

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE GAS DISTRIBUTION ACT

- and -

IN THE MATTER OF AN APPLICATION by **Heritage Gas Limited** for the approval of a Schedule of Rates, Tolls and Charges

BEFORE: Peter W. Gurnham, Q.C., Chair
Kulvinder S. Dhillon, P. Eng., Member
Murray E. Doehler, C.A., P. Eng., Member

APPLICANT: **HERITAGE GAS LIMITED**
John C. MacPherson, Q.C.
James MacDuff, LL. B.

INTERVENORS: **CANADIAN OIL HEAT ASSOCIATION**
Gary Highfield

NOVA SCOTIA DEPARTMENT OF ENERGY
Mark Rieksts, LL. B.
William O'Halloran
Richard Penny

BOARD COUNSEL: S. Bruce Outhouse, Q.C.

**BOARD COUNSEL'S
CONSULTANT:** Mel Whalen, P. Eng.

HEARING DATE: November 7, 2006

CLOSING ARGUMENT: November 17, 2006

REBUTTAL: November 22, 2006

DECISION DATE: **December 21, 2006**

DECISION: Pursuant to Section 21 of the Gas Distribution Act, the Board approves Heritage's Schedule of Rates, Tolls and Charges as amended.

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I Introduction

[1] Heritage Gas Limited (“Heritage” or “Company”) was awarded a full regulation class franchise for a period of 25 years in the counties of Cumberland, Colchester, Pictou and Halifax, and the Municipality of the District of East Hants and the Goldboro area of Guysborough County, by the Governor in Council on February 21, 2003. On June 3, 2003, Heritage formally accepted the franchise and since that time has been developing the distribution system for local gas delivery within the franchise area.

[2] The Board has approved, on two separate occasions, the distribution rates for Heritage. The first was for interim rates. The second was, following a rate study and application in 2004 (GTA-04), approved in a Board Decision reported at 2004 NSUARB 72 (2004 Rate Decision), which set the rates effective as of November 1, 2004 for the five year period.

[3] Partially through the five year period Heritage discovered that:

... circumstances and events have transpired that have impacted on the ability of Heritage Gas to achieve the results that were forecast in the GTA-04 application. These events, which are largely outside of the control of Heritage Gas, include; unfavourable market conditions that eroded the competitive position of natural gas relative to Bunker C oil; delays in the implementation of desirable environmental legislation that was expected to recognize the environmental advantages of natural gas; the resulting unwillingness of large “anchor” customers to convert their facilities to natural gas including an expected extra large Rate Class 4A customer in Dartmouth; recent volatility in energy pricing due to natural disasters; the inability of the downstream service industry to support natural gas conversions and a slower pace of growth of the customer base.

[Exhibit H-1, p. 2-2]

Accordingly, the current application (GTA-06) was presented to the Board for an increase of 2.5% per year for the next five years for all rates. Heritage has also made application to add into rate base a class 4A asset, which is not at present being utilized, and for other changes that would make it easier for them to expand service in the franchise area.

[4] Heritage called one witness panel:
Ray Ritcey, President;
Chris Smith, Vice-President, Finance and Business Services;
Harvey Fedyk, Vice-President, Engineering and Construction;
Norman Lawrence, Vice-President, Marketing and Customer Service.

[5] The two intervenors, Canadian Oil Heat Association and the Nova Scotia Department of Energy played an active role in the hearing by cross-examining the panel and in filing final submissions. Board Counsel called Mel Whalen, P. Eng., President Malteese Consulting Inc., as an expert witness.

[6] The Board, with variations as noted in this decision, has approved the application.

II Findings

1. Five Year Test Period

[7] Heritage has requested a five year test period starting January 1, 2007. The test period in GTA-04 was also for five years. So the current rate application is to supplant the 2004 Rate Decision to the extent of the overlap.

[8] When asked about the reason for a five year test period, Heritage responded:

Heritage Gas is in the early years of developing the natural gas market in Nova Scotia and is seeking approval of the continuation of the RDA in order to facilitate development of the franchise. Inherent in the concept of an RDA is the capturing of the impact of variances, positive and negative, from forecasts in the RDA largely due to the fact that accurate forecasting for a Greenfield development is extremely difficult. The five-year test period is designed to allow Heritage Gas to devote its resources to the development of the natural gas market including developments such as the servicing of Peninsula Halifax and to provide a sufficient period of time to accumulate an enhanced information base. The additional five-

year period will allow Heritage Gas to gain experience from the information associated with a growing customer and cost base consistent with what it thought it would do in the original test period. Heritage Gas will continue to provide all of the ongoing information that the NSUARB requires over the term of the test period.

[Exhibit H-4(a), NSDOE IR-2]

[9] One of the factors in choosing a five year test period in GTA-04 was that the Revenue Deficiency Account (RDA) would be depleted over that time. As discussed at this hearing:

Q. ...But my recollection -- and maybe I'm -- and correct me if I'm wrong -- is that a reason the five-year test period was chosen last time was that corresponded to the term of the revenue deficiency account. In other words, the revenue deficiency account would be depleted at the end of the five-year test period time. Am I correct?

A. That's one of the reasons. I think one of the main premises that we had is we recognized at that point in time we virtually had no capital in the ground and no customers, and so in terms of the situation that we were in we were looking at a way to develop the marketplace and again trying to find that balance.

Q. Right. But the test period and the deferral were very closely aligned?

A. That's correct.

Q. In fact, they were identical.

A. That's correct.

[Transcript, pp. 166-167]

[10] The RDA is now projected to have a balance until 2019 or 2020, so that is not the reason for this five year test period. When asked why not have a shorter test period Heritage stated it wants:

... to try to provide some rate certainty to those customers on our delivery cost. And we think that is a prudent way to go, based on the experience that we have today ...

We think it would be -- it would -- it wouldn't be practical to try to reset the rates on an annual basis, given that we're trying to develop the marketplace on an earlier basis -- it doesn't have to be annually -- biannually, whatever. We think that longer period of time is important to our customers to, again, try to provide some rate stability in that forecast period.

[Transcript, pp. 121-122]

[11] This sentiment was repeated by Heritage, in more detail later in the hearing:

Well, again in terms of -- many of the customers that we talk to look for different pay-back periods in terms of an investment decision that they have to make. That investment decision goes over periods of time, you know, from a year, year and a half, upwards of seven or eight years, and what we have tried to do in terms of finding that balance was to look at something that could give customers some price predictability, price stability for a period of time, and that's where we landed on the five years. We recognize that for periods shorter than the five years our challenge is to -- because we've got so much change coming into our system and as those customers come to our system it's not a normal year, if you will, every year that we have, it changes, so the change is significant. And so when we looked at that again, we felt that the five-year period was an appropriate period.

