. McShane had no comments in her evidence with reference to the proposed inclusion of deemed income taxes in cost of service.

Mr. Kumar in his evidence commented as follows: "However, the partners will be investing the money in the partnership in expectation of their profits net of income taxes. Thus the cost of capital to EGNB would reflect this expectation. To collect taxes on a hypothetical basis would be a windfall to EGNB and its partners." Kumar Evidence, page 59.

Later he indicated that: "In all probability, EGNB will have tax losses for many years, whether it incorporates or operates as a limited partnership. Therefore, for the years of tax losses, no income tax

allowance should be included in the rates."  Kumar Evidence, page 59.

The Board has carefully considered this evidence and notes that the general partner considers that it is unlikely that EGNB will be in a position where, as a deemed corporation, it will have taxable income before 2005.

The Board notes that if EGNB were to remain as a corporation it would obviously be required to pay income taxes.  Therefore, the customers of EGNB will be no worse off with EGNB operating as a partnership and having income taxes deemed as if EGNB were a corporation.

Although customers would be no worse off, the partnership arrangement will permit New Brunswick citizens to invest in EGNB.  This will provide the benefit of a certain amount of local control and involvement.

Therefore, during the development period, the Board approves of the inclusion of deemed payable income taxes in the cost of service, on the basis that they would have prevailed, in any given year, as if the partnership had been a corporation.

Deferral accounts.  EGNB proposed that it would be allowed to establish two deferral accounts, a pricing deferral account (PDA) and a forecast discrepancies deferral account (FDDA).  It also requested that these

accounts be amortized over a 40 year period and that the balance in the accounts would earn the weighted average cost of capital allowed for EGNB.

EGNB indicated that the PDA would consist of two components. One, the deficiency caused by the target rates being established at a level that did not recover the full cost of service. And, two, the deficiency resulting from the actual rates being lower than the target rates after rate riders had been used during the year.

The FDDA would be used to accrue the differences between "actual and forecast revenues and cost of service (not taking into account any reduction that EGNB had to make to the target rates during the year which will be captured in the pricing deferral account)". EGNB evidence, exhibit A, page 14.

EGNB summarized its position as follows. One, these accounts can conceptually be viewed as one account. Two, revenue from any source will essentially go to reducing the deferral accounts. Three, a return equal to EGNB's weighted cost of capital will be paid to the customers on any positive balance. And, four, a positive balance in one account will be netted out against any negative balance in the other account.

Irving Oil Limited (Irving) accepted the need for

deferral accounts but suggested that the Board should not allow these accounts to be accepted without question. EGNB should be required to defend all expenditures as used and useful and to justify all amounts accrued in these accounts. "The Board should establish a procedure through which the levels of the deferred account balances and the reasons and prudence of those levels that have been achieved can be examined by the Board and other stakeholders." Exhibit C-23, page 11.

Irving considers deferral accounts to be deferred income. It accepted that carrying costs should be allowed on the balances in these accounts, but suggested that EGNB should not be allowed to use them as profit centres.

Irving recommended that the Board ensure that EGNB has an incentive to keep the balances as low as possible. There should be no incentive to make them higher than necessary. To accomplish this Irving proposed that the carrying costs allowed on the balances in these accounts should be at the Board's approved cost of debt only.

Irving also expressed concern with the term over which these accounts would be amortized, suggesting that this would have an impact on rates for the indefinite future.

The revenues from the gas distribution system in New Brunswick will be insufficient in the early years to cover the investment by EGNB. Therefore, the Board accepts that

EGNB should be allowed to defer costs incurred during the early years for recovery over a future period.

The Board has concerns with the use of multiple deferral accounts. A review of the purpose of these accounts reveals that in total they will accrue the difference between the actual revenue received and the calculated revenue requirement for a full cost of service.

EGNB's proposal can be viewed as merely dividing this total among the different accounts.

