DECISION

IN THE MATTER OF an application by New Brunswick Power Distribution and Customer Service Corporation for approval of changes in its Charges, Rates and Tolls

February 22 , 2008

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

IN THE MATTER OF an application by New Brunswick Power Distribution and Customer Service Corporation for approval of changes in its Charges, Rates and Tolls.

NEW BRUNSWICK ENERGY AND UTILITIES BOARD (“BOARD”):

CHAIRMAN:	Raymond Gorman, Q.C.
VICE-CHAIRMAN:	Cyril Johnston
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COUNSEL:	Ellen Desmond

APPLICANT:

New Brunswick Power Distribution and Customer Service Corporation (“DISCO”)	Terrance Morrison Edward Keyes

FORMAL INTERVENORS:

Canadian Manufacturers and Exporters, N. B. Division (“CME”)	Gerald Lawson
Conservation Council of New Brunswick (“CCNB”)	David Coon Scott Kidd
Enbridge Gas New Brunswick (“EGNB”)	David MacDougall
Irving Oil Limited (“IOL”)	Gordon Nettleton
JD Irving Pulp and Paper Group (“JDI”)	Wayne Wolfe
Utilities Municipal (“UM”)	Peter Zed Q.C.

Vibrant Communities Saint John (“VCSJ”)	Kurt Peacock
Self-represented	Dr. Kenneth Sollows
Public Intervenor	Daniel Thériault

Informal Intervenors:

Agricultural Alliance of New Brunswick

City of Miramichi

Department of Energy

Flakeboard Company Limited

New Brunswick Forest Products Association

New Brunswick System Operator (“NBSO”)

Terry MacDonald

Saint John Board of Trade

Times and Transcript

TABLE OF CONTENTS

INTRODUCTION........ 1
PRELIMINARY MOTIONS........ 2
REVENUE REQUIREMENT........ 8
PURCHASED POWER........ 8
Hydro Flow Adjustments........ 9
Belledune Waterwall........ 10
Hedging and Fuel Costs........ 13
Non-Utility Generators........ 16
Export Benefit........ 17
PDVSA Settlement........ 18
Cost of Purchased Power........ 20
TRANSMISSION........ 20
OPERATIONS, MAINTENANCE & ADMINISTRATION........ 20
AMORTIZATION........ 22
TAXES, Excluding Payments In Lieu of Income Tax........ 23
INTEREST........ 23
NET EARNINGS........ 24
PAYMENT IN LIEU OF INCOME TAX........ 25
TOTAL REVENUE REQUIREMENT........ 25
REBATES........ 25
LOAD FORECAST........ 27
COST ALLOCATION........ 27
REVENUE TO COST RATIOS........ 29
REVENUE REQUIREMENT FOR EACH CLASS........ 32
RATE DESIGN........ 32
RESIDENTIAL RATES........ 32
Service Charge........ 33
Energy Charges........ 34
Farms........ 36

GENERAL SERVICE RATES.......... 36
SMALL INDUSTRIAL RATES.......... 37
LARGE INDUSTRIAL RATES.......... 37
WHOLESALE RATES.......... 38
OTHER RATES.......... 38
OTHER MATTERS.......... 38
DEMAND SIDE MANAGEMENT.......... 38
AFFILIATE TRANSACTIONS.......... 39
STANDBY RATES.......... 40
DEFERRAL ACCOUNT – PDVSA SETTLEMENT.......... 40
APPENDIX A – REVENUE REQUIREMENT FOR 2007/2008.......... 46
APPENDIX B – REVIEW OF REVENUE REQUIREMENT & INTERIM RATE INCREASES.......... 47
APPENDIX C – REVENUE REQUIREMENT BY CUSTOMER CLASS.......... 48
APPENDIX D – ADJUSTMENT TO THE PDVSA SETTLEMENT BENEFITS.......... 49

INTRODUCTION

DISCO applied to the Board on April 19, 2007 for approval of a change to the charges, rates and tolls for its services. This application was made pursuant to Section 101 of the *Electricity Act,* Chapter E-4.6, (the "*Electricity Act*").

The Board's responsibility is to ensure that rates are just and reasonable. If, at the conclusion of the hearing, the Board is not satisfied that the rates proposed are just and reasonable, it must fix such other rates as are just and reasonable.

In determining what are just and reasonable rates, the Board must consider DISCO's revenue requirement for the year. The revenue requirement is the amount of revenue DISCO must have to cover its costs, including an appropriate level of net earnings and taxes. In this decision the Board will review DISCO's costs and determine its appropriate revenue requirement.

In addition to considering DISCO's revenue requirement, the Board may also consider other matters, including DISCO's accounting and financial policies, the proposed allocation of costs among customer classes and rate design matters. Parties put forward positions on each of these topics during the hearing and each will be discussed in this decision.

DISCO charges its customers different rates depending upon which class they belong to, such as Residential, General Service, Large Industrial, etc. An important consideration for the Board in this decision has been the revenue to cost ratios for the various customer classes.

DISCO divides its costs among the various customer classes according to a methodology approved by this Board on December 21, 2005. The purpose of this process is to allocate to each class the costs they cause. DISCO arrives at a total amount in dollars for the costs allocated to each class. To obtain a revenue to cost ratio, one then divides the amount of total revenue derived from the class by the costs allocated to the class. A class which has a cost allocation equal to the revenue it provides DISCO would have a revenue to cost ration of 1.00. A class

with a revenue to cost ratio higher than 1.00 is providing more income to DISCO than the costs it causes. A class with a ratio below 1.00 is providing less revenue than the costs it causes.

Partly because the allocation of costs is not an exact science, the Board held that a range of .95 to 1.05 was an appropriate target for the various classes, but several classes remain well outside the range. In this decision, the Board will move the classes at the extremes toward the target range.

PRELIMINARY MOTIONS

The application also included two motions. The first motion requested that the Board make an interim order pursuant to Section 40 of the Electricity Act approving a 9.6 percent increase to all electricity rate categories, except water heater rentals and connection fees where the increase would be 3 percent to be effective from the date of such interim order until further order of the Board.