[Transcript, p. 168]

[12] The Consultant to the Board Counsel supported the proposed five year test period.

It was almost because of the uncertainty that I felt five years was an appropriate period. Looking just at what Heritage has tabled and looking at the forecasts and I think the first thing I looked at is what's happening to their investment. And I just took their investment or investment per customer and that's dropping fairly rapidly so that led me to say well, no one year in here would be representative. And normally the idea of a test year would be to try and find some representative period but I couldn't see any period in there that I would truly say would be representative, given as I said a minute ago they were still in the very early stages of their development, I thought the five year period would probably still be appropriate. And then there was the practical side of if you want to try and pick up all the variances and try and do it every year, it's just the logistics of trying to do that. I think The Chairman made a good point this morning that in 2004 the RDA was completely recovered in the five year period. And certainly that's different here. And I hadn't really considered that when I supported the five year period here. On the other hand five years wouldn't be long enough to be able to get all the RDA included here given the level of the RDA I think without having a major impact on rates.

[Transcript, pp. 184-186]

[13] Heritage believes that a shorter test period could also jeopardize the rate of penetration into Halifax Peninsula (the Company's most important market). It would also mean that there would not be sufficient base data. This is the data that is required to develop reliable projections of revenues and expenses that forms the basis for the test year information that would be used in a future rate hearing:

Many of the larger customers expected to attach to the system on Peninsula Halifax will not be added until late 2009. If the Board were to order, for example, a three-year test period ending in December, 2009, Heritage will not have had the opportunity to consider the actual consumption and cost patterns of these larger customers to determine whether there should

be adjustments to its Rate Classes. A test period shorter than five years will also detrimentally impact on the ability of Heritage to conduct a valid Cost of Service Study and Depreciation Study for its next Application.

[Heritage Post Hearing Submission, p. 7]

[14] The problem with the five year test period is the lack of certainty about the projections. There are large variances between the actual revenues as compared to the GTA-04 projections. Heritage defended the GTA-06 projections stating:

We have three years more experience than we had back in May 2004, and I believe what's in front of the Board today is realistic in terms of how we look forward to the next five years in our test period.

...

... I can't forecast into the future. We're optimistic and we believe that we've put in front of the Board a realistic projection of the future and one that could have -- you know, we're not sure how it unfolds but it could unfold better or worse than what we've provided. What we do know for sure is it won't be what we've provided to the Board, it's our best estimate of what we think we're looking at in those forward years.

[Transcript, p. 50]

[15] This argument was reiterated when Heritage stated:

Well, again, we're three years into our franchise and the experience that we've incurred to date -- we've gained a lot of experience over the last three years, we have an increasing customer base, but clearly one of the challenges that we have is we don't have enough customer information, either enough customers on the system or enough customer information, but as those customers are added to the system over that test period of time we believe that we will have a solid foundation in terms of looking forward to future test periods.

[Transcript, p. 169]

[16] Heritage was questioned about their confidence that it would not have to be back to the Board until after the five year period. The response was:

... we are getting better and stronger every day, we are listening to and learning from our customers and suppliers and stakeholders. ... We've overcome a number of issues that three years ago in May 2004 we didn't think that we'd be dealing with it through our current test period, ... As we go forward we have the experience of three years, we've factored it into the models, the financial models that are provided before you, and again we believe that they are realistic compared to -- at least at this point in time based on what we know as to how that future could unfold.

[Transcript, pp. 67-69]

[17] The uniqueness of having a five year test period was noted and acknowledged by Heritage who also added that they are "... sure that we're going to have more twists and turns ahead of us."¹

[18] Because of this uncertainty, the Nova Scotia Chapter of the Canadian Oil Heating Association (NS-COHA) recommended that:

... the Board restrict this test period to three (3) years. At that point the Board will be able to review Heritage's "track record" on forecasting and be in a better position to determine if a longer test period is appropriate at that time.

[NS-COHA Closing Submission, p. 3]

[19] The Consultant to Board Counsel commented upon the difficulty in getting accurate revenue projections:

A. Yeah, I was looking at each year and saying I don't think any one year is representative of -- but maybe five years you're starting to at least average it out a little bit more than if you went say for the early two years.

Q. I suppose we can always invite them back whenever we want.

A. Certainly

Q. Or they can ask to come back whenever they want.

A. Yes, that is true.

[Transcript, p. 186]

[20] To acknowledge this uncertainty, and to provide an option, Heritage submitted:

... Heritage undertakes to return to the Board prior to the end of the proposed five year test period in the event that there are "material variances" from the business plan on which this Application is based.

[Heritage Post Hearing Submission, p. 9]

¹[Transcript, p. 69]

[21] The Board accepts that there is value to Heritage and to the financial health of the franchise to have predictable rate changes over a lengthy period of time. These predictable rate changes can assist Heritage in meeting its customer goals. The Board, however, has concerns about the accuracy of the Company's revenue projections. The future by its very nature is unpredictable, but the variations in the first couple of years have been material and do not inspire confidence in the Company's projections.

[22] The Company has submitted, in response to Undertaking U-2, confidential information on the assumptions it used for revenues over the next five years. These assumptions were broken down into number of customers, by class and by average energy use for each class. The achievement of the projected revenue, without material negative variations in each of the next five test years, is a critical component of the Company achieving financial viability. Negative deviations from the assumptions could necessitate the Company requesting a rate hearing before the completion of the five year test period.

[23] To monitor the situation, and as a condition of approval of the five year test period, the Board will require annual filings in more detail than is now provided. The Board will be looking for an annual filing of actual revenues and actual number of customers by class and average usage by class as compared to the assumptions used in this rate application. The Board will also require that this data be incorporated into the forecast for the remainder of the five year test period. Any major deviations from the current application should be identified and explained.

[24] The Board approves the five year test period with the reporting conditions outlined above which are to be provided no later than 180 days after the end of each fiscal year.

2. Capitalization of Operating Costs

[25] In the 2004 Rate Decision, the Board approved the capitalization of a fixed portion of the departmental operating expenses. The amount of the departmental expenses that could be capitalized was outlined in a table for the six year period 2003 to 2008. According to the table the capitalization of the expenses in certain departments was to stop in 2007. Heritage has requested that this not happen and that all the capitalization rates in 2006 be extended. The main reason for the requested extension is:

... it was anticipated that Heritage would have progressed more quickly from a "greenfield" operation through to a more "operational" mode. Unfortunately, that has not occurred. This has resulted in the development period extending beyond the five years originally anticipated.

