DECISION

IN THE MATTER OF an application by Liberty Utilities (Gas New Brunswick) LP for approval of its 2019 Regulatory Financial Statements, approval to change its distribution rates effective January 1, 2021, approval of an excess earnings sharing mechanism, and approval of variance accounts for income tax, pension, and COVID-19.

(Matter No. 478)

January 13, 2021

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

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NEW BRUNSWICK ENERGY AND UTILITIES BOARD:

Acting Chairperson:	François Beaulieu
Members:	Michael Costello
	Patrick Ervin
	John Patrick Herron
Counsel:	Matthew Letson
Chief Clerk:	Kathleen Mitchell

APPLICANT:

Liberty Utilities (Gas New Brunswick) LP:	Len Hoyt, Q.C.

INTERVENERS:

Highlands Fuel Delivery G.P.:	Michelle Pye
Irving Oil Commercial G.P.:	Sara Gould

PUBLIC INTERVENER:	Heather Black

A. Introduction

[1] Liberty Utilities (Gas New Brunswick) LP, as represented by its general partner, Liberty Utilities (Gas New Brunswick) Corp. (Liberty), applied on August 7, 2020 to the New Brunswick Energy and Utilities Board (Board) for approval of Liberty's proposed distribution rates, effective January 1, 2021. The current matter represents the first application commenced by Liberty for the approval of gas distribution rates.

[2] Liberty also sought approvals of its 2019 Regulatory Financial Statements and its proposed excess earnings sharing mechanism (ESM, as set out under subsection 52.03(2) of the *Gas Distribution Act*, *1999*, S.N.B. 1999, c. G-2.11 (GDA) and otherwise). It also requested an order to establish income tax, pension, and COVID-19 variance accounts.

[3] The Board held a pre-hearing conference via video conference on September 1. Intervener requests were received by Highlands Fuel Delivery G.P. and Irving Oil Commercial G.P., which were granted. Neither party filed evidence in relation to this matter.

[4] A hearing was held on November 16 to 18. This was conducted by video conference pursuant to Rule 5.1.3 of the Board's Rules of Procedure.

[5] Liberty presented a panel that included Mr. Russell Feingold, Vice President and Rate & Regulatory Services Practice Lead at Black & Veatch Management Consulting LLC. Mr. Feingold was declared as an expert in the areas of utility costing, pricing, and related regulatory policy. The panel also included Mr. Paul Volpé, Mr. David Lavigne, Mr. Leo Nguyen and Ms. Jill Schwartz, all of Liberty or its related entities.

[6] Ms. Heather Black, the Public Intervener, filed written evidence prepared by Mr. Robert Knecht, a Principal of Industrial Economics, Incorporated. He was declared as an expert in the areas of regulatory economics and rate-making.

[7] The Board issued a Partial Decision dated December 16. In its decision, the Board made several findings with respect to the 2021 revenue requirement. Consequently, it ordered Liberty to refile its 2021 test year budget with the adjustments set out in paragraph 5 of the Partial Decision, cost of service study with adjustments, proof of revenue and resulting rates. Liberty filed these documents on December 22 and December 23, respectively. An order was issued on December 23 approving the distribution rates for each customer class, to be effective

on January 1, 2021. The Board also ordered in the Partial Decision that Liberty was to file an application with supporting evidence to evaluate the appropriate capital structure, cost of debt, and return of equity by March 31, 2021.

B. Legislative Framework

[8] The following provisions of the GDA apply to this application:

> **52**(2.1) The Board may, in accordance with generally accepted public utility practice, make an order permitting the general franchise holder to create or establish a regulatory variance account in respect of the occurrence of an event for the purpose of minimizing the rate impact of the costs arising from the event.
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> **52.01** On the commencement of this section, the balance in the regulatory deferral account shall be $144.5 million.
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> **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.
>
> **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.
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> **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
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> (b) if the difference between 10.9 per cent and the amount that exceeds 10.9 per cent exceeds 200 basis points,
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> > (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
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> > (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.

52.04(1) For the period commencing on January 1, 2020, and ending on the date the balance of the regulatory deferral account is recovered, the balance remaining in the regulatory deferral account after the amounts, if any, have been credited in accordance with section 52.03, shall be recovered by including in the revenue requirement of the general franchise holder those amounts authorized by the Board in accordance with this section.