A public hearing on this motion for interim rate relief occurred on May 31, 2007 at which time the Board heard argument as to whether the motion should be granted. After careful consideration, the Board ordered, in a decision dated June 1, 2007, that the interim rate changes as requested by DISCO would become effective on June 8, 2007 and remain in effect until a final order of the Board or until March 31, 2008 should no final decision be issued by that date. The main reasons for this decision were:

(a) The Board believed that interim decisions should be made in an expeditious manner on the basis of evidence that would often be insufficient for the purposes of the final decision;

(b) The Board considered that DISCO had made a "prima facie" case that its request was reasonable; and

(c) The fact that, if the final decision determined that the interim rates were too high, the Board would order DISCO to take the actions necessary to compensate for any over-collection of revenue but if it was determined that the interim rates were too low, DISCO would have no way to recover the lost revenue.

DISCO's second motion (the "second motion") requested:

> *"that the Board make a determination whether, during the course of the hearing of this application, it is appropriate to consider evidence as to the reasonableness of the generation and certain other costs which underlie the Applicant's revenue requirement for the test year (2007/2008)."*

The Public Intervenor, on May 23, 2007, filed the following motion:

> *"That the New Brunswick Energy and Utilities Board take jurisdiction over the Power Purchase Agreements (PPAs) and the Service Level Agreements (SLAs) that have been entered into by New Brunswick Power Distribution and Customer Service Corporation (DISCO)."*

JDI filed the following motion on June 4, 2007:

> *"That the New Brunswick Energy and Utilities Board order that the New Brunswick Distribution and Customer Service Corporation (DISCO) distribute at least quarterly, their financial statements. Such statements would be due no later than 30 days after the end of the selected period."*

A Motions day was held on June 21, 2007 to DISCO's second motion and the motions of the Public Intervenor and JDI.

These three motions arose as a result of the restructuring of the electricity industry in New Brunswick. This restructuring established DISCO as a separate legal entity responsible for distributing electricity to customers in New Brunswick. The restructuring also established a number of other separate legal entities to perform functions that had previously been done by one company, that being, New Brunswick Power Corporation. All of these new companies, except NBSO, are affiliated with DISCO. Of these new companies, DISCO, NBSO and the New Brunswick Transmission Corporation are subject to regulation by the Board pursuant to the Electricity Act. The Board does not regulate the New Brunswick Power Generation ("GENCO") or the New Brunswick Power Nuclear Corporations ("NUCLEARCO").

During the restructuring process, DISCO entered into various agreements, referred to as Power Purchase Agreements (PPAs) and Service Level Agreements (SLAs), to obtain services from a number of affiliated companies, the majority of which are not regulated by this Board. The costs associated with these agreements total approximately 80% of the costs that DISCO proposes to recover from its customers and therefore are a very important part of its proposed revenue requirement.

The Electricity Act places upon the Board the obligation to satisfy itself that DISCO's rates are just and reasonable but does not provide the Board with regulatory authority over GENCO or NUCLEARCO. The Board considered that it should enquire into DISCO's underlying costs in as detailed a manner as possible, without assuming regulatory authority over GENCO or NUCLEARCO. All parties recognized that GENCO and NUCLEARCO are separate legal entities and are not regulated.

The Board considered whether or not it should review the underlying costs of the PPAs and SLAs in its determination of whether DISCO's payments under those agreements are reasonable.

The Board heard submissions that, without a thorough examination of the underlying costs, it is difficult to determine the reasonableness of the costs that flow from the PPAs and SLAs. It was stated that while DISCO may legitimately do business with its affiliates, there should be transparency with respect to those transactions.

Transactions between affiliated companies, where one is a regulated monopoly supplier and others are unregulated, must be considered differently than transactions between companies that operate at arm's length. In order to protect the customers of the regulated monopoly, a regulator must be able to disallow recovery of costs by the monopoly if the regulator determines that the disallowed costs were not prudently incurred. To do otherwise would permit an affiliated company to earn unreasonable profits at the expense of the customers of the regulated company.

As a regulated utility, DISCO should demonstrate the reasonableness of any such costs. Section 125 (2) of the Electricity Act states:

> *"In an application regarding charges, rates, tolls or tariffs, the burden of proof is on the applicant."*

With respect to the PPAs and SLAs, the Board decided that DISCO must explain what it is doing to minimize the costs to it that flow as a result of its administration of these agreements. Further, DISCO must identify what it has done to determine that the costs that arise from the PPAs and SLAs are in fact its least cost option. In other words, DISCO must show that it cannot receive the same service from another supplier at lower cost.

The Board also stated that it is the responsibility of the other parties to examine the costs and the rationale provided in support of them as submitted by DISCO. If they consider that any such costs may be unreasonable they have an obligation to provide evidence that can be tested as part of the hearing process. As with any tribunal or quasi-judicial body, the Board must consider the evidence that is placed before it and should not rely entirely on submissions that are made without an evidentiary foundation.

The Board concluded that the costs associated with the PPAs and SLAs should be carefully examined in the public hearing process to consider DISCO's application for rates for 2007/2008.

The Board, however, did not consider it appropriate to conduct a review of the efficiency of GENCO's operations.

With respect to the JDI motion, the Board, after hearing argument, ordered DISCO to provide it with quarterly financial statements starting with the results for the April 1 - June 30, 2007 quarter. The first quarterly statement must be filed within 45 days of the date of this ruling and subsequent statements are to be filed within 45 days from the end of each successive quarter.

In a third motion filed with the Board on August 8, 2007, DISCO stated that the settlement of a lawsuit involving New Brunswick Power Holding Corporation and Petroleos De Venezuela, S.A

("PDVSA Settlement") will result in reduced fixed charges to New Brunswick Power Coleson Cove Corporation ("Coleson Cove"). The benefits of such reduced charges will be passed through to DISCO by way of reduced charges flowing to DISCO through the Coleson Cove Tolling Agreement ("Tolling Agreement"). DISCO proposed the establishment of a deferral account that would permit it to levelize, on an annual basis, the amount of the benefit that would be credited to the customers of DISCO. DISCO requested that the Board approve the following:

(a) the establishment of the Deferral Account;

(b) a reduction in the forecasted revenue requirement shortfall to $83.1 million from $112.3 million; and

(c) a reduction in the interim rate increase to 7.1 % for all those electricity rate categories whose rates had increased by 9.6% on June 8, 2007;

A public hearing was held on August 17, 2007 to hear argument from the parties. The Board carefully considered the evidence and those arguments and on August 23, 2007 issued a decision that ordered:

(a) the establishment of a deferral account with a term of 23 years;

(b) the benefits to be credited to customers over a period of 17 years starting with the 2007/2008 year in equal annual amounts (and not over 23 years as requested by DISCO).