In most jurisdictions the regulatory agency approves the use of deferral accounts when changes occur that are outside the control of the utility. The balances in the accounts can generally be traced to specific events or the actions of specific customers and/or customer classes. The balances are ultimately either collected from or returned to the specific customers or customer classes based on cost causality.

In this case, although the deferral accounts proposed by EGNB are to accommodate circumstances beyond its control, neither account can be identified with the occurrence of specific events or the actions of specific customers or customer classes.

Both EGNB witnesses and its counsel stated that conceptually these accounts could be viewed as one. The Board can find no justification for separating these

accounts, particularly for regulatory purposes. EGNB is directed to establish one deferral account in which it will record the difference between the actual revenue received and the revenue requirement approved by the Board.

EGNB requested that the amount deferred should be amortized over 40 years so as to minimize the impact on rates. The Board is concerned that such a long period of amortization will not necessarily be in the best interests of the customers. The Board therefore requires that EGNB establish an amortization schedule at the end of the development period that will clear the balance in the deferral account over the remaining term of the initial general franchise agreement.

The Board accepts that to allow only the approved cost of debt on the balance in the deferral account would result in a reduction in the allowed rate of return on EGNB's investment. EGNB will be allowed to accrue a return on the average balance for each fiscal year equal to the overall rate of return as approved by the Board.

Maritimes and Northeast Pipeline (M&NP). The Enbridge Gas New Brunswick (EGNB) distribution system must be connected to the Maritimes and Northeast Interprovincial Pipeline in order for customers in New Brunswick to receive natural gas.

This connection requires an interconnecting pipeline, referred to as a lateral, together with custody transfer stations.

EGNB's distribution network required to serve Moncton, Riverview, Dieppe (Moncton), Fredericton, Oromocto (Fredericton), and St. George require a lateral at each location. A custody transfer station is required for each of these three laterals. And four stations are required off the M&NP lateral to serve Saint John, for a total of seven stations.

It is the policy of M&NP that it must build the custody transfer stations. EGNB has reluctantly accepted this policy in order to permit the timely development of the natural gas industry in New Brunswick. It is noted that this policy has not been formally adopted by the National Energy Board (NEB) which is the Federal agency with regulatory oversight of M&NP.

It also clear in the record of this proceeding that the cost of the seven stations to be build by Maritimes and Northeast significantly exceed the cost estimated by EGNB to build the stations itself.

No party in this proceeding objected to Maritimes and Northeast building these particular facilities. The Board therefore considers that it is appropriate for Maritimes and Northeast to build the seven custody transfer

stations. The Board strong encourages EGNB to pursue before the National Energy Board the possibility of it being permitted to build any future custody transfer stations itself.

The Board also encourages the National Energy Board to closely scrutinize the costs of Maritimes and Northeast in the construction of both the custody transfer stations and the laterals in light of EGNB's cost figures presented to this Board.

EGNB stated that its overriding objective was to reduce capital expenditures and expenses associated with the construction of the laterals and thereby reduce the size of the deferral account balances. However, with respect to the Fredericton lateral, EGNB also considered the effect on its ability to serve customers. After weighing these two objectives, EGNB decided it was preferable to build this facility itself. No party objected to this approach. The Board will accept EGNB's proposal to construct the Fredericton lateral.

EGNB's position was that it is preferable for Maritimes and Northeast to build the Moncton and St.George laterals. Again, no party objected to this approach. The Board considers that it is appropriate for Maritimes and Northeast to construct the Moncton and St. George laterals. The cost of the seven custody transfer stations

will be included with the cost of the laterals.

EGNB presented two options with respect to paying for the combined cost of the two laterals and seven stations. Once choice was a contribution in aid to construct. This would require an upfront payment of $12.2 million. This approach would not provide EGNB with any transportation capacity on the Maritimes and Northeast system.

The second choice was to enter into a firm service agreement (FSA) with Maritimes and Northeast. This would require annual payments of approximately $3 million for 20 years, and provide transportation capacity on the Maritimes and Northeast system of 11,805 gigajoules per day for the 20 year period of the FSA. EGNB is not permitted to sell gas except as a supplier of last resort.