[Heritage Post Hearing Submission, pp. 34-35]

[26] This concept was explored further in the hearing. Some of the details behind the request were:

... we acknowledge that the development period will extend beyond 2008 and certainly for the test period, we didn't see that things were changing that dramatically over that period of time ... While we do see a decline in the rates of the capitalization from the 100 percent that was in 2003 and across all categories, we have reduced that to 25 percent in some of the categories as we've mentioned, which acknowledges the fact that we are -- we have reached a certain level of operational status across all of our various departmental -- departments. But even in areas such as operations, a significant amount of time of our staff is still dedicated and is expected to remain dedicated to the development of the business where the -- while they're field operators they are more than -- the majority of their time is developed to activating new customers, educating new customers in the field in terms of the attributes of natural gas and things of that nature versus general maintenance if you will. So while it -- we've reduced that ratio to 25 percent it's, I would suggest to you, that in actual fact a greater portion of their time is actually dedicated to the development of the business. When you look at the other categories and example of the -- for the executive line of the business, I can assure you that the majority of our time is dedicated to the development -- the ongoing

development of the business in terms of whether that's marketing or business development type activities or other things of that nature. And certainly obviously Harvey's [Fedyk] time and Norm's [Lawrence] time is virtually exclusively dedicated to the development of the business. So if you, in a general sense -- I would agree with you in time that the ratio should decline but even in mature utilities, there is a large component of development activity -- or sorry, marketing and ongoing customer addition activity that is still capitalized on an ongoing basis, whether it's still -- it wouldn't be 100 percent but there's always a component of that activity that would be capitalized because it relates to the ongoing development of the business ... we thought that a continuation of the 2006 ratios was an appropriate way to carry on.

[Transcript, pp. 96-99]

[27] Mr. Whalen in his pre-filed evidence stated:

... Heritage's primary focus is on building its system, it is likely that some portion of these costs is devoted to that objective. Over time, the system will reach the point where the focus on expansion will diminish and more attention will be required to routine operation. Exactly when that will occur is difficult to pin point, but it is probably beyond the current test period.

[Exhibit H-5, p. 9]

[28] Additionally, Mr. Whalen stated:

I kind of see the five year test period, the capitalization of some of the O&M and the RDA as all kind of linked in some ways. And it seemed to me that with -- ... And it also lined up with the fact that Heritage is still a developing company. And when I compared their revenue at the end of 2006 actual to the revenue that they had anticipated 2006 would be in GTA 04, it's only about 12 percent or so. So it seemed to me that they were still very much at the end of 2006 in the early stages of their development, having reached only about 12 percent of where they thought they thought they would be. So it seemed to me it made some sense to push it out a little bit, given that they were still very early in their development.

[Transcript, p. 183]

[29] The effect of continuing the capitalization of some operating costs is to defer the eventual matching of expenses to revenues. As explored in the questioning of Heritage:

Q. While that may be true, Mr. Ritcey, the effect of it is that there's a deferral of certain operating expenses, what would ordinarily be operating expenses.

A. That's correct, and it recognizes in the future over a period of time that more of those costs would find their way into the operating account.

Q. In the meantime what happens with those costs is they're treated as capital and return is calculated on them, correct?

A. That's correct.

Q. And so, again, this has the effect of potentially at least pushing costs off into the future which you hope to be able to recover from customers?

A. That's correct.

[Transcript, pp. 53-54]

[30] Heritage believes that at some future time, it will be appropriate to reduce and/or eliminate the requested capitalization rates, although these rates were used throughout the 13 year projection model:

Heritage believes that all expenses incurred that relate to the engineering, design and construction of the natural gas system, the recruitment of new customers to the network; and the attachment of new customers to the natural gas system, should always be capitalized. In time, the proportion of day-to-day activity dedicated to the growth of the company will gradually be reduced.

[Exhibit H-4(a), NSUARB IR-9, p. 1]

[31] The Board notes that only anecdotal information was provided in support of the capitalization of operating costs. No analysis was presented to indicate whether the 25% capitalization ratio for executive, operations, human resources, and finance and administration was appropriate. Under Generally Accepted Accounting Principles (GAAP) certain operating costs can always be capitalized if they are shown to be directly linked to the asset being created. Heritage can always elect to use GAAP. To do so would require detailed analysis and record keeping in order to justify the level of expenditure which is going to be capitalized. For a greenfield operation, some flexibility can be provided, by regulation, in the earlier years. Under the 2004 Rate Decision an option was provided in allowing the company to capitalize a fixed percentage per department per year of its annual operating costs.

[32] The Board is aware that the Company is not recovering its current total operating costs and that if the capitalization does not occur then the loss will be greater

and it will increase the RDA. In either case the result will be that Heritage will be increasing the value of a regulatory asset that will be recouped from future customers. This future amount could become rather large if not properly controlled.

[33] The Board is not prepared to change the conclusion reached in the 2004 Rate Decision on the capitalization of operating costs. Given that Heritage is still a greenfield operation, the Board will allow Heritage to continue capitalizing 100% of marketing, engineering, construction and regulatory and public affairs until 2011. The table of allowed capitalization rates would then become:

| Department | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Executive | 25% | 0% | 0% | 0% | 0% | 0% |
| Marketing | 100% | 100% | 100% | 100% | 100% | 100% |
| Engineering | 100% | 100% | 100% | 100% | 100% | 100% |
| Construction | 100% | 100% | 100% | 100% | 100% | 100% |
| Operations | 25% | 0% | 0% | 0% | 0% | 0% |
| Human Resources | 25% | 0% | 0% | 0% | 0% | 0% |
| Finance and Administration | 25% | 0% | 0% | 0% | 0% | 0% |
| Regulatory and Public Affairs | 100% | 100% | 100% | 100% | 100% | 100% |
| Overhead | 25% | 0% | 0% | 0% | 0% | 0% |

[34] The above simplistic and formulaic method for capitalizing operating expenses requires less effort than would have to be expended if a full annual analysis had to be performed. Such an analysis would require reviewing each expense and the activities of all personnel to determine if they were creating asset value or were engaged in general operations. The latter would be required if the Company followed GAAP. If it is advantageous to Heritage to use GAAP to determine capitalization of operating

expenses, then the Company may do so. However, if Heritage elects to adopt GAAP, the Board directs that the Company cannot revert back to the formulaic method outlined above.