52.04(2) On application by the general franchise holder for an order approving or fixing rates and tariffs in accordance with section 52, the Board shall authorize the recovery of the balance in the regulatory deferral account in any manner it considers appropriate, including determining the period during which the balance is to be recovered and the amounts to be included in the revenue requirement of the general franchise holder in any year.

52.04(3) Despite subsection (2), the Board shall authorize the recovery of $100 million of the balance in the regulatory deferral account on a fixed straight line amortization basis for the period commencing on January 1, 2020, and ending on December 31, 2045, unless the balance of the regulatory deferral account has been fully recovered before that date.

52.07 Subject to subsection 52(2.1), clause 52.03(2)(b)(ii)(B), subsection 52.06(4) and section 52.08, the rates and tariffs approved or fixed by the Board with respect to the general franchise holder’s application dated July 25, 2016, for the following classes of customers shall, in aggregate, be subject to a rates and tariffs freeze and shall remain in effect until December 31, 2019:

(a) Mid-General Service Class;

(b) Large General Service Class;

(c) Contract General Service Class;

(d) Industrial Contract General Service Class; and

(e) Off-Peak Service Class.

56 A gas distributor shall not make any change to its rates or tariffs for the distribution of gas except with the approval of the Board, after a proceeding determined by the Board, and any approved charge shall be plainly indicated on new schedules that shall be filed with the Board before the change comes into effect.

[9] The following provisions of the *Energy and Utilities Board Act*, S.N.B. 2006, c. E-9.18 apply to this application:

> **57**(1) Every public utility shall, within 3 months after the end of its financial year, or within such further period of time as the Board may allow, file with the Board a return in a form acceptable to the Board showing
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> (a) a statement showing its rates,
>
> (b) its financial statements for the financial year in the form and verified in the manner directed by the Board, and
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> (c) a statement setting out the name, address and duties of every officer.

C. Analysis

1. 2019 Regulatory Financial Statements

[10] The Board's review of regulatory financial statements is conducted, in part, to ensure that the actual return on equity (ROE) is reasonably calculated and applied in accordance with section 52.03 of the GDA. The review is also to ensure that the ROE values used in the ESM, reviewed below, are calculated based on Liberty's actual and approved historical results.

[11] As indicated in sections 52.02 to 52.03 of the GDA, 2019 is the final year for which legislation prescribes specific measures relating to the regulatory deferral account (RDA) and ROE.

a. Revenue and Expenses

[12] Liberty's 2019 Regulatory Financial Statements disclosed a total revenue of $49.262 million and total expenses of $31.641 million. This resulted in income of $17.621 million before extraordinary items, regulatory deferral, return on rate base, and excess returned to customers (through the ESM). The 2019 rates for all customer classes, except the residential Small General Service (SGS) class, were subject to a rate freeze pursuant to section 52.07 of the GDA.

[13] In Liberty's final submission, Mr. Len Hoyt, Counsel for Liberty, stated that the 2019 expenditures should be found to have been prudent unless the presumption of prudence is

rebutted on reasonable grounds. He submitted that there was no suggestion or evidence of imprudent spending in 2019.

[14] Mr. Knecht did not identify any evidence of imprudence with respect to Liberty's 2019 revenue and expenses. In her closing submission, the Public Intervener stated that she had no objection to the approval of the 2019 financial statements.

[15] The Board has reviewed the 2019 Regulatory Financial Statements and finds that 2019 revenues and expenses are calculated and allocated in accordance with the GDA.

b. System Expansion Portfolio Test

[16] In its assessment of financial results, the Board evaluates the prudency of Liberty's 2019 system expansion capital spending, by using a system expansion portfolio test (SEP Test).

[17] The SEP Test is based on a three-year average of incremental capital costs and revenues associated with system expansion. The test evaluates whether capital spent on attaching new customers was justified by increased revenues.

[18] In particular, the SEP Test demonstrates whether incremental revenues from system expansions exceed the depreciated expansion capital costs by at least four per cent. Failing the test could result in the Board reducing Liberty's rate base by an amount that would be required to pass the test. This would, in turn, impact the ROE used in the legislated sharing mechanism, which is reviewed below.

[19] Based on Liberty's 2019 financials, the 2017 to 2019 average incremental revenues of $793,000 exceeded the average depreciated capital spending of $667,000 by 19 per cent, which passes the SEP Test for 2019.

