DECISION

IN THE MATTER OF an Application by Enbridge Gas New Brunswick Limited Partnership, as represented by its general partner, Enbridge Gas New Brunswick Inc. for approval of its 2017 Regulatory Financial Statements, a modified System Expansion Portfolio Test, and the establishment and use of variance accounts for incentives.

(Matter No. 398)

May 29, 2019

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

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NEW BRUNSWICK ENERGY AND UTILITIES BOARD:

Vice-Chairperson:	François Beaulieu
Members:	Michael Costello
	John Patrick Herron
Counsel:	Ellen Desmond, Q.C.
Chief Clerk:	Kathleen Mitchell

APPLICANT:

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

INTERVENERS:

J.D. Irving, Limited:	Christopher Stewart

PUBLIC INTERVENER:	Heather Black

A. Introduction

[1] Enbridge Gas New Brunswick Limited Partnership, as represented by its general partner, Enbridge Gas New Brunswick Inc. (EGNB or utility) filed an application with the New Brunswick Energy and Utilities Board (Board) seeking approval of its 2017 Regulatory Financial Statements. The application was revised on December 21, 2018 to include a request for Board approval to modify the System Expansion Portfolio (SEP) test. The revised application also sought Board approval to establish variance accounts for its Residential and Commercial Incentive Programs, and for the Retention and Winback Programs.

[2] The *Gas Distribution Act, 1999,* S.N.B. 1999, c. G-2.11 (Act) provides the Board with the jurisdiction to supervise natural gas distribution. The Act was last modified in 2016 giving specific directions with respect to the return on equity (ROE), the regulatory deferral account (RDA), and variance accounts.

[3] The Board's review of the utility's 2017 financial performance is conducted, in part, to ensure that the actual returns are reasonably calculated and are appropriately applied, as per the Act. This issue and EGNB's other requests are discussed below.

B. Legislative Framework

[4] Sections 52.02 and 52.03 of the Act are applicable to this application and state:

> **Regulatory deferral account – 2017 to 2019**
>
> **52.02** For the period commencing on January 1, 2017, and ending on December 31, 2019, no portion of the regulatory deferral account shall be included in the revenue requirement of the general franchise holder.
>
> **Return on equity – 2017 to 2019**
>
> **52.03(1)** For the period commencing on January 1, 2017, and ending on December 31, 2019, no amounts shall be credited towards the balance in the regulatory deferral account except as provided for in this section.
>
> **52.03(2)** If, between January 1, 2017, and December 31, 2019, both dates inclusive, the general franchise holder recovers in any year an amount from rates and tariffs or from any other source that results in an actual return on equity in excess of 10.9 per cent, the amount that exceeds 10.9 per cent shall be allocated as follows:

> (a) if the difference between 10.9 per cent and the amount that exceeds 10.9 per cent does not exceed 200 basis points, an amount equal to the difference shall be credited towards the balance in the regulatory deferral account; and
>
> (b) if the difference between 10.9 per cent and the amount that exceeds 10.9 per cent exceeds 200 basis points,
>
> > (i) with respect to the portion of the difference that does not exceed 200 basis points, the portion shall be credited towards the balance in the regulatory deferral account; and
> >
> > (ii) with respect to the portion of the difference that exceeds 200 basis points,
> >
> > > (A) an amount equal to half of the portion shall be credited towards the balance in the regulatory deferral account, and
> > >
> > > (B) the remaining amount shall be applied to reduce the revenue requirement of the general franchise holder for the following year and this reduction shall be applied to decrease rates and tariffs for one or more classes of customers other than the Small General Service class of customers for that year.

C. Analysis

1. 2017 Regulatory Financial Statements

[5] In a Decision dated December 13, 2017 (Matter No. 371), EGNB was directed to file its 2017 Regulatory Financial Statements with the Board. The statements were filed with the application and prepared in the same format and manner as the 2016 review.

[6] As described above, subsection 52.03(2) directs how EGNB is to apply its actual ROE, and once calculated, any return between 10.9 per cent and 12.9 per cent (i.e. 10.9% + 200 basis points) is to be credited to the RDA. Returns in excess of 12.9 per cent are split equally between a credit to the balance of the RDA and a reduction to the revenue requirement for the following year. The reduction is applied to reduce rates and tariffs to classes of customers other than the Small General Service class. As these requirements are based on historical results, the Board must ensure that the ROE is correctly applied. This retrospective review will be addressed below.

a. Return on Equity

[7] EGNB reported earnings of $13.908 million in 2017, or a ROE of 11.58 per cent. Pursuant to section 52.03, this would result in a credit to the RDA of $0.811 million.