[35] No matter which method Heritage decides to use to capitalize operating expenses, the calculation should be done on a monthly basis.

[36] The Board is also aware, as has been detailed by Heritage in response to Undertaking U-6, that if the capitalization rates of operating expenses are not extended as requested, and if no increases in RDA are allowed, then the annual increase in rates must be 3% per year for each of the next five years. This matter is more fully explored in section 5 of this decision.

[37] The Board approves the capitalization of operating expenses as outlined in the above table.

3. Rate Class 4A Facility

[38] Heritage had constructed a 12 inch steel line to serve one customer, Nova Scotia Power Inc. (NSPI), on the assumption that NSPI would take service from the facility. As of the date of the hearing, NSPI has not agreed to take service. Heritage has requested that the cost of this facility ("4A facility") be included in rate base.

[39] When the Board issued the Permit to Construct the 4A facility, it stated in the covering letter:

By issuing this Permit to Construct to Heritage, the Board is simply confirming that, in its view and that of its Certifying Authority, Heritage's filing meets the technical requirements under the Pipeline Act and Regulations for the issuance of a Permit. The Board wishes to make it very clear that the issuance of this permit does not provide any guarantee or assurance that

Board approval will be issued for NSPI's Burnside project. Similarly, by issuing this Permit to Construct, the Board is in no way prejudging the merits of the request by Heritage, as part of the recent Tolls and Tariff proceeding on which a decision has been reserved, for approval of Rate Class 4A which is intended to apply, as the Board understands it, solely to NSPI's Burnside facility.

Accordingly, should Heritage undertake activity and costs pursuant to the Permit to Construct in advance of the Board's ruling on either of these matters, it does so at the shareholder[s]' risk.

[Exhibit H-4(a) NSUARB IR-5, pp. 4-5]

[40] Heritage believes that the 4A facility could eventually be used for its original purpose:

Heritage Gas continues to have discussions with the expected customer concerning utilizing the facilities as originally planned. The customer continues to express an interest to Heritage Gas in taking service; however, to date the parties have not been able to reach a successful outcome.

[Exhibit H-4(a), NSUARB IR-5, p. 2]

[41] Heritage made the following argument to include the 4A facility in rate base:

The company believes that the proper accounting and regulatory treatment of the costs associated with the facilities constructed to serve the Rate Class 4A (Extra Large Rate Class) customer is to include the assets in rate base as of December 31, 2006. The Province of Nova Scotia loan, described below, more than offsets the balance of the related assets. Heritage Gas believes that this 2004 investment was a prudent one and that steps have since been taken to ensure that the assets are used and useful.

In 2005, the company received a \$7.6 million loan from the Province of Nova Scotia. If certain capital investment targets are achieved by December 31, 2006, up to \$2.0 million of the loan will be forgiven. Management assumes that it will meet the investment targets and the \$2.0 million has been treated as a contribution in aid of construction and netted against rate base.

On or before July 1, 2011, the company must elect to either repay the loan in one lump sum payment on July 31, 2014, or in five equal annual installments beginning on July 31, 2012. The company assumes it will elect the latter repayment option. According to the terms of the loan, the unpaid balance of the loan must be netted against the plant-in-service balance.

Heritage Gas has taken steps to activate the facilities originally built to serve the Rate Class 4A customer mentioned above. Activation of this line provides benefits to Heritage Gas customers including 1) serving several customers in the Burnside Industrial Park; 2) System re-enforcement for the entire Dartmouth system and short term storage capability.

[Exhibit H-1, p. 4-1]

[42] The concept of serving customers that are adjacent to the 4A facility was further elaborated upon as follows:

Customers along Akerley Boulevard, Joseph Zatzman Drive, Simmonds Drive, Sterns Court, and Topple Drive will be served by the steel line which Heritage Gas constructed to serve the Rate Class 4A customer. Thirty-two (32) customers are signed up to use gas in 2006 and the remaining 64 customers will connect over a four-year period from 2007 to 2011.

[Exhibit H-4(a), NSUARB IR-6, p. 1]

[43] Heritage in response to Board IR-6 provided the following:

If Rate Class 4A facilities were not in place, Heritage Gas would have to construct approximately 1000 metres of polyethylene pipeline.

...

The cost of the polyethylene pipeline described in...would be approximately \$250,000.

[Exhibit H-4(a), NSUARB-IR-6, p. 2]

[44] The Board further explored this issue with Heritage during the hearing:

Q. Oh. We heard this morning that if the steel pipe is not used to service the customers, you will need a thousand meters of PVC pipe at a cost of two hundred or two hundred fifty thousand dollars (\$200 or \$250,000), I guess. That 1,000 meter pipe is 32 customers, or it's 96 customers?

A. That pipe would be, in essence, replacing the pipe section we would be using with 12-inch pipe. So it would -- it would basically be -- it would just be replacing the capacity of the 12-inch line. Then we would have to add other polyethylene lines to connect those customers, the 32 and 96.

[Transcript, pp. 134-135]

[45] Heritage provided another example where the 4A facility could be used for system reinforcement:

The Rate Class 4A facilities will provide future hydraulic re-enforcement and reliability to the existing Dartmouth system by utilizing the Maritimes & Northeast Pipeline (M&NP) tap station as a second supply source for Heritage Gas. A second regulator station will also be constructed at the end point of the 12-inch steel pipeline on Joseph Zatzman Drive. This new regulator station will be located at the far north end of the Dartmouth service area and will enhance the existing Dartmouth polyethylene system by providing increased pressures for the distribution system and improve flow capacity to existing and future customers. It will also provide system reliability to customers should the current facilities at the Thornhill location be interrupted during an unforeseen equipment outage.

Heritage Gas will also consider using the Akerley-Burnside M&NP tap station to supply new customers in the Bedford area once sufficient customer commitment is obtained.

[Exhibit H-4(a), NSUARB IR-7, p. 1]

[46] Heritage's estimated costs for this system reinforcement is between "\$2.0 million to \$2.5 million".²

[47] Heritage had estimated that the new customers could use 4% of the capacity of the 4A facility and the system reinforcement could end up making it "possible for up to one-half of the Dartmouth system requirements to be served through these facilities in the future."³

[48] The *Gas Distribution Act* S.N.S. 1997, c.4, states under s. 22(3)

s. 22(3) In approving or fixing rates, tolls or charges, the Board shall give due regard to the following criteria and may give appropriate weight to each of them relative to the others:

...