[20] In his report, Mr. Knecht agreed that Liberty passes the 2019 SEP Test and that no disallowances to 2019 growth-based capital spending are necessary.

[21] The Board finds that for 2019, Liberty passed the SEP Test. There will be no disallowances to 2019 growth-based capital spending, and therefore, no adjustment to the 2019 rate base.

c. Earnings Sharing Mechanism

[22] Consistent with the Board's interpretation in Matter 453 of the phrase "the following year" as found in clause 52.03(2)(b)(ii)(B) of the GDA, the "remaining amount" of the 2019 surplus will be applied to reduce the revenue requirement for 2021 for the purposes of determining 2021 rates.

[23] Accordingly, the actual ROE of $17.621 million will be allocated in accordance with the ESM as follows: $3.464 million, to be applied to the RDA, and $1.065 million to be applied to reduce the 2021 revenue requirement and used to decrease rates and tariffs for one or more rate classes, other than the SGS class.

d. Board Conclusion – Regulatory Financial Statements

[24] Based on the foregoing, the Board approves the 2019 Regulatory Financial Statements, as filed.

2. Revenue Requirement for 2021

[25] The 2021 revenue requirement is based on budgeted expenses, which includes income before extraordinary items, regulatory deferral, return on rate base, and excess returned to customers (through the ESM). This is summarized as follows:

	Component	**Budgeted Revenue Requirement**
1.	Operating and Maintenance Expenses	$13.594 million
2.	Bad Debt Expenses	$0.173 million
3.	Amortization of Property, Plant and Equipment	$7.237 million
4.	Municipal and Other Taxes	$1.297 million
5.	Interest on Amounts Due to Associates and Affiliates and Other Interest	$4.929 million
6.	Other Expenses	Nil
7.	Amortization of Deferred Developments Costs	$3.193 million
8.	Amortization of Regulatory Deferral Account	$3.846 million
9.	Income before Extraordinary Items, Regulatory Deferral and Return on Rate Base	$12.196 million

10.	Excess Returned to Customers (through the ESM)	$1.065 million
Total Budgeted Revenue Requirement		$47.530 million

[26] During the hearing, Liberty made the following adjustments:

(a) The addition of $47,000 in relation to miscellaneous revenues associated with late payment penalties, as they flow through the requested revenue requirement;

(b) A reduction of $66,000 in relation to computer and telecom services; and

(c) A further reduction of $211,000 in relation to the amortization as a result of the withdrawal of the pension variance account.

[27] The Board's review below includes operating and maintenance expenses, interest on amounts to associates and affiliates and other interest, and miscellaneous revenues.

a. Operating and Maintenance Expenses

[28] Liberty's proposed 2021 budget for operating and maintenance (O&M) expenses is $18.474 million. O&M to be capitalized as property, plant and equipment totals $4.88 million, reducing O&M expenses to $13.594 million, as shown in the above table. The net O&M expense for 2021 is forecast to increase by $659,000 compared to the 2020 budget.

[29] Mr. Knecht stated in his report that he did not review O&M expenses in extensive detail. He noted however, that labour costs increased modestly, relative to the approved 2020 budget, but are "well below the current forecast for 2020." He also noted that Liberty's budget does not appear to be unduly pessimistic with respect to its ability to keep costs under control, compared to historical performance.

i. Corporate Allocations

[30] The 2021 O&M budget includes the amount of $2.081 million in corporate allocations. Corporate allocations from related entities were raised as an issue in this proceeding.

[31] Corporate allocations represent costs passed or allocated from parent companies or affiliates to a related utility. In its Decision dated September 20, 2012, the Board approved a methodology for assessing such costs. In the past, the Board has reviewed corporate allocations to determine whether, or in what amount, such costs should be borne by the utility's customers, as part of its revenue requirement.

[32] Since the October 2019 acquisition, Liberty has been using the Cost Allocation Manual (CAM) issued by Algonquin Power & Utilities Corp. (Algonquin). Liberty proposes to change the Board's previously approved methodology. It requests the inclusion of the full amount of $2.081 million of corporate allocations in the 2021 revenue requirement.

[33] During the hearing, Mr. David Lavigne, Director, Finance and Regulatory at Liberty, explained that the change in ownership has resulted in a different approach with respect to corporate allocations. He testified that, under Liberty ownership, some of the costs that were formerly under service level agreements are now classified as corporate allocations. He stated that there has been "significant movement between the various buckets" such as the former service level agreements, and that Liberty's understanding of corporate allocations is continuing to evolve.