(c) that the equal annual benefit to customers be set at $36.8 million.

(d) a reduction in DISCO's forecasted revenue requirement shortfall for 2007/2008 to $75.5 million from $112.3 million, $7.6 million less than requested by DISCO;

(e) a reduction in the interim rate increase to 6.4% for all those electricity rate categories whose rates had increased by 9.6% on June 8, 2007, which was 0.7% less of an increase than requested by DISCO. These new interim rates were to take effect on August 28, 2007 and to remain in effect until further order of the Board or March 31, 2008 should no final decision be issued by that date;

(f) that DISCO must apply to it for approval of any adjustment to the deferral account.

The hearing on DISCO's application began on November 26, 2007 and concluded on December 20, 2007 after 14 days of hearing. The witnesses who testified were:

Applicant:	David Hay
	Sharon MacFarlane
	Blair Kennedy
	Jeff Good
	Dr. James Sustman
	Angela Leaman
	Neil Larlee
	Kathleen McShane
	John Dobson
	Andrew Cook
	John Calabrese
CME:	Mark Drazen
EGNB:	Dave Charleson
Self-represented:	Dr. Kenneth Sollows
VCSJ:	Kurt Peacock
Public Intervenor:	Robert Knecht
	Kurt Strunk
	Dr. Lawrence Booth

The Board also held a public day on December 13, 2007 at which time the general public and the informal intervenors were given an opportunity to make public presentations. The following made presentations:

Real Poverty Incorporated	Bethany Thorne-Dykstra Lois Dunfield Glen Baldwin Harold Gladstone
Canadian Federation of Independent Business	Leanne Hachey Richard Dunn
Flakeboard Company Limited	Barry Gallant
Agriculture Alliance of New Brunswick	Robert Thériault
Jolly Farmer	Jonathan English
New Brunswick New Democratic Party	Patrick Hanratty
Communications, Energy and Paper Workers Union	Ervan Cronk

The Board thanks all participants, both formal and informal.

The Board has carefully considered all of the evidence and arguments presented in this proceeding. This decision first establishes the overall revenue requirement for DISCO for 2007/2008, then determines the revenue requirement for each customer class and the specific rates for each class and finally discusses certain other related matters.

REVENUE REQUIREMENT

The Board has established the total revenue requirement for DISCO for 2007/2008 by reviewing each major expense category and determining the appropriate amount to allow for each.

PURCHASED POWER

The PPAs stipulate the terms under which DISCO purchases the power necessary to serve its customers. The PPAs are contracts between DISCO and its affiliated power generation companies. Certain PPAs take into consideration contracts between GENCO and Non-Utility

Generators (NUGs) which are private companies that supply power to DISCO through GENCO. The costs arising from the PPAs represent the largest portion of DISCO's costs for 2007/2008.

The following amendments to the PPAs were the subject of review during the hearing:

(a) hydro flow adjustments;

(b) the Belledune Generating Station waterwall upgrade;

(c) hedging and fuel costs; and

(d) the PDVSA Settlement.

Any amendment to the PPAs requires the consent of DISCO and therefore the Board's concern is whether the amendment has an impact on the ratepayer and, if so, does it provide an appropriate and reasonable result.

The Board must be satisfied that DISCO has administered the PPAs prudently and has acted in the best interest of the ratepayer. If the Board is not satisfied that DISCO has negotiated an amendment in a fashion that protects the ratepayer, the revenue requirement will be adjusted accordingly. This is true, regardless of the specific contract language used in each instance.

With this in mind, the Board discusses each amendment below as part of its review of the elements of the PPAs and its determination of the appropriate cost for purchased power for 2007/2008.

Hydro Flow Adjustments

A forecast of 2654 GWh from hydro generation is used in the PPAs and is allocated on a monthly basis. When the actual monthly net energy from hydro generation is less than forecast, DISCO must make a payment to GENCO and conversely, when the actual monthly net energy production exceeds the forecast, GENCO must make a payment to DISCO. These payments are referred to as the hydro flow adjustment and do not affect the amount of DISCO's revenue requirement in any given year.

The PPAs were amended to change the methodology that is used to calculate the hydro flow adjustment. As a result of the amendment, the price used for the hydro flow adjustment is based on the most expensive capacity used to supply the in-province load.

DISCO stated that the change was done to correct an inequity in calculating the amount of the monthly hydro flow adjustment and was not detrimental to DISCO's customers because the risk of any intra-year benefit or loss is borne by its shareholder. The Public Intervenor took issue with this amendment. The Board notes that this change is a departure from previous practice but the evidence clearly shows that it has no impact on the rates for 2007/2008. The Board therefore finds that the method used by DISCO is appropriate for 2007/2008.

As a related matter, the Public Intervenor requested that DISCO be required to establish a deferral account in which to record the hydro flow adjustments. Although the hydro flow adjustments do not affect the amount of the revenue requirement, the Board believes that the establishment of a deferral account could be a good practice for DISCO. Use of a deferral account would insulate DISCO from variances in energy production related to hydro flow and could mitigate DISCO's financial risk.

Belledune Waterwall

DISCO agreed to the following amendment to the PPAs with respect to the upgrade of the boiler waterwall at the Belledune Generating Station.