(c) effectiveness in yielding total revenue requirements under the just and reasonable return standard;

The Board, for this particular issue, places the most weight on s. 22(3)(c). As such, the critical elements are the reasonableness of the costs and whether or not the facility is used and useful. A facility must include both of these attributes before it can be included in rate base.

[49] This does not mean that if an alternative use can be found for the 4A facility that will benefit present and future customers that this cost should not be included in rate base. The costs that could be included in the rate base will be those avoided costs that

²[Exhibit H-4(a), NSUARB IR-7, p. 2]

³[Exhibit H-4(a), NSUARB IR-6, p. 1]

would have been incurred by Heritage to meet the needs of its customers at an appropriate time. As has been stated by the Province:

The Province endorses the incremental inclusion approach suggested by Board Chair with respect to the Rate Class 4(A) assets as reasonable in the circumstances, and submits that the Rate Class 4(A) assets should be brought into rate base only as these assets become used and useful.

[Province Closing Submissions, p. 6]

[50] The Company was able to arrange a loan from the Province for \$7.6 million (“Provincial loan”), with no interest charges until certain criteria have been met, to help fund the expansion of the distribution network in certain areas of the franchise. The reason Heritage went to the Province for this loan was because NSPI was not a customer.

Heritage Gas expected revenue stream associated with the Rate Class 4A customer [NSPI] to commence in 2004. Without this revenue, Heritage Gas faced uncertainty in the face of building out its system to Cumberland County and the Town of Amherst. The loan provided financial assistance to continue to aggressively build infrastructure.

[Exhibit H-4(a), NSUARB IR-2, p. 1]

[51] Heritage attempted to show that there was a link between the Provincial loan and the 4A facility and that this linkage was a further reason to include the facility in rate base.

[52] The Board finds that even if there is a direct link between the Provincial loan and the 4A facility, it does not supplant the primary test as to whether or not the facility is, at this time, used and useful.

[53] Accordingly, the Board does not agree that the total costs of the 4A facility be added into rate base at this time. Upon application by Heritage, the Board will allow a portion of the costs of the 4A facility to be added to rate base. The portion to be allowed

is the cost of comparable, needed, facilities (avoided costs) that would have had to be constructed to meet the needs of customers. It should also be noted that this only applies to needed facilities, and not those that would be nice to have and hence could take advantage of the 4A facility.

[54] The Board has already approved Permit to Construct, NSUARB-NG-HG-PC-82(01), to utilize a portion of the 4A facility to supply customers on the majority of the streets noted above. The Board approves an amount, not to exceed \$250,000, of the 4A facility cost to be included in rate base. The Board understands that this amount is equivalent to the amount that Heritage would have had to pay to construct alternate facilities if it had not used portions of the 4A facility. In addition the Board also approves operating costs for inclusion in the rates, which Heritage would have incurred if separate facilities were constructed by Heritage without using the 4A facility.

4. Revenue Deficiency Account Recovery Period

[55] As a result of Heritage not meeting the revenue projections used in GTA-04 it will not be able to deplete the Revenue Deficiency Account (RDA) by 2009. Accordingly, using revenue assumptions based on current data, Heritage now projects increases in the RDA until 2011, with its full depletion by 2019 or 2020.

[56] In its application Heritage states:

Due to the slower than expected pace of development of the natural gas market, it is apparent the revenue deficiency account ("RDA") will not be fully recovered in 2008 and a longer period will be required. Heritage Gas is requesting that the Board approve an extension to the recovery period until such time as the RDA achieves a zero balance.

[Exhibit H-1, p. 2-2]

[57] Heritage believes this request is reasonable from two perspectives:

...First, extending the period during which Heritage will be able to accumulate contributions to the RDA is compatible with the dual objectives of building a market while continuing to have the opportunity to earn a fair return. Second, the requested extended period for the RDA is consistent with the regulatory precedents, albeit limited, for "greenfield" natural gas utilities in Canada.

[Exhibit H-1, p. 16-3]

[58] The need for an RDA was accepted in the 2004 Rate Decision. The reason was reiterated by Heritage as it stated that they are:

... a start-up utility and we need to find a way to put rates in front of customers cognizant of the fact that the limited customers that we have on the system today cannot absorb the full cost of the assets that are put in place. ...

[Transcript, p. 59]

and that the "...ultimate recovery of the RDA is apportioned over a larger base".⁴

[59] There were two regulatory precedents for a lengthy recovery period for the RDA cited in support of Heritage's argument. When asked if there were more than two precedents, Heritage responded:

A. Those are the two that we're most familiar with mainly because they're the most recent natural gas utilities that -- of any substance that exists in Canada. We are aware though of deferral accounts generally being available to both gas and electric companies and certainly as they evolved over the last, I don't know, 50 to 100 years so the concept has been in place except the situations that we're in we can't really go back that far and point to ones that are -- may be relevant to the situation that we're in.

Q. So it's a bit of a unique situation we have here?

A. Well, it is, you know, natural gas and electricity have been around for a very long period of time except natural gas in the -- in Nova Scotia has only been available for just over three years. Compared to 100 years most other places.

[Transcript, pp. 106-107]

⁴Transcript, p. 58

[60] The extension of the RDA recovery period was commented upon by Mr.

Whalen:

The RDA is essentially a rate stabilization mechanism. Such mechanisms are common in regulated utilities, particularly where some components of a utility's cost are beyond the control of the utility and are known to vary year to year. The RDA is a form of this, designed primarily to allow early year deficiencies to be deferred and recovered in later years. Such a device is necessary in the case of new, regulated businesses such as Heritage.

...

From an intergenerational equity perspective, it should be noted that the RDA continues to grow until 2011 and is fully recovered by 2019. The recovery period (eight years) is comparable to the period over which the RDA develops (seven years).

[Exhibit H-5, pp. 2-3]

[61] All regulated utilities are entitled to recoup their expenses and to have an opportunity to earn an approved return on their invested capital. A greenfield utility, such as Heritage, has the added burden of establishing a service where no such service has existed before. This requires the utility to heavily invest in plant and marketing in the beginning to attract customers. The difference between a mature utility and a greenfield utility is that a mature utility does not have to go through this initial phase again. Mature utilities (such as power, water and telecom in Nova Scotia) have already gone through their greenfield phase and are now just recovering their operating costs and an adequate return on their investment.