[34] Ms. Jill Schwartz, Rates and Regulatory Affairs, Senior Manager at Liberty Utilities, testified that the utility would work with the Board and interveners to "understand and do a deeper dive into these costs."

[35] It is difficult to assess the actual cost of the proposed corporate allocations, as Liberty has eliminated service level agreements. In addition, it has moved certain functions previously performed by affiliates to Liberty.

[36] Mr. Knecht recommended that the Board accept Liberty's corporate allocations for 2021 and consider an independent review of corporate allocations in advance of its 2022 rate application. He also recommended continuing to closely monitor affiliates' allocated costs. Mr. Hoyt, in his summation, stated that Liberty supports this suggestion.

[37] In final argument, the Public Intervener submitted that, given the evolving understanding of this issue, the Board should accept the corporate allocations for 2021, pending a deeper review next year.

[38] The Board accepts the budgeted 2021 corporate allocations, as filed. The Board directs Liberty to obtain an independent review of corporate allocations and file it as part of its 2022 general rate application.

ii. Capitalization to Property, Plant and Equipment

[39] Liberty filed a revised capitalization study of indirect overhead. The study concludes that a greater proportion of operating expenses is related to growth and capital expansion. As a consequence, Liberty proposes to capitalize O&M expenses totaling $4.88 million, resulting in a net O&M of $13.594 million budgeted for 2021.

[40] The Board accepts the proposed change in capitalization methodology for the purposes of Liberty's 2021 O&M budget.

b. Interest on Amounts to Associates and Affiliates and Other Interest

[41] Interest on long-term debt is a significant annual cost. In Matter 453, this totaled $6.8 million. For the 2021 test year, Liberty proposes a change in the interest on long-term debt that would result in a cost reduction of $1.909 million.

[42] In its Decision dated November 30, 2010, the Board approved a regulated cost of debt based on a long-term interest rate charged by the parent company plus 100 basis points.

[43] Liberty's long-term debt was restructured as a result of the acquisition by Algonquin. In addition to taking advantage of current lower interest rates, Algonquin has opted not to charge Liberty the extra 100 basis points.

[44] In his report, Mr. Knecht stated that Liberty "has restructured its long-term debt, in the form of a 30-year instrument with an interest rate of 3.315 percent [which] represents a substantial cost reduction from the prior arrangement, in which the interest charge was based on the Enbridge Inc. debt costs plus 100 basis points."

[45] The reduction of $1.909 million benefits ratepayers. The Board finds the interest cost of $4.929 as reasonable. As discussed below, this issue will be reviewed by the Board in 2021.

c. Miscellaneous Revenues

[46] Liberty receives certain non-rate related revenues reported as miscellaneous revenues. This is budgeted as $1.109 million for the test year. Miscellaneous revenues include other interest income, late payment penalties, and other revenue items.

[47] In its Decision in Matter 453, the Board stated that a five-year historical average of late payment penalties and other interest income would provide a better basis for budget purposes.

[48] Liberty did not follow this approach in its 2021 budget. It explained in its rebuttal evidence that it does not interpret the Board's orders requiring them to do so. Liberty submitted additional reasons why, in its view, a five-year average is not appropriate. First, other categories use a three-year average at most. Second, Algonquin's interest payment policies are expected to result in less interest revenue than in previous years. Therefore, averaging over an extended period would skew what is expected under new ownership.

[49] The Public Intervener submitted that these reasons are insufficient to justify a departure from the Board's directed five-year average approach. Ms. Black stated that the 2020 forecast, which uses a five-year historical average, indicates that miscellaneous revenues will be on budget.

[50] The Board finds that the five-year historical average, as stated in Matter 453, continues to provide a better basis for budget purposes. This approach may be reconsidered in a future proceeding, once the Board has the benefit of historical results under current ownership.

[51] The Board directs Liberty to recalculate and file its forecast of late payment penalties and other interest income revenues based on its five-year historical average.

d. Board Conclusion – Revenue Requirement

[52] The Board makes the following findings with respect to the 2021 revenue requirement:

(a) Pension Variance Account – Accumulated Amortization: The pension variance account has been withdrawn, which reduces the Amortization of Deferred Development Costs by $211,000;

(b) Operating and Maintenance Expenses – Computer and Telecom Services: Transition expenses included in the 2020 forecast have been erroneously included in the 2021 budget, which results in reducing this expense by $66,000;

(c) Miscellaneous Revenues: Liberty is to recalculate and file both the late payment penalties and other interest income using a five-year historical average; and

(d) Income Tax Variance Account: The income tax variance account is denied, which increases the revenue requirement by $586,309, as discussed below.