> "*10.* <u>*Belledune Generating Station*</u>
> *Disco and Genco have agreed that Genco should proceed to upgrade the boiler waterwall at the Belledune Generating Station (the "**Belledune Boiler Upgrade**") and that Disco shall reimburse Genco for the costs and expenses incurred by Genco in connection with the Belledune Boiler Upgrade (collectively, the "**Belledune Boiler Upgrade Costs**") as follows...*

10.3 The Monthly Payment shall be adjusted as set forth in Schedule 7.2, provided that for the purposes of calculating such adjustment:

10.3.1 "Environmental Costs" shall be deemed to mean the Belledune Boiler Upgrade Costs;"

For the past 10 years, the Belledune plant has been burning a mixture of coal and petroleum coke (petcoke) in the boiler because petcoke is less expensive than the coal it replaces. The proportion has varied up to a maximum of 25% petcoke to 75% coal. During a recent boiler inspection it was noted that since the proportion of petcoke was set at 25%, significant tube wastage and tubewall thinning had occurred.

During the annual maintenance shutdown in 2007/2008, contractors repaired the thinned tubes and then welded a stainless steel overlay to all the waterwall tubes in order to make them more resistant to thinning due to corrosive attack by sulphur and allow the plant to continue to burn a mixture of 75% coal and 25% petcoke for the remainder of the life of the plant, that is, until October 2028. The total cost of this upgrade was $9.1 million and the impact of the amendment on ratepayers in 2007/2008 is an increase of $800,000 in the capacity payments that DISCO must make under the PPAs.

Exhibit A-53 stated that the higher sulphur content and slow burning rate associated with petcoke led to greater-than-expected corrosion on the waterwall.

In order to determine the appropriateness of recovering the increase in the capacity payment from customers the Board has considered the following four issues:

1. Whether the upgrade, if justified, could be classified as an "environmental cost" under the terms of the PPAs?
2. Whether the accelerated corrosion on the waterwall was solely the result of the burning of petcoke, or whether other factors may have contributed to the damage to the boiler?

3. Whether or not the repair to the Belledune boiler constituted a "refurbishment" under the terms of the PPAs?
4. Whether the fuel cost savings from burning petcoke justify the capital costs of the upgrade?

The PPAs provide a specific mechanism for GENCO to pass on costs to DISCO that are directly attributable to changes in the Environmental Law of New Brunswick, or Canada; provided that the costs incurred represent "the least cost method for addressing the change in Environmental Law".

The description of Environmental Costs is quite specific and requires that any capital charges passed on in this manner be mandated by changes to the Environmental Law. This is an exacting description. Based on the evidence, the Belledune Boiler Upgrade does not meet the criteria specified at Section 7.2.1.2. The Board finds that this was an inappropriate use of Section 7.2 and should have been dealt with by use of a more specific amendment.

If any of the degradation to the waterwall was related to a source other than the burning of petcoke, GENCO would be responsible for that portion of the repairs. However, based on a careful examination of the evidence, the Board finds that the accelerated degradation of the Belledune boiler was a consequence of burning petcoke in the boiler at up to 25% concentrations.

Under the terms of the PPAs, if the repair to the waterwall constituted a "refurbishment", the costs of the refurbishment would properly be classified as "generation costs" and would be the responsibility of GENCO.

Refurbishment is defined in the PPAs as:

> "…any refurbishment, construction or rehabilitation of or in respect of that Unit Generator that is required in order to enable that Unit Generator to continue to operate until its Estimated Shutdown Date…"

The Board finds that the Belledune Generating Station could have continued to operate to the end of its estimated service life, 2028, without the upgrade to the boiler waterwall so long as it did not use petcoke as a fuel. Therefore, the Board finds that the boiler waterwall repairs are not a "refurbishment" under the terms of the PPAs.

The continued burning of petcoke at higher percentages will generate several million dollars a year in fuel cost savings, over-and-above the amortization of the cost of repairing the boiler waterwall. These cost savings are being passed on to DISCO's customers. As the repair to the boiler waterwall was necessary in order to continue to burn petcoke and to achieve the fuel cost savings, the Board finds that the full cost of repairs to the boiler waterwall are an appropriate expense to be recovered from customers.

For the reasons stated above, the Board finds that DISCO acted prudently with respect to this expenditure and approves the cost of $800,000 associated with the Belledune Boiler Upgrade as a reasonable expense for 2007/2008.

Hedging and Fuel Costs

DISCO agreed to the following amendment to the PPAs:

"*For each fiscal year commencing on or after April 1, 2005, the Operating Committee shall determine the Fuel Component of the Vesting Energy Price by reference to the following modeling guidelines:*
7. All financial hedges will be included in the calculation of the Vesting Energy Price."

The Public Intervenor argued that the PPAs do not permit financial hedge costs to be passed on by GENCO to DISCO, except for the costs associated with financial hedges executed prior to October 1, 2004. This issue was examined at length at the hearing. The Board finds that this amendment to the PPAs simply confirms the way the hedging program has been operating in a consistent manner since 2000 and is a reasonable amendment.

There was also considerable debate on DISCO's policy of hedging its fuel and foreign exchange requirements. DISCO stated that fuel costs represented almost half of the increase in its purchased power expense ($45.3 million of the $100.9 million increase).

DISCO stated that its policy of hedging fuel and foreign exchange dated back to 2000 and pre-dated the restructuring of the New Brunswick Power Corporation. The primary objective is "to ensure the predictability of net income/cash flow." To that end, DISCO has adopted formal hedging criteria which include:

1. Fuel and foreign exchange exposures are hedged on a rolling one-month basis out for a term of eighteen months
2. Hedges are established on Oct 1st for 100% of forecast HFO and natural gas requirements for the next eighteen months
3. Hedges for the eighteenth month are added at 80% of forecast requirements. Hedges are increased or decreased as dictated by updated PROMOD runs.
4. Outstanding hedges are trued up to 100% prior to setting the Vesting Energy Price

DISCO applies a "mechanistic approach" to hedging, that is, it exercises its hedges at regular intervals, as dictated by its production modeling (PROMOD) software. These hedges are executed without regard to subjective influences as regards price, timing or the magnitude of the hedge positions. The hedge program serves a defensive objective of managing financial risk by setting fixed prices for fuel and foreign exchange. The hedge program is not undertaken for speculative purposes such as generating hedging profits. DISCO's contention that this approach to hedging represents an industry best practice, is supported by one of the conclusions from a report by RiskAdvisory entitled "NB Power Review of Commodity and Foreign Exchange Hedging Activity". The July 24, 2005 report stated:

> "*NB Power has achieved an industry best practice standard with respect to the continued application of its mechanistic hedge strategy, which has served to increase cash flow predictability and limit the upside exposure to rising commodity prices.*" (p. 3)

Several intervenors took issue with this hedging policy indicating that, in 2007/2008, DISCO's hedging of forward contracts (natural gas and heavy fuel oil) had generated "hedge losses" that totaled into the tens of millions of dollars.