In the FSA option EGNB would market its capacity rights on the Maritimes and Northeast system to gas marketers, single end use franchisees and other shippers on the Maritimes and Northeast pipeline located in New Brunswick as well as other jurisdictions. Any revenues from the sale of this capacity would be used to reduce the cost to the ratepayers of EGNB.

The contribution in aid to construct approach would require the ratepayers of EGNB to make a payment sufficient to amortize the 12.2 million. They would also be required through rates to pay the interest, income

taxes and return on equity associated with the unamoritized amount of the 12.2 million payment.

There was discussion at the hearing of the possibility of EGNB being responsible for property tax payments associated with the facilities in question. However, EGNB stated that the facilities would be owned by Maritimes and Northeast, and that EGNB had not gone to the Province for a ruling on the issue.

Mr. Marois stated that the net present value to EGNB of the contribution in aid to construct was $19 million. Although no detailed study was presented in the evidence by EGNB, it is clear that this amount includes annual payments for property tax. The Board doubts that this should have been included in the calculation as real property taxes are normally assessed against the owner of the property.

The FSA approach would require ratepayers to pay approximately 3 million per year for 20 years. This amount of 3 million would be reduced each year by the amount of revenues received from the sale of the capacity that EGNB owned on the Maritimes and Northeast system. Mr. Marois provided an estimate of 26 million as the net present value for the annual payments associated with the FSA. This amount did not include any allowance for staff costs required to monitor market conditions and to

negotiate sales.

The precise cost to ratepayers for the contribution in aid to construct approach is not clear from the record. However, it is clear that it is less than the cost of the annual payments under the FSA method. However, the FSA does provide an opportunity to reduce the cost through the sale of capacity.

EGNB stated in its prefiled evidence that it is reasonable to assume that over time 60 to 75 percent of the capacity costs could be recovered. Mr. Marois, under cross examination, stated that EGNB believes it can beat the target of 50 percent recovery of capacity.

In summation, the Province of New Brunswick maintained the uncontested evidence is that ENG expects to sell 65 to 70 percent of the FSA capacity. At these levels of cost recovery, it is clear that the ratepayers would be better off with the FSA approach than the contribution in aid to construct approach.

It is also clear on the record, that there is considerable risk associated with the sale of capacity by EGNB.

The market for natural gas is new to New Brunswick and will evolve over time. In response to Board Staff Interrogatories EGNB stated it did not have a forecast to revenues from the sale of capacity and that the price and

length of contract for capacity would be best set by the marketplace.

The Board considers that the sale of capacity will occur in a market where numerous buyers and sellers are trading. It is therefore extremely difficult to predict the actual amount of revenues that will be provided by the sale of capacity over the 20-year period of the FSA.

The marketing or sale of capacity by EGNB and the terms and conditions under which such sales should occur was a topic of considerable discussion at the hearing. EGNB's strong preference was to have considerable if not complete flexibility with respect to the sale of capacity. EGNB in response to Irving interrogatory number 5, stated "that it is essential that it is able to keep all options open for the release of its capacity in order to maximize cost recovery."

In summation, Counsel for Irving suggested the following ground rules relating to the sale of capacity: 1. The process must be open, public and transparent. 2. No prearranged deals unless the full toll is recovered. 3. Notice of sale of capacity must be given, and 4. Sales of capacity should be limited to a two year term.

EGNB stated that it would provide information to the Board annually with respect to the sale of capacity during the previous year. However, EGNB did not consider it

appropriate to report, in advance, to the Board at the time of each sales transaction. If required to do so, it maintained that this would seriously limit its flexibility and impact negatively on its ability to maximize sales revenues and thereby reduce the overall cost.