3. Cost Allocation, Load Forecast and Rate Design

[53] Once the revenue requirement is established, rate setting requires three inputs: cost allocation, load forecast, and rate design.

a. Cost Allocation

[54] The Board approved a cost allocation methodology in a previous proceeding. Liberty is not proposing any change to the methodology.

[55] Mr. Knecht questioned the value of annual updates of the cost allocation model, because Liberty does not rely on it for determining rates. He pointed out that the Board rejected a cost-based revenue allocation in favour of a multi-dimensional approach in Matter 453. Given that direction, Mr. Knecht noted that it may be more efficient to forego annual updates of the cost of service study.

[56] Mr. Feingold disagreed with that conclusion. He maintained that the study provides the Board with an annual picture of revenue to cost ratios. He stated that the competitive pressures that currently influence ratemaking will diminish over time, and cost allocation will regain its importance. Mr. Feingold also stated that it is important to continually update the cost of service study.

[57] Mr. Lavigne testified that discontinuing a cost of service study would not result in any significant savings.

[58] The Board finds that the information provided by the cost allocation model provides useful information. If revenue-to-cost ratios further deteriorate, the Board may order changes to rate

design. The Board therefore will require the continued filing of the cost allocation model in the general rate applications.

b. Load Forecast

[59] Liberty's 2021 Budget forecasts total throughput of 5,719 terajoules from 12,269 customers among the six rate classes. The forecast is based on the historical consumption of existing customers adjusted for normal weather. This is combined with a forecast of expected consumption for new customers in 2021, based on either a standard or average profile or, in the case of larger customers, based on specific customer information at the time of customer signing.

[60] The load forecast is a critical element in the setting of rates and the Board must be satisfied that the forecast is reasonable. An unreasonably low forecast will result in higher rates that increase the likelihood that Liberty will overearn. Alternatively, a throughput forecast that is too high will result in rates that are too low and jeopardize Liberty's chance to earn a fair return. While all forecasts contain errors, it is expected that such errors will balance out over time.

[61] At issue are the details of how Liberty arrived at its 2021 forecast were not readily available for this hearing. In response to an interrogatory seeking an explanation as to the methodology used to derive the test year load forecast, Liberty states:

> The load forecast for continuing customers is created by LULP's forecasting system. Extensive formulae are layered into the programming of the system and are not readily available for extraction.

[62] Mr. Paul Volpé, Manager, Regulatory Affairs at Liberty, also testified that the formulae involve different data bases, which makes them difficult to provide. He indicated that the information could be provided for future hearings.

[63] In his evidence, Mr. Knecht stated that this inability to probe the load forecast resulted in a "black box" model where the driving forces are unknown and untestable. His own "back-of-the-envelope" calculation (based on historical loads corrected for weather) suggests that Liberty may have understated the throughput for some classes. Correcting this issue using a three-year historical average suggests potential savings to customers of $1.85 million.

[64] In its rebuttal evidence, Liberty suggested that the discrepancy that Mr. Knecht highlighted was the result of changes to the forecast methodology implemented in 2020. Mr. Knecht stated that

Liberty has misinterpreted his evidence, and that the utility fails to properly explain the decline in throughput for some classes.

[65] Ms. Black maintained in final argument that, given the discrepancy between historical loads and the current Liberty forecast, the Board should order Liberty to adjust its forecast using historical averages, as suggested by Mr. Knecht. She also suggested that the Board require Liberty to provide more details of the forecast methodology.

[66] The Board shares the concerns raised by Mr. Knecht and the Public Intervener. It is unclear if, or to what extent, the changes highlighted by Liberty have lowered the forecast. To address these concerns, the Board orders Liberty to provide a report detailing the load forecasting methodology and formulae by May 31, 2021. Liberty is also required to organize a technical session of stakeholders prior to the next rate application. This will provide a more informative analysis of the load forecast in future rate hearings.