Both the Public Intervenor and JDI recommended that the Board disallow over $40 million in "hedging losses" incurred by DISCO.

DISCO maintained that the "hedging losses" identified by the intervenors are better described as "accounting losses" as they represent a snapshot view of the applicant's hedged positions at a particular point in time. The "accounting loss or gain" is the difference between what DISCO paid for the hedges and what they could be sold for at a particular point in time. DISCO's position was that any such "accounting losses or gains" are irrelevant for the purpose of determining the revenue requirement for 2007/2008. This is because any gain or loss on the financial position is offset by a corresponding increase or decrease in the spot price of the underlying commodity. This ensures that the actual price that DISCO pays for the commodity is equal to the price used in the PPAs.

DISCO rigorously holds to its mechanistic approach. This is an appropriate way to manage risk. The Board finds that while DISCO's hedging policy may result in unrealized gains or losses at any point in time, such gains or losses do not affect the actual cost of procuring fuel for the purposes of establishing the revenue requirement for 2007/2008.

The Public Intervenor took exception to DISCO's practice of acquiring fuel contracts eighteen months in advance but provided no evidence on the advantages of a different time span. The Risk Advisory report stated that an 18-month hedge horizon is a very common hedging term among the North American energy utility community.

For the above reasons, the Board finds that DISCO's hedging policy is appropriate.

Non-Utility Generators

An additional concern in this hearing has been the NUG contracts. These contracts are between GENCO and the NUGs for the supply of capacity and energy in New Brunswick. DISCO is not a party to these agreements.

All of the energy arising from the NUG contracts is conveyed to DISCO under the PPAs. Some NUGs operate natural gas fired plants. The cost to DISCO for natural gas used by the NUGs is increasing by over $20 million in 2007/2008 over the cost for last year. This is a significant increase and various parties raised issues with respect to the NUGs.

The PPAs require that the fuel consumption for the NUG plants be estimated using the modeling assumption that the NUG plants are dispatched on a "must run" basis, without regard for their economic order. If the NUG plants were dispatched in accordance with the principles of economic merit, the fuel volume and costs estimates associated with these contracts might be reduced.

Mr. Strunk submitted that dispatching the NUG's energy as "must-run" units negatively impacts on the cost of operating the system because it forecloses the opportunity to replace the energy from the NUG contracts with lower cost energy from a purchase or from another GENCO unit.

Similarly, the UM submitted that these "take or pay" contracts result in higher costs being attributed to New Brunswick customers while lower capacity costs are available for the export market. This, in turn, results in export benefits which, appear to favor GENCO to the detriment of DISCO and ultimately to the detriment of the ratepayer.

Mr. Strunk submitted that over $11 million might be saved by re-negotiating a NUG contract but he did not have sufficient data to fully analyze the impact of moving this contract from "must run" to one of economic dispatch.

The Board will not reduce the revenue requirement by $11 million as requested by the Public Intervenor as there is insufficient evidence before the Board to disallow this expense.

The Board does however, accept the view that there has been a strong trend in the industry for utilities to move away from these "must run" contracts. While it is recognized that any savings arising from a re-negotiation of these contracts may have to be shared with the NUG that is party to the said contract, there might still be possible savings for the ratepayer.

In this case, and given that the cost of natural gas has impacted significantly on the revenue requirement, it is important that DISCO work with GENCO to pursue re-negotiation opportunities to determine if savings may be achieved. The Board expects DISCO to vigorously pursue this issue in the interests of its ratepayers.

Export Benefit

The amount of the Export Benefit for DISCO for 2007/2008 is identified in the PPAs as $69.6 million. This is based on an estimate of the benefits to be achieved by GENCO from export sales in 2007/2008. The forecast of $69.6 million was used by DISCO in determining its costs under the PPAs.

If the actual benefits to GENCO exceed the forecast by more than 20%, GENCO pays DISCO 50% of the excess. Conversely, if the actual benefits are more than 20% below the forecast, DISCO pays GENCO 50% of the shortfall. Payments by DISCO to GENCO or by GENCO to DISCO in 2007/2008 that are related to the export benefit do not affect DISCO's revenue requirement for 2007/2008.

UM stated that, designating the NUG capacity as must run for the in-province load, allows for lower cost capacity displaced by the NUG dispatch to be available to compete in the export market. UM said that this could result in greater export sales. UM stated that 100 percent of the benefits associated with the export of power from generation units whose fixed costs are recovered in rates to in-province customers should be applied to reduce rates to in-province customers.

During cross examination Ms. McFarlane made the following statement regarding export benefits:

> *"And as I say, the situation post restructuring was to emulate the situation before restructuring.*
>
> *GENCO is not buying the right to export. GENCO has a responsibility to export because it has in-province customers paying the entire cost of capacity for its fixed cost units. And it has a responsibility then to make the best use of those units and sell whenever it can into the export market and provide the benefit back to DISCO.*
>
> *Now as Mr. Kennedy pointed out earlier, it is not a direct pass through of the export benefits. Because there is an incentive built in there. It is a prescribed amount that changes every year. And there is a formula around it.*
>
> *But conceptually GENCO has the responsibility to in-province customers and to DISCO to export wherever it can. Because DISCO is paying the full capacity payment. And those benefits go back to the in-province customers." (Transcript p. 1195-6)*

The Board notes that the amount of the Export Benefit credit was set in the PPAs. The change requested by the UM would require an amendment to the PPAs. No evidence was offered to support such a change in the PPAs and, as noted above, the payments between DISCO and GENCO do not affect the revenue requirement for 2007/2008.