The Board has carefully considered all evidence presented concerning the sale of capacity by EGNB. The Board believes that such sales will occur in a competitive market. Such a market requires EGNB to be able to respond quickly in order for it to be as effective as possible. It is not reasonable to require each potential deal to be submitted to the Board for review and approval. Any such review would require information on the currently available options and an informed assessment of the options that might reasonably arise in the future. The Board does not consider that it would be appropriate for it to conduct such reviews. For the same reasons, it considers any review of the sale of capacity by EGNB to be of little value. It encourages EGNB to conduct sales of its capacity in a manner that is as open and transparent as possible, including the possible use of an electronic bulletin board. The Board believes that Section 69 of the Act provides a basis for parties to file complaints if they consider that any sales of capacity by EGNB have occurred in an inappropriate manner. It believes that the

interest of ratepayers will be best served by allowing EGNB to market its capacity rights on the Maritimes and Northeast system without any specific constraints imposed by the Board.

EGNB requested that the Board approve the inclusion of the financial commitments of the FSA in its cost of service for the life of the contract. The Board has carefully considered this request in light of the risk associated with the sale of capacity. The comments provided suggest that it would not be unreasonable to expect that 50 percent or more of the costs will be recovered. However, there is obviously no guarantee that this will occur. This uncertainty is highlighted by the following:

Mr. Marois, under cross examination by Mr. O'Connell, stated that EGNB would not be prepared to arrange for capacity on the Maritimes and Northeast system if this were to be treated as an unregulated part of the business. The Chairman asked "if the Board were to allow 35 percent of the cost to flow into your rate base, would you then be prepared to have it an unregulated service for that 65 percent?" Transcript page 1356. Mr. Maclure responded: "I think that we would want to do a fair bit of thinking about the extent to which we would want to enter into that agreement." Transcript 1356.

The Board believes that it is appropriate to establish a mechanism, which will provide a balance between the interests of EGNB's ratepayers and shareholders with respect to the risk associated with the sale of capacity. The Board will therefore allow EGNB to include in its cost of service each year 50 percent of the annual payment to Maritimes and Northeast. This amount will be adjusted each year by one-half of the amount by which the revenue from the sale of capacity differs from 1.5 million.

For example, if revenue equals 1.5 million there would be no adjustment. The ratepayers would pay 1 1/2 million. This together with the sales revenue of 1 1/2 million will provide for the $3 million payment to Maritimes and Northeast.

If revenue were only 1 million the ratepayers would pay an additional quarter of a million (that is 1 million less 1.5 equals .5 million, which divided by 2 equals one quarter million) for a total charge of 1.75 million.

Now I will go back and just read that so that it will be a little clearer even to me, and leave out the explanation.

If revenue were only 1 million the ratepayers would pay an additional quarter of a million for a total charge of 1 3/4 million. This, together with sales revenues of 1 million, provides 2.75 million. The remaining one quarter

million necessary for the $3 million payment to Maritimes and Northeast would be provided by the shareholders of EGNB.

If revenue were 2 million, the ratepayers would benefit by a quarter of a million. An explanation is 2 million less 1 1/2 million equals a half a million, which divided by 2 equals a quarter of a million. Their total charge would therefore be reduced to 1 1/4 million. This amount together with the 2 million of sales revenue would provide a total of 3.25 million. After the payment of 3 million to Maritimes and Northeast this would leave a quarter of a million for the shareholders. This quarter million of profit would be over and above the allowed rate of return on equity.

Other issues. Agent billing and collection (ABC) Service. EGNB is offering the ABC Service as an option to all gas marketers. Under this service, EGNB will bill customers for gas supply charges on behalf of the marketer. And it will also be responsible for collection from the customer. Since EGNB will be billing customers for distribution services, this service will result in the customers receiving only one bill.

EGNB is planning on outsourcing part of this service to its parent company Enbridge Consumers Gas in Toronto. The rates it will offer marketers in New Brunswick are the

same as ECG, that is Enbridge Consumers Gas, offers in Ontario. The proposed charges for this service are as follows:

Small General Service (SGS) $1.05 cents a bill. General Service (GAS) is $2 a bill. Contract General Service (CGS) $5 a bill.