[62] In order to attract investment capital for greenfield utilities, any revenue shortfalls (where operating costs and return on invested capital are higher than revenue) are allowed to be added to an account called the RDA. The creation of an RDA recognizes that, in the beginning, a greenfield utility must invest a substantial amount in infrastructure with limited return from current customers. This investment in infrastructure will benefit

future customers as they are added to the system. To have the earlier customers pay for all the infrastructure and start-up costs to the benefit of future customers, who may not have to pay for these costs, maybe inequitable. The creation of the RDA permits an adequate return to the current investors while preserving intergenerational equity. It also allows the Company to charge competitive rates in the early years.

[63] The balancing act that must be performed by the regulator is to ensure that accumulations in the RDA occur for a reasonable period of time and that the expenditures that are incurred in this initial phase are appropriate and not extravagant. The RDA must then be recovered from future customer revenues over a period of time that is neither excessive nor potentially unobtainable.

[64] In the case of Heritage the original projections in GTA-04 were overly optimistic. The expectation was that the RDA would be completely discharged within the first five year test period. Now based on the projections presented in this rate hearing, the RDA will peak in the year 2011 and be completely depleted by the year 2019 or 2020. The accuracy of the assumptions used in projecting the revenue streams from new customer additions is critical to these target dates being met. This forms the basis for the monitoring requirement outlined in section 1 of this decision.

[65] The Board is aware that by disallowing the addition to rate base of the 4A facility, the RDA should peak in the year 2010 and be completely depleted by the year 2018.⁵

[⁵ Exhibit H-4(a), NSUARB IR-11, p. 2]

[66] On the other hand, the Board's denial of Heritage's request that certain operating expenses be capitalized on the formulaic basis as described in section 2, will probably lengthen the time required to completely deplete all of the RDA.

[67] The Board accepts the extension of the use of the RDA account as proposed. Because the Board, in this decision, has made changes to the assumptions used for the RDA projection it is now unsure as to when the peak and depletion dates may occur. Heritage, therefore, is directed to file with the Board revised projections to reflect the changes made in this decision.

5. Rate Increase

[68] Heritage is asking for rate certainty over the test period and requested an annual increase of 2½% across all rate classes for five years.

... This period of rate certainty will provide for the development of the franchise and will provide customers with a degree of delivery cost certainty that will help promote conversions. It is expected that natural gas will remain competitive with other fuels in the market and the rate increases will not negatively impact customer additions and revenues.

[Exhibit H-1, pp. 2-3]

[69] Heritage's rate application included a projection of operating costs, with explanations, for the five year test period. In essence the operating costs, before capitalization, remain almost constant over the full five years. Inflationary salary increases of 2½% and all other annual operating cost increases of 2% are mainly offset by the reduction in employee costs as out of province staff are replaced by local hires.

[70] The 2½% annual rate increase smooths out the relatively minor annual variations and reduces the amount that would be added to the RDA:

Q. I presume at a minimum you have to be confident that the 2.5 percent covers the normal increases or inflationary increases in your actual operating costs?

A. That's part of it. We have adjusted the -- the financial information that's in front of you has an escalator in there for operating costs as well.

Q. So, at a minimum it has to cover that?

A. That's correct.

[Transcript, p. 61]

[71] As to why 2½% was selected, instead of a higher or lower number, Heritage stated they wanted:

... to find a rate that could find balance between the competitive energy alternatives that exist in the marketplace, but one that could also temper the growth of the revenue deficiency account. So with that in mind, that's how we landed on the 2.5 percent ...

[Transcript, p. 29]

[72] Heritage expressed some concern about having a higher annual increase because it might not gain as many new customers, but no study was prepared on this issue:

...While no study has been done, we do have the experience that we've had over the last three years. We are conscious of the economic spread between natural gas and oil, and based on our limited experience to date and going back over a historical period of time we were confident that the 2.5 percent increase was reasonable.

[Transcript, p. 63]

[73] When Heritage was questioned as to whether they ever considered a higher increase, such as 3% or 4%, they responded:

... we ran a number of scenarios where we looked at higher and lower numbers and where we settled when we looked at it, again based on our limited experience and our limited customer base and information base, if you will, we were more comfortable settling on 2.5 percent than a higher number based on our experience to date.

[Transcript, p. 63]

[74] A higher annual rate increase would help to reduce the additions to the RDA and the time required to deplete the full amount. Heritage stated that:

We've grappled with the same issue and where we're at at this stage of our development, we were more comfortable and confident in a 2.5 percent increase than something higher.

[Transcript, p. 65]

[75] It appears to the Board that Heritage, using its own internal resources and information sources, has determined that a 2½% rate increase per year, for the next five years, is palatable to both the present and future customers of the Company. In order to accomplish this relatively minimal rate of increase, per year, Heritage has looked at other ways to retain its profitability and to minimize annual net operating expenses. This is accomplished through the extension of the capitalization of operating expenses and the extension of the life of the RDA. It has been suggested that the Company conduct a study to see what an appropriate rate increase should be, or whether it could be higher or lower. The Board is concerned with the time delay that would occur in performing this study and there is no assurance that such a study could determine a more accurate percentage increase.

[76] As has been stated in prior sections, the Board is concerned with continuing the capitalization of operating expenses. The Board is also concerned with the growth in the term of the RDA. This was reflected in the question by Board Counsel during the hearing: "...how does the Board feel assured that through the RDA and the capitalization of operating expenses a time bomb isn't being built..."⁶. In the absence of any evidence to the contrary, the Board, while having significant concerns, approves the annual rate increase of 2½%. To allay the Board's concerns, the Company's annual reports will be

⁶[Transcript, p. 58]

closely monitored. If it appears that the rate of increase of the RDA does not abate, or there are other adverse effects, then a new rate application will be ordered.

[77] The Board approves an annual rate increase of 2½% for each rate class for five years effective January 1, 2007. The rate schedules, as amended in Undertaking U-4, are approved.

6. Other Matters

6(a) Minor Variation in Community Test

[78] Heritage, in this rate application, had asked for a minor variation to its community feasibility test. As outlined in its final submission:

The proposed variation of the community feasibility test being sought by Heritage in this Application arises from the timing for the crossing from Dartmouth to Peninsula Halifax. In this instance, over the course of time, expansion to Peninsula Halifax will meet all elements of the community feasibility test. However, in the short term, the year one “trigger” will not be met.

[Heritage Post Hearing Submission, p. 40]

[79] Upon a request for clarification of what changes are required in the tests approved by the Board in the 2004 Rate Decision, it was discovered that the so called “trigger” is an internal test applied only by Heritage. The requested variation does not affect the Board approved two part feasibility test to extend the gas distribution system. Accordingly, the Board notes this variation but makes no ruling.