The Board therefore finds that $69.6 million is the appropriate amount of the export benefit to be used in calculating the purchased power expense for 2007/2008.

PDVSA Settlement

The Board's decision of August 23, 2007 ordered that the annual benefit to customers from the PDVSA Settlement be set at $36.8 million beginning with the 2007/2008 year. The decision

stated that the underlying assumptions would be fully examined during the public hearing process. The Board acknowledged that adjustments to the deferral account may be necessary as the actual value of the benefits becomes known. The Board also said that, since the benefits would be fully realized by 2009/2010, an adjustment could be made in that year, if necessary.

This approach was consistent with DISCO's evidence filed in support of its application for the deferral account. Page 3 of Exhibit A-13 discusses how the deferral account will operate and states:

> "*Until the settlement is fully realized, adjustments to the deferral account will be made as required to reflect actual results. Updated deferral calculations will be reflected in **future** revenue requirements.*" (*emphasis added*)

The concept that any adjustments to the deferral account would only take effect in future years is confirmed by the following comments that occurred on November 26, 2007 when DISCO requested approval to file new information with respect to the deferral account:

> Vice-Chair Johnston:
>
> "*And with respect to the changes to the deferral account, it is my reading of it, and I certainly stand to be corrected, and I would ask any of the parties to comment on this, that the changes to the vesting agreement – excuse me, the changes to the deferral account do not have an impact on the revenue requirement in the test year. It would appear from my reading, and again please correct me, anybody, if I'm wrong, that the proposed changes to the deferral account will maintain the status quo during the test year from what had previously been filed.*" (Transcript p. 972)
>
> Mr. Morrison:
>
> *"… in essence it consists of two fundamental changes in what was filed in August. The first is there is an adjustment to the value of the settlement, and secondly, there is a change in the interest calculation.*

And as Mr. Johnston just mentioned a moment ago, there is no impact on the rate request for 2007 and 2008. And I would submit that this is the very type of information which the Board ruled it would consider in the course of this full hearing." (Transcript p. 985)

The Board therefore affirms its order of August 23, 2007 and sets the benefits to customers from the PDVSA Settlement for 2007/2008 at $36.8 million.
The new information on the deferral account filed by DISCO in November 2007 involves certain adjustments to the deferral account. These adjustments and the amendment to the PPAs that involves the PDVSA Settlement will be discussed later in this decision as they do not affect the revenue requirement for 2007/2008.

Cost of Purchased Power

The only adjustment to the cost of purchased power for 2007/2008 is due to the benefit from the PDVSA Settlement and it reduces the cost as originally proposed by DISCO by $36.8 million.

The Board therefore approves an amount of $1,061.6 million for the cost of purchased power for 2007/2008.

TRANSMISSION

DISCO forecasts Transmission costs to be $65.9 million for the test year. No party challenged the forecast. Transmission costs are based upon the Board approved rates for the New Brunswick Power Transmission Corporation. The Board approves the cost of $65.9 million for 2007/2008.

OPERATIONS, MAINTENANCE & ADMINISTRATION

DISCO forecast its Operations, Maintenance and Administration (OM&A) expense for 2007/2008 to be $106 million. It categorized OM&A costs as either Direct OM&A, Inter-company, Shared Services or Corporate Services. Direct OM&A includes labour and benefits and accounts for more than 70 per of the forecast. Services from affiliates that are categorized as

either Inter-Company or Shared Services are provided for and billed under the Service Level Agreements (SLAs). Corporate Services allocates costs to the NB Power group of companies based on the percentage of total OM&A costs that is distributed among the operating companies.

DISCO stated that there was no serious challenge to the proposed OM&A costs. It noted that the SLAs entered into with affiliates are cost based and were for a 3.5 year term expiring on March 31, 2008. DISCO further stated that the SLAs maximize efficiencies and that if it did not use services from sister companies then it would have to hire additional staff.

The Public Intervenor expressed concern with costs arising from the SLAs and stated that DISCO should acquire services from affiliates through the Public Purchasing Act.

VCSJ questioned the role of DISCO's energy advisers and asked if that expenditure was generally classified as customer service operations. DISCO agreed with the classification and indicated that 6 energy advisors and a supervisor at an approximate cost to DISCO of $600,000 focus on serving its approximately 300,000 residential customers. DISCO agreed that one of the roles of the energy advisors is to promote the work of external agencies such as Efficiency New Brunswick.

During final submissions, VCSJ requested the Board to examine DISCO's revenue requirement with the aim of removing whatever expenditures that fail to meaningfully contribute to the provision of electricity at the lowest possible cost to the ratepayer and cited the staff expenditures related to the energy advisers program.

The *Energy Efficiency and Conservation Agency of New Brunswick Act*, Chapter E-9.15 establishes an energy efficiency agency whose objects and purposes are as follows:

> (*a*) to promote the efficient use of energy and the conservation of energy in all sectors of the Province,
> (*b*) to develop and deliver programs and initiatives in relation to energy efficiency and conservation,
> (*c*) to promote the development of an energy efficiency services industry,

(*d*) to act as the primary organization for the promotion of energy efficiency and conservation in the Province,

(*e*) to raise awareness among energy consumers of energy use and the associated economic and environmental consequences, and

(*f*) to carry out such other activities relating to energy efficiency and conservation as directed by the Lieutenant-Governor in Council.

The Board finds that it is the energy efficiency agency whose mandate it is to provide advice on energy use to the residential class. Although challenged on this issue, DISCO did not provide evidence that has convinced the Board that DISCO's energy advisors are not performing work that is properly the mandate of the energy efficiency agency.

The Board finds that DISCO's forecast expense for its energy advisers group is not prudent as the focus of their work is primarily a duplication of work done by the energy efficiency agency. The Board therefore disallows the cost of DISCO's energy advisors, an amount of $600,000. Taking this into account, the Board approves an amount of $105.4 million for OM&A for 2007/2008.

AMORTIZATION

For 2007/08, DISCO has included $41.9 million in the revenue requirement for amortization of capital assets. DISCO commissioned a study of its amortization policies and practices by Gannett Fleming, an independent expert. All of the recommendations made by Gannett Fleming were adopted and they accounted for all of the increase in amortization expense for 2007/2008 over 2006/07.