EGNB will pay ECG for the Agent Billing component of the service at 85 cents a bill for SGS customers, $1.63 for General Service customers and $4.06 for CGS customers. The additional amounts of 20 cents a bill for SGS customers, 37 cents a bill for GAS customers and 94 cents a bill for CGS customers is based on the Ontario experience. And it will be collected by EGNB to cover the cost of bad debt.

EGNB witnesses stated that the marketer would always be paid in accordance with its agreement with its customers. In some cases the marketers could be paid for gas supply before EGNB has billed the customer for that gas. EGNB stated that it will bear the full collection risk from customers for all marketers who elect to take this service.

Although EGNB is requesting Board approval of the above rates for its ABC Service, it also indicated that it "will need the flexibility to adjust these charges in the future as costs and market conditions dictate". EGNB

evidence, Exhibit A, page 16.

Irving notes that this is an optional rate, but suggests that the objective should be -- I think that should have read, this is an optional service -- but suggests that since the objective should be to encourage marketers to come into this area, this rate should be as low as possible. It also recommends that the rates for this service should be a straight pass through from ECG to the marketers, without any markup by EGNB.

Irving pointed out that these charges require Board approval. It suggested if EGNB proposed to increase these charges in the future that marketers must be given notice, with the right to object. If the rates generate too much revenue, possibly as a result of bad debts being lower than forecast, then EGNB should be required to lower the rates as an encouragement to marketers. Irving argued that EGNB should not be allowed to make a profit from the provision of this service.

No Intervener objected to either the provision of the service or the rates that are proposed by EGNB. The Board approves both the service and the rates as proposed, but will require that EGNB annually file information related to this service. EGNB will file sufficient information each year on revenues and costs resulting from this service to justify both the continuation of the service

and the level of the rates. EGNB must file an application for any changes to the rates for ABC service.

The Board is concerned that the ABC service is only offered as a bundled service with one charge for all three components. It suggests that EGNB consider changing this rate so that marketers have the option to be responsible for the collection of bad debts. This would allow those marketers who wish to provide their own bad debt coverage to do so, thus avoiding EGNB's charge for that service.

Supplier of last resort. The Act only permits EGNB to sell natural gas in the event that a gas marketer fails to supply gas to a customer on a timely basis and no other gas marketer is able or willing to do so. In this instance, EGNB acts as or arranges for a supplier of last resort service.

At Exhibit B in this application, EGNB proposed a Last Resort Supply Service rate which was calculated to be 110 percent of the full replacement costs of the gas delivered at city gate. In a response to an interrogatory, EGNB elaborated on the rate components. It explained that the full replacement cost of the gas would include the cost of the commodity, fuel and transportation. In addition, other activities such as making contractual arrangements with third parties to acquire the gas, monitoring and billing would need to be performed. The 110 percent was

set arbitrarily by EGNB to compensate for the activities directly related to the provision of the Last Resort Supply Service that are in addition to the full replacement costs.

No party opposed EGNB's Last Resort Supply Service rate or offered an alternative rate design. The Board has reviewed EGNB's proposal and accepts that the Last Resort Supply Service will only be provided by EGNB on an emergency basis. Basing the rate on 110 percent of the full replacement costs is reasonable for this service. The Board will approve EGNB's proposed rate for the Last Resort Supply Service.

The wholesale rate. In its proposal to the Province, EGNB provided illustrative rate schedules and a rate handbook which included a wholesale rate. However, its rate application to the Board did not include a wholesale rate.

EGNB provided the following reasons to justify its dropping of the wholesale rate. The contractual relationship with the end use customer would be different under a wholesale rate. The marketer, contracting as principal with EGNB, would eliminate EGNB's direct relationship with the end user. EGNB raised the issue of safety and stated that it would have a reduced ability to communicate directly with the end use customer when it

only knows the location of the initial service connection as opposed to the identity of the end use customer. Wholesale service would remove the distributor from being the initiator of disconnection procedures and would mean that the marketer would bill end use customers for EGNB's distribution charges. The marketer is not regulated and therefore, the Board would not have the authority to regulate the distribution rates charged by the marketer.