[67] In the interim, the Board will approve the forecast for 2021, as filed.

c. Rate Design

[68] Liberty proposes no rate increase to SGS customers in 2021 and rate decreases to the other classes. The decreases are largely due to the reduction to the cost of debt, the $1.065 million rebate from the ESM, and excess revenues in 2019. Liberty proposes to allocate the $1.065 million between the non-SGS classes, based on the proportion of revenue from each class in 2019. This is consistent with the method used last year. The Board approves the proposed allocation of the excess revenue.

[69] In recent years, Liberty's rate design has been heavily influenced by competition from alternative fuels. Mr. Knecht expressed concern about the lack of data or price information related to competitive fuels. He stated that it is difficult to properly assess the extent or nature of the market pressures without more evidence.

[70] Liberty provided some evidence related to competitive fuel prices, but noted that for heating oil and propane, the market remains opaque and information on the true prices is difficult to obtain.

[71] During cross-examination, Mr. Knecht explained that more information about the price of competitive fuels, combined with information about the nature of the customers who are at risk, may result in alternative solutions that are more effective and efficient.

[72] In final argument, Ms. Black reinforced this sentiment and submitted that it is important that both the Board and interveners have as much information as possible to support the rate design.

[73] The Board agrees and orders Liberty to begin collecting more information about the nature of competitive fuels and the customers at risk of leaving the system. Such information is to be provided at the next general rate application.

D. Miscellaneous Issues

1. Recovery of the Regulatory Deferral Account

[74] The GDA prescribes how the balance of the RDA is to be recovered for the period after 2019 until the balance of this account is recovered.

[75] Subsection 52.04(3) addresses the recovery of $100 million of the balance in the regulatory deferral account. Such recovery is based on a fixed straight line amortization basis between 2020 and 2045.

[76] Under subsection 52.04(2), the Board has the discretion to authorize the recovery of the balance of the regulatory deferral account above $100 million "in any manner it considers appropriate." This must include a determination of the recovery period and the amounts to be included in the revenue requirement in any year.

[77] Liberty proposes to recover the balance by continuing to use an ESM for 2020 and beyond. The proposal does not specify an end date for recovery of the balance. That proposal would see excess earnings from 2021 credited to the regulatory deferral account and applied to decrease customer rates, other than the SGS class, in 2023.

[78] In Matter 453, Liberty proposed to continue using the same ESM model in relation to the 2020 earnings. That proposal would have any excess credited against the balance of the regulatory deferral account and a portion applied to decrease rates for non-SGS customers in 2022.

[79] The Board accepts this proposal in relation to 2020 earnings. Any excess return earned in 2020 is to be distributed in the manner described by the ESM model, as set out in the GDA and applied to decrease rates in 2022. As it applies to earnings in 2021, the Board will also accept Liberty's proposal for an ESM.

[80] The Board directs Liberty to file a detailed proposal with the next general rate application in relation to a mechanism to address the recovery of the balance above $100 million, for earnings beyond 2021.

2. Proposed Variance Accounts

[81] Liberty seeks an order to establish three variance accounts, pursuant to subsection 52(2.1) of the GDA.

[82] The report prepared by Mr. Feingold states that the general objective of the request "is the stabilization of its distribution rates over time to ensure the impact of these additional expenses do not result in immediate and significant changes to customers' rates." The report notes that the use of variance accounts is a ratemaking approach that is widely accepted by utility regulators to enable the smoothing of unusually large, one-time expenses over a multi-year period.

[83] Mr. Knecht considered the proposed accounts to be somewhat different than a traditional variance account. He stated that the rationale for these accounts falls into three categories:

(a) To retroactively and prospectively recover costs incurred as a result of an extraordinary event that could not have been anticipated, and whose impacts cannot be predicted.

(b) To retroactively recover certain costs that it will incur in the current year on the grounds that these costs were (a) unforeseeable, and (b) are at least partly related to a management plan to reduce future employee benefits costs.

(c) To push certain future test year costs further into the future in order to stabilize rates.

[84] In Mr. Knecht's view, the creation of variance accounts is appropriate where (a) the costs in question are outside the control of the utility; (b) the costs are uncertain and cannot reasonably be foreseen or predicted; and (c) the cost variances have a material impact on the utility.

[85] For the purposes of this proceeding, the Board agrees and will apply these guiding principles in relation to the requested variance accounts, as detailed below.

a. Income Tax Variance Account

[86] Liberty seeks a Board order to establish an income tax variance account in order to minimize impacts to revenue requirement, to smoothen the changes to rates, and to minimize impacts to ratepayers from year to year.