[8] Mr. Robert Knecht, in evidence filed by the Public Intervener, stated that EGNB's calculations of the 2017 ROE were incorrect. He provided alternate calculations in his report.

[9] Ms. Pamela Mayo, Regulatory Finance Specialist at EGNB, testified that upon reviewing Mr. Knecht's calculations, EGNB realized its calculation of the RDA adjustment was incorrect. An error was made by including three adjusting journal entries to income prior to calculating the sharing mechanism. EGNB corrected this error and filed, as rebuttal evidence, a Revised Income Statement as at December 31, 2017, Attachment D, which showed a regulatory deferral account adjustment of $0.978 million.

[10] The Board finds that the calculations as presented by EGNB in Attachment D of its rebuttal evidence are accurate. Consequently the ROE for 2017 shall be adjusted to 11.65 per cent, and not 11.58 per cent, as it was initially filed.

[11] The Board concludes that EGNB has recovered a return on equity for 2017 of 11.65 per cent, which is within the range between 10.9 per cent and 12.9 per cent, as contemplated by subsection 52.03(2) of the Act. As the return does not exceed the threshold set by the legislation, the Board agrees with EGNB's revised calculations, resulting in $0.978 million being applied towards reducing the RDA in 2017.

b. System Expansion Portfolio Test

[12] In the assessment of EGNB's financial results, the Board also evaluates the prudency of system expansion related to capital expenditures. The SEP test, which was proposed by EGNB and approved by the Board in 2011, has been revised over the years. The current test requires that EGNB must demonstrate that the earned annualized revenues from system expansions in a year must exceed the depreciated expansion capital costs by at least four per cent (or a ratio of 104 per cent). Failing the test could result in the Board reducing EGNB's rate base by an amount that would be required to pass the test.

[13] Between 2011 and 2015, EGNB has passed the SEP test, but failed it in 2016. During that review (Matter No. 371), it was determined that the revenue-to-cost ratio was 78 per cent. While EGNB sought to modify the SEP test, the Board did not approve the proposed modifications as there was nothing in the evidence or argument that demonstrated that it would be necessary to depart from the methodology adopted in 2011. At that time, the Board suggested that EGNB could propose modifications to the method of evaluating the prudence of expansion projects in a future application.

[14] In this proceeding, the evidence shows that EGNB has failed to pass the SEP test, as the revenue-to-cost ratio is 77 per cent.

[15] As a result, EGNB is proposing a modification to the SEP test to provide a more appropriate evaluation which, it believes, reflects changes in market conditions. It recommends:

(a) using a three-year rolling average of incremental capital costs and revenues associated with the system expansion activities during each three-year period; and

(b) that the Board should have some degree of regulatory discretion if, in a year, EGNB fails to pass the test.

[16] In EGNB's view, the proposed modification would minimize the negative impact of the mismatch between the incremental capital costs and revenues associated with EGNB's system expansion activities created by the time lag in initiating gas service to its new connected customers.

[17] The expertise of Mr. Russell Feingold, Vice President and Rates & Regulatory Services Practice Lead at Black & Veatch Management Consulting, LLC was relied upon by the utility. In his report, he stated that there were a number of challenges that affected new customers regarding the connection to EGNB's gas distribution system and the utility's capital cost expenditures during 2016 and 2017. For example, he mentioned many of the projects completed by EGNB during those years did not have the expected number of customers commence gas service in the same year as the capital project was undertaken. This affected revenues and resulted in the revenue-to-cost ratio for those years being lower than the 104 per cent threshold. As a result, Mr. Feingold concluded that the current regulatory reporting method for system expansion activities should be refined.

[18] Mr. Feingold also stated that the utility failed to pass the SEP test for 2016 and 2017 as "incremental revenues from new customers had not reached the higher levels expected when the decisions were made to expand its gas distribution system."

[19] Mr. Knecht stated that replacing the current SEP test with a three-year average is reasonable and a practical proposal to address the problem of mismatch between incremental revenues and costs. He acknowledged that using a three-year average retains the basic framework used by the Board for several years, while mitigating the impact of timing differences.