Irving argued that a wholesale service would permit marketers to offer a one stop shopping option to customers giving them the simplicity of having all natural gas services dealt with by the marketer. This would encourage more customer conversion to natural gas, which would be beneficial to the customer, the marketer and EGNB. If the Board were concerned that it would no longer have the authority to regulate the contents of the bill for distribution rates, Irving stated that the Board could control the contents of the marketer's bill through its marketer's certification process. Irving also stated that it would bill each customer the same distribution rate that the customer would be charged if it were billed directly by EGNB. This would ensure that distribution rates continued to be on a postage stamp basis. The same rate would apply to all customers in the same rate class no matter where they lived in the province and whether

they were billed by Irving or EGNB.

EGNB argued that Irving's proposal was not a wholesale service but rather a billing scheme. The Company believed that this was an issue which had been dealt with at the Marketer's Hearing. EGNB stated that Irving had challenged EGNB's proposed sole right to bill end use customers for distribution service at the Marketer's Hearing and failed. EGNB maintained that Irving's wholesale service proposal in this proceeding was simply a repackaging of their approach to billing.

EGNB's argument was supported by the Province of New Brunswick and Energy Source Canada. No other Intervener commented on this issue.

The Board considers Irving's wholesale service concept to be a marketing strategy that simply provides a single bill option for the customer enabling a marketer to bill for EGNB's distribution services and its own. The provision of billing services and the question of who should provide billing services was determined by the Board after the Marketer's Hearing. Therefore, the Board will not require EGNB to offer a wholesale service at this time.

Contract power plant service. EGNB has requested Board approval of a customer class identified as Contract Power Plant Service. The application states "The Rate for

service shall be determined for each Applicant based upon the costs imposed upon the Company to provide the requested service." The Board will approve this class of customer but EGNB must file an application with the Board requesting approval each time EGNB plans to offer this service to a customer. The application must provide all relevant information on the costs and revenues that would be associated with the particular customer.

Union of New Brunswick Indians (UNBI). The UNBI advised the Board in its summation that negotiations had been initiated between EGNB and the UNBI with respect to concessions to be made to the aboriginal peoples, including training, job opportunities and the protection of medicinal plants and sacred sites. Its purposes in intervening in this hearing was to ask the Board to approve the inclusion in EGNB's cost of service of all costs associated with the negotiation of an agreement and all costs to EGNB resulting from any agreement.

UNBI claimed it had researched regulatory practice in the U.S. and Canada and had found no instances of regulators refusing to include such costs in the cost of service for a utility. However, no examples were provided of Canadian regulatory tribunals who had specifically approved the inclusion of such costs in the cost of service for any utility. Examples were provided from the

United States and Columbia, showing that regulators had included specific provisions for First Nations in those countries.

The Board will not approve in advance EGNB including an unknown amount of expenditure for an, as yet, unspecified purpose in its cost of service. The onus is on EGNB to prove to this Board that any costs it wishes to include for regulatory purposes are reasonable, that they have been prudently incurred and that they are necessary for the operation of the gas utility.

Customer information. EGNB's market-based approach for setting target rates during the development period allows EGNB the opportunity to adjust the target rates on an annual basis.

This approach also provides a ceiling or cap, as EGNB may only reduce its rates below the target rates during the year. The Board is concerned that new gas consumers might think their distribution rates are regulated in the traditional manner. To avoid this, customers must be given clear notice prior to receiving service from EGNB that their rates are market-based rates and are subject to change after a specified notice period. This message must be repeated annually with the notice of any target price changes to ensure that consumers remain aware of this term of service. The Board directs EGNB to work with Board

staff in preparing these notices to customers.