6(b) Extension of Rate Classes

[80] Heritage has requested that the present five classes, as approved in 2004, be continued.

[81] As stated by Mr. Whalen:

... Heritage has proposed that the current rate classes continue through the next test period. I agree with that. The current classes were established in GTA-04. It appears that they will be adequate to accommodate all customers expected to take service over the next five years. There is no evidence in this hearing to suggest that the current rate classes are inappropriate. In my view, there is no need to establish new rate classes.

[Exhibit H-5, p. 3]

[82] The Board accepts the continuation of the five rate classes.

6(c) Income Tax Flow Through Policy

[83] Heritage has been applying the following accounting policy for income taxes:

Income taxes are provided by the Company using the taxes payable method approved by the NSUARB. No future income taxes are recognized in the financial statements. The Company is rate-regulated enterprise and all future income taxes are expected to be recovered in the rates charged to customers in the future.

[Exhibit H-1, p. 14-8]

[84] This accounting policy is accepted by the Canadian Institute of Chartered Accountants (CICA) for regulated industries. This policy has been applied in Heritage's financial statements since 2004. The Board had not ruled on the application of this policy in the 2004 Rate Decision.

[85] The Board accepts the retroactive application of this accounting policy from 2004 and forward for Heritage's financial statements.

6(d) Allowance for Funds Used During Construction

[86] Heritage has been applying the following accounting policy for the allowance for funds used during construction (AFUDC):

The Company capitalizes an imputed carrying cost on assets under construction at a rate accepted by the NSUARB. This amount capitalized is disclosed on the income statement as

allowance for funds used during construction (AFUDC). AFUDC is the amount that a rate-regulated enterprise is allowed to earn to recover its cost of financing assets under construction. It is calculated at the Company's mid-month cost of construction work in process times the Company's cost of capital. AFUDC is included in the cost of the related assets and recovered in future periods through depreciation charges.

[Exhibit H-1, p. 14-9]

[87] This accounting policy is accepted by the CICA for regulated industries. This policy has been applied in Heritage's audited financial statements since 2004.

[88] The AFUDC in general, is the carrying cost of funds used to fund the work in progress until the asset is added to rate base. The value of the asset included in the rate base includes the amount of AFUDC. The corresponding amount is also included in the income statement as a credit. The Board is uncertain, based on the information provided in GTA-06, as to how Heritage has calculated the amount of AFUDC and its treatment in the income statement and rate base.

[89] The Board accepts the retroactive application of this accounting policy from 2004 and forward, but is not satisfied as to the procedures used for its implementation. The Board directs Heritage to file a copy of the procedures used to calculate AFUDC and how it is stated in the calculations of the test years' costs and revenues. The Board expects the Company to follow similar procedures as used by NSPI. This filing is to be provided to the Board on or before January 31, 2007.

6(e) Return on Rate Base Calculation

[90] The Board is unsure as to the procedures followed by Heritage in calculating its return on rate base. It is understood the calculation is made on a monthly basis, but the

details of this calculation and the transfer of assets from work in progress to used and useful are not known to the Board. Heritage is directed to file, for Board review, the procedures it uses for the calculation of the return on rate base. This filing is to be provided to the Board on or before January 31, 2007.

6(f) Municipal Taxes

[91] The Board in its 2004 Rate Decision approved the municipal taxes deferral account and stated that:

For purposes of future test periods, the Board intends to revisit whether it is necessary to include in the deferral, the first element of the tax calculated on the basis of customer usage.

[2004 NSUARB 72, para. 34]

[92] In its Post Hearing Submission of GTA-04, Heritage defined the composition of deferred municipal taxes as follows:

... There are two elements to the municipal taxation of local natural gas distribution companies in Nova Scotia. The first element of the tax which is calculated on the basis of customer usage is readily ascertainable. The second, however, relates to the municipal tax as set out in Schedule "D", Municipal Tax Riders, Rate B at page 229.2 of the Application as follows:

"ELIGIBILITY

Additions to be made to the rates of customers who are resident of municipalities who are eligible to receive a tax pursuant to applicable provincial legislation in place from time to time. All high pressure distribution pipeline assets and pressure reductions stations of the franchisee excluding those serving a single end-user, will be taxed pursuant to Section 3 of the agreement between Heritage Gas and the Union of Nova Scotia Municipalities (UNSM)."

Heritage considers it appropriate to have a deferral account for municipal taxes because of the uncertainty in forecasting the amount of revenues which will be generated by this component of the municipal tax. In addition, revenues will be generated on a monthly basis but will be paid to the municipalities within a set time frame, usually 30 days. Hence, there is a "timing issue" in respect of the receipt of the funds from customers and the distribution

of the funds to the municipalities. In particular, this timing inconsistency may extend from one calendar year to another which impacts on the reporting of these receipts on the financial statements of the company.

[2004 NSUARB 72, para. 33]

[93] The matter was again reviewed during the current hearing:

Q. Sorry. Take me back then to municipal taxes. Where do I find that?

A. Municipal taxes we did apply for and we are utilizing a municipal tax account which we will continue to utilize, and it relates to the collection of the -- there's two tolls right now, Rate Rider A and Rate Rider B, one is a simple 2 percent calculation off all of our delivery margin which is remitted to the different municipalities on an annual basis. So, there is a timing difference. The second is what we had a question on earlier. We proposed a 2 percent Rate Rider B which is based on the asset balance of certain assets and it also is to be recovered from the delivery margin, but given that it is subject to how successful we are on the revenue side to satisfy a known tax base, we do carry that balance on the -- the difference of that sits on the balance sheet.

Q. And I think there was a direction in that last decision that we would review the need to continue that municipal tax deferral account. Has that been looked at?

A. We certainly need to -- whether you need to include the first part in it, I would agree that there isn't really a need for that because it's sort of a wash, the timing difference, if you will. But the second certainly, I would suggest, needs to continue given that it is the -- we are funding that in advance of the actual collection from the customers at the present time.

Q. So, Step 1 of the deferral can come out?

A. I believe so, yes.

[Transcript, pp.162-164]

[94] The municipal taxes deferral account has two components, Rider A and Rider B. Rider A relates to the municipal taxes payable by Heritage which are calculated as 2% of the revenues from the delivery margin. Heritage collects these amounts and makes payments to different municipalities. Rider B is a tax on certain assets of Heritage as per an agreement between Heritage and the Union of Nova Scotia Municipalities.

[95] Heritage has in its Post-Hearing Submission agreed that Rider A calculated on the basis of customer usage should be removed from the municipal taxes deferral account.