The Board has reviewed the changes and finds them to be appropriate. No interveners challenged any of the changes. The Board, therefore, approves an amount of $41.9 million for amortization expense for 2007/08.

TAXES, Excluding Payments in Lieu of Income Tax

The forecast for 2007/08 included an amount of $12.7 million for taxes, excluding payments in lieu of income taxes. This amount is made up of property taxes, utility taxes, right of way taxes and the provincial large corporation tax.

The Board has reviewed the calculation of these taxes and finds them to be in order. The taxes are statutory obligations of DISCO and there were no contrary positions put forth by any intervener. The Board therefore approves an amount of $12.7 million for 2007/2008 for taxes, excluding payments in lieu of income tax.

INTEREST

Interest expense for 2007/2008 is forecast to be $39.2 million. This includes interest on long-term and short-term debt, a debt portfolio management fee, miscellaneous other interest charges and adjustments for interest incurred on construction projects and the regulatory deferral account. The Board has reviewed DISCO's calculations of interest expense for 2007/2008 and finds that the amount has been properly calculated.

DISCO's outstanding long-term debt at March 31, 2007 was $531.3 million bearing interest at rates ranging from 4.25% to 7.50%. The debt is held by the Electric Finance Corporation (EFC) which charges DISCO a debt portfolio management fee. The fee is to recognize the value that DISCO receives for having access to debt capital markets utilizing the Province's credit rating. The fee is set annually by Order in Council and is .6489% for the test year which amounts to $3.6 million.

The Electricity Act clearly gives EFC the authority to levy the portfolio management fee on DISCO and, once levied, DISCO has an obligation to pay. This fee has been levied for 2007/2008 and the Board finds the debt portfolio management fee of $3.6 million to be a reasonable and prudent expense. The Board therefore approves an amount of $39.2 million as interest expense for 2007/2008.

NET EARNINGS

Net earnings before payments in lieu of income taxes (PILT) included in the revenue requirement for 2007/2008 is $9.8 million representing a pre-tax interest coverage ratio of 1.25 times. DISCO put forth argument that the company must achieve self-sufficiency in order to access the debt capital markets without a provincial guarantee. DISCO provided evidence that suggested a target net earnings figure providing a pre-tax interest coverage ratio of 1.75 times would permit, over a reasonable time frame, an accumulation of earnings consistent with a self-sufficient organization. They also recognized that a gradual approach to this target would alleviate rate shock to the consumer and proposed a 1.25 times ratio for the test year. They further cited that this ratio was consistent with previous Board rulings in 1991 and 2006.

Several intervenors agreed with DISCO's position indicating that it was prudent to allow DISCO to accumulate earnings and that the proposed amount for the test year was reasonable and conservative.

The Public Intervenor argued that DISCO is not a stand alone private utility and should be treated as a Crown Corporation. It was argued that the ratepayers should not have to provide funds in order to create the equity required in DISCO but rather the Province should make an equity injection. The Public Intervenor submitted, that since DISCO currently has no equity and that the shareholder has the right to remove earnings, DISCO should not be permitted to accumulate earnings. The Public Intervenor requested that the net income before payments in lieu of taxes of $9.8 million be disallowed.

The Board finds that it is prudent for DISCO to have net income and to accumulate earnings towards its stated goal of self-sufficiency. The Board believes that the best method for determining net income is applying an allowable rate of return to equity. This, however, is not possible as no equity injection has been made by the shareholder, and DISCO has only accumulated nominal retained earnings to this point. Consequently, the Board accepts DISCO's approach of using an interest coverage ratio to set income for the test year.

The Board considers that the recent history of electricity rate increases has had a significant impact on customers as will the increases approved in this decision. The Board finds that increasing the interest coverage ratio to 1.25 would not be appropriate at this time. The Board

will therefore maintain the interest coverage ratio at the currently approved level of 1.10. This reduces the amount of net earnings, before PILT, required for 2007/2008 to $3.9 million. After PILT, the net earnings is $2.5 million and the Board approves this amount for 2007/2008.

PAYMENTS IN LIEU OF INCOME TAX

DISCO is required to make payments in lieu of income taxes (PILT) to the EFC. For 2007/2008, DISCO has included an amount of $3.4 million for PILT in the revenue requirement.

Previously DISCO had not calculated PILT as required by Section 37 of the Electricity Act. The Electricity Act clearly indicated that PILT was to be calculated using the relevant Income Tax Act provisions for such calculations. DISCO simply applied the applicable tax rate to their calculated net income. DISCO used the same approach for this rate application. However, on December 20, 2007, Section 37 was amended so that DISCO's calculation of PILT is now in compliance with Section 37.

The amount of PILT is determined by the amount of net income. Consequently, the approved amount of PILT for 2007/2008, after giving consideration to the amendment to net income found in the preceding section, is $1.4 million.

TOTAL REVENUE REQUIREMENT

For the reasons provided above, the Board approves a total revenue requirement for 2007/2008 of $1,330.6 million. This results in a revenue shortfall of $69.0 million. Appendix A provides a table that shows the amount proposed by DISCO and the amount approved by the Board for each expense category.

REBATES

DISCO's original application requested an increase in total revenue of $112.3 million on an annualized basis. The amount of the increase was determined by comparing the total costs

estimated for 2007/2008 with the total revenues that would be provided at current rates.

Rates for all electricity rate categories, except water heater rental rates and connection fees, ("Customer Classes") were increased 9.6%, on an interim basis, by the Board, in its decision of June 1, 2007. The Board ordered DISCO to keep appropriate records in order to permit a rebate to customers should one be necessary.

DISCO filed a notice of motion on August 8, 2007 informing the Board of the PDVSA Settlement. The Board, in a decision dated August 23, 2007, ordered that the interim rate increases for the Customer Classes be reduced by 3.2%, from 9.6% to 6.4%.