Comments on Legislation. This is the first time that the Board has had an appropriate opportunity to comment on the Act since its passing in March of 1999. In the Board's opinion the Act is a progressive regulatory tool. However, there are a few sections that the Board believes must be amended in order for the natural gas market to develop in an orderly fashion in this province.

It is obvious to the Board that the Legislature wished to have the monopoly local distribution company, EGNB, regulated by the Board. The Board is free to use whatever form of regulation it deems appropriate. It is further evident that the Legislature wished to have the sale of the commodity occur in an open, competitive market. It is also plain that the sale of customer services as defined in legislation should occur in that same open competitive marketplace.

The Board's regulatory responsibilities concerning the marketers of gas and of customer services were restricted to reviewing an application for a certificate based upon the criteria set forth in section 62. This section only requires that the applicant be financially responsible and show past conduct which does not indicate undesirable business practices. Once those tests are established the Board must issue a certificate. It is in the light of

this understanding, of the scheme of the legislation, that the Board wishes to comment on three specific problems.

1. The definition of gas marketer. Section 58 requires the Board to issue a certificate to every gas marketer. The definition of gas marketer includes a person who (a) "sells or offers to sell gas or a customer service to a customer." The definition of customer service is "a service that is not a natural monopoly and includes appliance service, yard line or house line maintenance, meter reading, billing, collections, call centre, load balancing, peaking service, supplier of last resort service, storage and arranging for pipeline capacity on a transmission line or a pipeline regulated by the United States Federal Energy Regulatory Commission."

This Board questions why persons selling the following customer services should have to be granted a certificate by the Board to compete in a competitive marketplace, appliance service, meter reading, billing, collections, call centre, load balancing, peaking service, storage and arranging for pipeline capacity.

It is this Board's opinion that by the inclusion of these services in the definition of customer service and thereby requiring a Board certificate, the Act is imposing an unwarranted degree of regulation on the delivery of customer services in the natural gas industry. In

addition to increasing regulatory impediments to entry in the market place, the process of issuing certificates will increase administrative costs of the Board which will have to be borne by natural gas customers.

2. Assessment provisions. Section 87 (4) of the Act reads as follows: "The Board shall assess each gas distributor and gas marketer (a) its direct expenses, and (b) its share of the common expenses, which shall be determined according to the proportion of the gross earnings of that gas distributor or gas marketer bears to the aggregate of the gross earnings of all gas distributors of gas marketers to which this Act applies."

The Board does not criticize the framers of the Legislation. However, in modeling this section after the assessment provisions of the Public Utilities Act, we believe the provisions of this section to be simply unworkable in the natural gas industry for the following reasons:

1. Unless the definition of "gas marketer" is amended, the Board must ascertain the gross earnings of every person that, not only sells gas, but offers a customer service. This would be a monumental task and add further regulation and barriers to market entry to an industry where open competition is intended to exist.

2. Even if the Act were amended to remove providers of

customer services from the definition of gas marketers, the Board is of the opinion that those who sell gas would still find the assessment provisions to be inequitable. The gross revenues of a gas seller will include the price of the commodity and the cost of transport on the transmission line. Thus, it appears likely, in aggregate, that the sellers of gas will have greater gross revenues than will the local distribution company. The gas sellers will therefore pay a greater proportion of the Board's annual assessment than will the regulated local distribution company. It is the opinion of the Board that the sellers of gas in an open competitive market place should not pay the lion's share of the regulator's cost.

The Board believes that the possibility of gas marketers -- sorry, lost my place.

(Short Recess)

CHAIRMAN: I am trying to pick up where I left off. The Board believes that the possibility of gas marketers or gas sellers having to pay the lion share of the Board's cost is mitigating heavily against gas marketers entering the New Brunswick marketplace. Experience elsewhere indicates that gas marketers operate on a very thin margin. The additional unknown costs of assessment by the Board could well result in a perspective gas marketer not entering the New Brunswick marketplace. This may lead to

a lack of competition in the New Brunswick natural gas market.