[87] The 2021 forecasted regulated tax expense is $586,309. Liberty proposes to defer this expense to 2022. A proposal for deferrals beyond 2021 would be brought to the Board for review with the next general rate application. No carrying charges would be applied to the account.

[88] Liberty also seeks to extend the variance account for its forecasted (and much higher) cash taxes for 2022 through 2025, when no tax loss carry-forwards are forecasted. Liberty's rationale is that starting in 2022, it will be fully taxable. It proposes to amortize the cash tax expense over two years, so as to lessen the pressure on rates, and provide a smoothing of the revenue requirement over that period.

[89] Mr. Knecht recommended against the Board approving the income tax variance account for the 2021 test year. In his view, the impact of the relatively low forecasted 2021 cash expense would not cause unstable rates. He listed several other reasons for rejecting Liberty's request including:

(a) In most years other than 2023, the impact of the variance account would result in avoidance of rate increases by not more than 1.0%.

(b) Liberty's forecast is based on the assumption of a stable ROE of 10.9%. Mr. Knecht believes that there is a reasonable probability that ROE will be reduced in 2023, with resulting easing of rate pressure associated with the expiration of the net operating losses for deemed tax accounting.

(c) The structure of the proposed variance account is "technically flawed." If Liberty has a favorable year in terms of revenues or cost controls, its income will exceed budget, as will its deemed income tax cost. This would be passed to future ratepayers under the variance proposal, which is inconsistent with the utility having a good year. Conversely, in a poor year, Liberty would be obligated to refund its reduced tax burden to ratepayers.

[90] Mr. Knecht stated that there is no need to adopt an income tax variance account, given its relatively small impact on the 2021 test year budget and its concurrence with an overall rate reduction without such a deferral. The Board agrees with Mr. Knecht's submission.

[91] The Board is not satisfied that a variance account to simply defer tax costs from 2021 to 2022 is appropriate in this instance. The Board is of the view that the creation of the proposed income tax variance account is inconsistent with the guiding principles, as noted above, for the creation of variance accounts. The proposal for an income tax variance account is denied. Accordingly, the 2021 cash tax expense of $586,309 will be added to the 2021 revenue requirement.

b. Pension Variance Account

[92] Liberty had originally proposed the creation of a pension variance account.

[93] In his written evidence, Mr. Knecht stated that it fails the "traditional regulatory standards for variance accounts" for several reasons, including that it is retroactive, in that it seeks to recover costs incurred in 2020.

[94] In its rebuttal evidence, Liberty acknowledged the concern about retroactivity, and withdrew its proposal for a pension variance account.

c. COVID-19 Variance Account

[95] On March 19, the Province of New Brunswick declared a State of Emergency under the *Emergency Measures Act* and issued a mandatory order in response to the threat posed by COVID-19 to public health and safety.

[96] Liberty seeks a Board order to establish a variance account for COVID-19 costs. More specifically, Liberty proposes to include expenses for incremental costs including bad debt, additional safety supplies, and lost revenues from actions taken to provide relief to customers, including uncharged late payment fees.

[97] Liberty proposes to report on these transactions in future rate applications. Carrying charges will be applied to this variance account at the short-term borrowing rate, currently at 2%.

[98] Mr. Knecht recognized that many utilities and regulators are evaluating and adopting variance accounts related to the COVID-19 pandemic. He also noted that most of the substantive issues concerning the account, including exactly how the costs will be defined, and its specific amortization period, are being deferred for future Board review and evaluation. As such, he considered Liberty's proposal to be a request for conceptual approval of a variance account.

[99] Liberty agrees with this assertion. It proposes to determine the term of amortization and methods for inclusion in future revenue requirements when Liberty has ascertained the total amounts once the pandemic is over and it can truly assess how they can be amortized with reasonable impact to rate payers.

[100] The Board approves the creation of a variance account for COVID-19 costs. Only costs that are directly related to the COVID-19 pandemic will be eligible for recovery. These costs, along with the amortization into revenue requirement, will be subject to Board review during the 2022 general rates application**.**

3. Audited Financial Statements

[101] In its evidence, Liberty stated that its parent company does not carry out financial statement audits on its stand-alone utilities and that there will not be an audit on Liberty's 2020 year-end financial statements.