[20] The Board finds that the time lag inherent in system expansion projects between incurring capital costs and earning revenues may negatively impact the SEP test results. The Board therefore agrees that replacing the single-year SEP test with a three-year rolling average test is an equally effective measure. This modification will help to mitigate the timing issues raised by EGNB by averaging incremental capital costs and revenues over three years, rather than over one year.

[21] With respect to the request to add a discretionary element to the SEP test, the Board finds that this change is not required, as the Board always retains discretion when discharging its duties.

[22] Having approved the three-year rolling average modification, the Board must determine whether it should be applied in this review, as proposed by EGNB.

[23] Ms. Black submitted that there is no constraint from a legal perspective in doing so, because the SEP test is only an evaluation technique. She also submitted that applying the test in 2017 does not create any intergenerational inequities or uncertainty to ratepayers.

[24] The Board agrees. The modified SEP test, using the average of approved 2015, 2016 and 2017 results will accordingly be used by the Board to determine the prudency of EGNB's capital expenditures for 2017. Based on the modified test, the Board concludes that all 2017 capital expenditures were prudent, as the revenue-to-cost ratio from the SEP test is 106 per cent.

[25] The modified SEP test will be applied to future system expansion reviews.

2. Variance Accounts – Incentive Programs

[26] EGNB offers a number of incentive programs that have been approved by the Board in previous matters. They include both Residential and Commercial Incentive Programs as well as Retention and Winback Programs.

[27] In Matter 371, the variances between approved budgeted amounts for marketing initiatives and the actual spending for these initiatives were discussed. As budgeted amounts and actual spending for incentive and retention programs differ frequently, EGNB is proposing to implement variance accounts to accommodate and track such differences.

[28] EGNB submitted that the variance accounts will ensure that ratepayers are fully benefitting from the programs which they are paying for. It proposed to use year-ending variance balances, positive or negative, in the following year. In the event a program is discontinued, EGNB proposed that the variance balance offset the general revenue requirement after two years. It also proposed that unspent amounts in these programs be used to the benefit of customers in future years and overspent amounts would reduce its earnings. As submitted by Mr. Len Hoyt, counsel for EGNB, it wishes to begin using a variance tracking mechanism in the 2017 ending balances.

[29] Mr. Feingold, in his report, supported EGNB's proposal to implement multiple variance accounts for its marketing incentive programs. He stated that the conceptual basis and structure of EGNB's proposed variance accounts will address and track, for ratemaking purposes, the annual variation in the budgeted funding level of its marketing incentive programs, compared to its actual spending.

[30] While Mr. Knecht did not oppose EGNB's proposal to establish such a mechanism for incentive programs, he noted that there is a shifting of responsibility from the utility to the customer with such variance account mechanisms. For example, he testified that if there is overspending, it will be added to the budget for the next year, and ratepayers will absorb this risk. He acknowledged that the proposal does provide a mechanism for more formally recognizing historical over and under spending in setting test year revenue requirements.

[31] The Board finds that with the proposed variance mechanism, any underspending of funds in a year will accrue to the benefit of its customers in future years, and requires the shareholder to bear the burden of overspending once a program is terminated.

[32] The Board approves the proposed variance mechanism, limited to the incentive and retention programs. Each program shall have a variance mechanism to begin with the 2017 year-end balances. No amortization, interest, financing costs or return to the balance of the programs will apply under the approved variance mechanism.

D. Conclusion

[33] The Board concludes that:

1. EGNB's 2017 Regulatory Financial Statements are approved, as filed, with a credit of $0.978 million to be applied to the RDA.
2. The single-year SEP test shall be replaced with a three-year rolling average test, commencing in 2017. There will be no other change to the current Board approved methodology.
3. The result of the SEP test using a three-year rolling average for 2017 is 106 per cent, which demonstrates that revenues exceeded incremental costs. EGNB has accordingly passed the test for 2017.
4. The proposed variance mechanisms for the Residential and Commercial Incentive Programs, as well as the Retention and Winback Programs, are approved and shall commence in the 2017 year-ending balances.
5. The 2017 year-ending balances are:

   (a) Residential Incentive Program: $11,750; and

   (b) Retention Program: $39,899.

   There are no year-ending balances for the Commercial Incentive and Winback Programs as these programs were not in place in 2017.

Dated in Saint John, New Brunswick, this 29 th day of May, 2019.

François Beaulieu
Vice-Chairperson

Michael Costello
Member

John Patrick Herron
Member