[96] The Board has reviewed this request and approves the removal of Rider A from the deferred municipal taxes account.

6(g) Cross Subsidization

[97] The Board in its 2004 Rate Decision stated that it does not have the authority to regulate the sale of gas by Heritage or any other company. The Board did express concern with potential cross-subsidization between the sale of gas and gas distribution activities. The Board directed Heritage to file annual information on these two activities to ensure that costs relating to the sale of gas are not being allocated to the regulated gas delivery service.

[98] This matter was further explored with Heritage during the hearing:

Q. So my question is that is there no charges to the company on this here? Like, there's the purchases on the top, and there's no operating or administrative costs for the sale of the gas and purchase of the gas.

A. We have nominal expenses in terms of administering the purchase and sale of gas.

...

Q. It's not a significant, as you're saying that.

A. No.

Q. And you plan to do in the future, like, when it becomes significant, as you expand so much volume -- down the road.

A. I think that -- that's a good point. Once we -- as we grow and -- well, maybe I'll let Mr. Ritcey answer the -- answer the question.

Q. I guess I'd like to know ---

A. Mr. Dhillon, I think as we grow and probably move forward to more complicated supply terms than we have in place today, and certainly as our customer base grows, then that is a consideration. Obviously if it attracts more costs, then this would be the mechanism for it to recover it. I think as Mr. Smith pointed out, we have very small involvement in terms of support -- ongoing support for the negotiation and execution of the one supply contract that we have in place in the marketplace, which is -- has been renewed on an annual basis for each of the gas contract years over the past three years.

[Transcript, pp. 152-154]

[99] The Board has reviewed the evidence provided by Heritage and accepts that the cost of managing gas sales, at present, is minimal and not material. These costs in the future could become material. Hence, the Board orders that all costs related to the purchase and sale of gas should be properly segregated. In its annual filings with the Board, Heritage should reflect this costing information.

6(h) Weather Normalization of RDA

[100] Heritage has stated that the RDA is adjusted on an annual basis by the weather normalized actual under/over collection of the annual revenue requirement. In response to Undertaking U-1, Heritage stated:

While the company does perform a weather normalization calculation each month for the purposes of analyzing the impact of weather on revenue, it does not adjust the revenue deficiency accrual for the impact of weather. This is a contradiction of its stated policy and the policy approved by the NSUARB. It is also regrettably an error.

The annual weather normalization analysis for the years 2004 and 2005 are attached. In both years, the weather was warmer than normal. Weather reduced revenue by \$974 in 2004 and by \$44,205 in 2006. The RDA should have been reduced by the impact of weather in each year and therefore the present balance is overstated. As a result, the company will be making an adjustment to the RDA for the cumulative effect of the error. In addition, the impact of any 2006 error in treatment will be calculated and corrected as part of its year end procedures.

[Undertaking U-1, p. 1]

[101] The Board accepts this correction as has been determined by Heritage and

understands that there will be a monthly weather normalization adjustment in future determinations of the RDA.

6(i) Permit to Construct and Licence to Operate

[102] A protocol has been established and followed by both Heritage and the Board for the approval of Permits to Construct and Licences to Operate. This protocol covers all permits to construct transmission or distribution pipelines of over 50 metres in length, and all amendments to licences to operate for any section of any pipeline.

[103] This decision does not alter those established protocols and that all applications for such permits and licences will continue to be submitted to the Board.

6(j) Filings for Next Rate Hearing

[104] In this rate application, Heritage has not filed certain basic studies and analyses to support its requests. This was permitted in recognition that Heritage is a greenfield operation and that the results of updated studies will be no more accurate than those done for GTA-04. The advantage to Heritage (and ultimately the customers) is that costs are reduced in the start-up years.

[105] The disadvantage of not conducting such studies is that there maybe misallocations among different customer classes and inappropriate rate design that would be addressed by a cost of service study. One such potential deficiency was raised by Mr.

Whalen about the revenue/cost ratio (R/C) for the class 3 rate. His analysis concluded that:

The important comparison in this case is the comparison of each class R/C to the system average, since this gives an idea of whether the shortfall in revenue recovery is appropriately spread across all classes.

As the results indicate, Rates 1 and 2 R/C's are reasonably comparable to the system R/C, but Rate 3 R/C is significantly lower.

[Exhibit H-5, p. 7]

[106] In Mr. Whalen's evidence, he acknowledged that he had to make many assumptions in order to arrive at his conclusions. The historical data, because of the greenfield operation, was not sufficient for an accurate analysis. It was also noted that to date there are no class 3 customers taking gas delivery. Heritage has accepted the findings and will be cognizant of this matter when preparing its next rate application. Given that there are no customers in this class, no further action is required at this time.

[107] A cost of service study, along with a lead/lag study and a depreciation and amortization study, are the major components of a full rate application. It is anticipated that for the next rate hearing, all of these studies will be included in the application.

III Summary

[108] The Board approves the annual rate increase of 2½% effective every January 1 for the next five years commencing January 1, 2007.

[109] The Board approves the continuation of the five Rate Classes.

[110] The extension of the Revenue Deficiency Account (RDA) is approved. Heritage is directed to refile the projected RDA balances, and all the supporting schedules,

for the next fifteen years reflecting the various elements of the decision. This should be done before January 5, 2007.

[111] The Board approves the extension of some of the rates used to capitalize operating costs with the option to use GAAP at anytime.

[112] The Board does not approve the addition of all of the costs of the Rate Class 4A facility at this time. Upon application, however, the Board will allow a portion of the costs to be added as the facility becomes used and useful. The Board already has approved a Permit to Construct for some streets and approves an amount of \$250,000 of 4A facility costs to be included in rate base upon these facilities becoming operational.

[113] The Board approves the use of the accounting policies for Income Taxes and the Allowance for Funds Used During Construction.

[114] The Board approves the removal of Rider A from the deferred municipal taxes account.

[115] Heritage is to file information on its procedures on the calculation of the AFUDC and the Return on Rate Base by January 31, 2007.

[116] The Board directs certain reporting conditions on revenues and costings be met in the annual filings by Heritage.

[117] The tariffs and rates are approved as amended for the five year test period from January 1, 2007 to December 31, 2011.

[118] An Order will issue upon receipt and review of the information requested in paragraph 110 of this decision.

DATED at Halifax, Nova Scotia, this 21st day of December, 2006.

Peter W. Gurnham

Kulvinder S. Dhillon

Murray E. Doehler