The Board recommends that the assessment section be amended. The first preference is to amend it so that the local distribution company (LDC) will pay all of the Board's assessments each year. The customers will pay for this through the LDC's rates.

If this is not acceptable to the Legislature, then the second preference is an amendment that gas sellers not pay any portion of the Board's assessment until such time as the market matures. This could be at the end of the development period. Until the development period ends, the gas distributor would pay all of the Board's costs.

If neither of the two preceding options are acceptable to the Legislature, the Board suggests that the amendment give it discretion to decide what portion of its common expenses will be recovered from gas distributors, and what portion from gas marketers.

The distributor's portion would then be assessed against each distributor based on the proportion its gross earnings bears to the total gross earnings for the group.

The marketer's portion would be assessed against each marketer based upon the proportion its sales, in cubic meters, bears to the total sales in cubic meters.

Finally in reference to assessment, the Board notes

that the Select Committee of the Legislature recommended that the annual single end use franchise fee be used to reduce the cost of regulation. The Board supports this recommendation and notes that receipt by the Board of the annual $250,000 would cover over two-thirds of the Board's estimated cost of providing safety inspection services for the natural gas distribution industry in this province.

Definition of pipeline. In the Act pipeline is defined as, "Any pipe, system or arrangement of pipe wholly within the Province for distributing gas, and all property and works of any kind used in connection therewith. But does not include a pipeline for which a permit has been issued under the Pipeline Act or a transmission line."

Sub section 25(1) states "A gas distributor shall not operate a pipeline unless it either holds a licence or a provisional licence granted by the Board under sub section 2."

Sub section 25(2) states "After a pipeline has been tested to the Board's satisfaction, the Board may grant a licence or a provisional licence upon such terms and conditions as it considers necessary."

The definition of pipeline in the Act, combined with sub sections 25(1) and (2) creates a situation which places totally unnecessary reporting and review

requirements not only on the gas distributor, but also on this Board. These requirements do not exist in any other jurisdiction in this country.

In ENGB's recent construction application the gas distributor applied for approval from the Board for the extra high and high pressure pipe required to serve the communities of Moncton, Riverview, Dieppe, Fredericton, Oromocto, Saint John and St. George. This extra high and high pressure pipe was to be laid during the year 2000 construction period.

The gas distributor also applied for a permit to construct the "infill" with intermediate pressure pipe in these communities over a 20 year period. There is no question that the high and extra high pressure pipe should be treated in accordance with sub section 25(1) and (2). However, it is the Board's opinion that the intermediate pressure pipe should not be subject to this section. As the Legislation is presently written the gas distributor will have to report to the Board as often as each day during the construction period.

For example, it would report today that it has laid 500 meters of intermediate pressure pipe along Canterbury Drive in the city of Fredericton. The gas distributor would then return the next day and test this pipe and report to the Board. Then the Board would issue a

separate licence to operate the 500 meters of pipeline.

To the best of the Board's knowledge, that kind of reporting and licencing is not required for distribution companies in any other jurisdiction in Canada and most likely not in North America.

The Board believes that the Act and Regulations set forth a comprehensive scheme to ensure the safety of all pipe which the gas distributor intends to lay in this Province. The Board believes that the provisions of Section 25 should not apply to intermediate pressure pipe. The Board has safety inspectors on staff to ensure that the Act and Regulations are complied with by the gas distributor in the laying of such pipe.

The Board requests that the legislation be amended so that the provisions of sub section 25(1) and (2) and any other sections which impose unnecessary or onerous reporting or other requirements do not apply to any pipe with a maximum operating pressure under 60 pounds per square inch or 414(Kpa), which would remove the detailed reporting requirements for intermediate pressure pipe or infill.

And that concludes the substance of the Board's decision in reference to rates and tariffs.

We will take a three minute recess so I can get the construction panel up here.

Certified to be a true tanscript of the proceedings of this hearing as recorded by me, to the best of my ability.

Reporter