[102] Paragraph 57(1)(b) of the *Energy and Utilities Board Act* requires public utilities to file with the Board, no later than three months following its financial year end, or within such further period of time as the Board may allow, its financial statements for the financial year in the form and verified in the manner directed by the Board.

[103] During the hearing, Mr. Lavigne stated that Liberty was willing to continue to do an external audit.

[104] The Board directs Liberty to file on an annual basis, an audited financial statement by March 31, in accordance with paragraph 57(1)(b).

4. Cost of Capital Hearing

[105] Liberty restructured its long-term debt financing which resulted in a 3.315 percent interest charge.

[106] The allowed return on investment was reviewed by the Board in 2010. In its Decision dated November 30, the Board:

(a) Approved the rate of ROE at 10.9 per cent;

(b) Regulated the cost of debt as Enbridge Inc.'s borrowing rate plus 100 basis points; and

(c) Reduced the equity component of Enbridge's debt to equity ratio from a maximum of 50 per cent to a maximum of 45 per cent.

[107] In the same decision, the Board found the risk-free rate was 4.6 per cent, using the long-term Government of Canada bond rate. Liberty's 2021 budget assumptions include a ROE of 10.9 per cent, derived from the Board's 2010 decision, and a capital structure of 55 per cent debt and 45 per cent equity.

[108] In Matter 453, the Board ordered Liberty to file an application in 2021, with all necessary documents for the Board to properly evaluate the appropriate capital structure, cost of debt, and ROE applicable to Liberty on an ongoing basis.

[109] Liberty is directed to file that application with supporting evidence by March 31, 2021.

5. Capital Budget

[110] The capital budget includes those funds used to expand or improve the distribution system. Liberty's 2021 budget is $6 million more than for 2020. The main variances relate to a project to expand the system to Havelock and a proposal to increase capitalization of operating costs.

[111] Mr. Knecht expressed two concerns about the capital budget. First, Liberty's recent history with budgeting its capital expenditures seems overly optimistic. For example, actual additions to property, plant and equipment, being the main category of capital, was less than budgeted in each year from 2016 to 2019.

[112] The consequence of overestimating the capital budget can be significant. A revenue requirement includes compensation for interest on debt related to a capital project. As well, there will be a return on added equity, and depreciation. While any extra revenue will be

eliminated in the following year, the Board must still be concerned about the reasonableness of the projected capital spending.

[113] Mr. Knecht's second concern related to the detail provided to support the capital budget. Mr. Knecht stated that is difficult to assess the capital budget, or understand budget errors, because there is no variance analysis between budget years. Nor is there an explanation for the difference between budget and actual spending.

[114] Liberty stated that it could provide more information in future years. It did not dispute Mr. Knecht's conclusion about past budgets, except to say that in 2020, it expected to exceed its capital budget and that this reflects a renewed focus on expansion. Additionally, in its rebuttal evidence, Liberty pointed out that the 2021 increases are clearly identified. Consequently, Liberty maintains that the 2021 capital budget is reasonable.

[115] In final argument, Ms. Black suggested that "it makes more sense to budget in line with a long-term average" and that the 2020 forecasted results do not give enough reason to alter that opinion. Ms. Black submitted that, given the history of over budgeting, the Board should substitute a capital budget based on the long-term average of capital additions for the budget proposed by Liberty.

[116] The current budget includes an identifiable project to be commenced and completed in 2021. As the Board has accepted the increased capitalization, it accepts the 2021 capital budget, as proposed.

[117] The Board requires that, in future rate applications, Liberty provide a more detailed capital budget, including the projects and assumptions that make up the budget. Liberty must also provide a variance analysis for budget to actual and budget to forecast spending.

E. Conclusion

[118] The Board concludes that:

(a) Liberty's 2019 Regulatory Financial Statements are approved, as filed;

(b) The 2021 revenue requirement is approved, subject to the adjustments set out above;

(c) As it applies to earnings in 2021, the Board accepts Liberty's proposal for an ESM and directs Liberty to file a detailed proposal with the next general rate application in relation to a mechanism, for earnings beyond 2021;

(d) The proposed income tax variance account is denied; and

(e) The proposed COVID-19 variance account is approved, as set out above.

Dated in Saint John, New Brunswick, this 13th day of January, 2021.

François Beaulieu
Acting Chairperson

Michael Costello
Member

Patrick Ervin
Member

John Patrick Herron
Member