As a result of the full public hearing, the Board has reduced DISCO's revenue requirement for 2007/2008 by $6.5 million. The original request for an increase in revenue of $112.3 million is thereby reduced to $105.8 million on an annual basis. The Board has determined that the benefit from the PDVSA Settlement in 2007/2008 is $36.8 million. This leaves $69.0 million, on an annualized basis of which $0.6 million is to come from water heater rental rates and connection fees. The balance of $68.4 million is 5.9% of the annual revenue from the Customer Classes. Appendix B provides a table that shows the above numbers.

The Board finds that a 5.9% average increase in the rates of the Customer Classes together with the PDVSA Settlement benefit and the increase in revenue from water heater rental rates and connection fees will provide DISCO with the full amount of its approved revenue requirement for 2007/2008, on an annualized basis. The Board therefore approves an average increase of 5.9% for the Customer Classes for the period June 8, 2007 to March 27, 2008 on a final basis.

During the period when the interim rates were in effect, all customers in the Customer Classes were paying the same average increases. These increases were in excess of the 5.9% approved by the Board on a final basis. Each customer in the Customer Classes is therefore entitled to a rebate. The rebate must reflect the fact that there were two different levels of rate increases during the period in question. For the period June 8, 2007 to August 27, 2007 the average increase for the Customer Classes was 9.6% and individual customers are entitled to a rebate of

3.7% (9.6% less 5.9%) of the amount they paid to DISCO during that period. For the period August 28, 2007 to March 27, 2008 the average increase for customers in the Customer Classes was reduced to 6.4% and individual customers are entitled to a rebate of 0.5% (6.4% less 5.9%) of the amount they paid to DISCO during that period.

For existing customers DISCO is to apply the rebate to the customer's bill beginning no later than the bills in May 2008. For parties who had been customers in the period June 8, 2007 to March 27, 2008 but who are no longer a customer, DISCO is to send the rebate to the customer at their forwarding address if one is available.

The Board approves the water heater rental rates and connection fees that were in effect during the interim period on a final basis and therefore no adjustments or rebates are required for those services.

This covers the treatment of rates during the period that interim rates were in effect. The Board will discuss the rates that will be in effect going forward from the interim period later in this decision.

LOAD FORECAST

DISCO's load forecast for 2007/2008 is a total of 14,876 GWh of energy for all of the various rate classes. A number of intervenors raised concerns with the forecast methodology used by DISCO. This forecast is based on the methodology approved by the Board's December 21, 2005 Cost Allocation and Rate Design Ruling and is the most current information available.

The Board finds that DISCO's load forecast is the most complete and best estimate for 2007/2008 and therefore approves it for use in determining the rates for 2007/2008.

COST ALLOCATION

The Board ruled on October 2, 2007 that it intended to accept the currently approved

methodology for use in allocating costs for 2007/2008. However, a number of parties raised cost allocation issues during the hearing and identified areas where they argued that DISCO's methodology was incorrect. The Board has reviewed each of these and considers that it is not necessary to make any adjustments to the cost allocation as filed by DISCO for 2007/2008.

On November 23rd, 2007 the CME filed a motion with the Board requesting:

> *"That the Energy and Utilities Board order that immediately following the hearing currently scheduled to be held from November 26 to approximately December 20, 2007, or as soon thereafter as the Board is able to deal with such matter, a hearing be held by the Board to review the issue of allocation of costs among customer classes."*

With the consent of all parties, this original motion was set over until final argument.

It should be noted that CME subsequently modified its original motion and requested that the Board order a conditional rate increase and that within six months, conduct a cost allocation and rate design hearing. If, following that hearing, there was no significant change in cost allocation, the conditional order would be permanent. If however, there were significant changes to cost allocation, the Board would have to decide what should be done as a result.

A conditional rate increase would be the worst possible outcome. Given the time required to retain experts and to have an interrogatory process, the conditional rate increase could continue for several months and as such, the revenue requirement for the test year could not be finalized.

The Board finds that a final determination as it relates to rates must be made at this time and as such, the request for a conditional rate increase is denied.

The Board, however, will deal with the merits of the original motion. Various positions were advanced by the intervenors during final submissions on December 19th and 20th, 2007.

The Board notes that various parties were concerned about the allocation of costs to the customer classes. An inappropriate allocation of costs can have a significant impact on revenue to cost ratios, rate design, and on the actual rates charged to the various customer classes.

Issues were raised as to whether the cost allocation methodology was appropriate and correctly applied. The Board's October 2, 2007 ruling dealt specifically with this issue and stated:

> *"The overall revenue requirement is allocated to the various customer classes based on a cost allocation methodology that was approved in a decision of June 19, 2006. There was some discussion on the methodology at the hearing on September 27' 2007 but no party suggested that a review of the methodology be done prior to the Board setting the rates for the 2007/2008 year. The Board intends to accept the currently approved method for use in allocating costs for 2007/2008."*

The Board believes that a cost allocation methodology review should be done in a separate proceeding outside of a general rate application. A review should be done at a time that offers the most value to the parties. The last review was completed in December of 2005 and less than 18 months had passed between the completion of that review and the filing of the current application. In light of these factors, the Board is not prepared to set a date for a hearing at this time.

However, prior to a public hearing on any future application by DISCO for a change in rates, the Board believes that a cost allocation methodology review should be completed.

REVENUE TO COST RATIOS

The principle, that customers should pay their fair share of the cost of the electricity they use, is well established and generally not disputed. The Board has stated that a reasonable range for

revenue to cost ratios is .95 to 1.05 and urged DISCO to move its rates so that all of the customer classes were within that band.

On the first day of the hearing Mr. Hay testified:

> *We agree entirely, everybody should pay a hundred cents for a hundred cents worth of electricity. There is no question about that. (Transcript p.1076)*

UM stated that the target for a revenue to cost ratio should be 1.00 and that the range of .95-1.05 should be used as a way to set priorities in adjusting rates. The Board concurs and believes that ideally rates would be set so as to have revenue to cost ratios for each of the classes at 1.00. The Board also believes that ratios outside the range of .95 to 1.05 are of special concern. Moving the ratios to 1.00 will result in rates that are fair and reasonable as that will mean that each customer class is paying its fair share of the overall costs.

As a general principle, the Board believes that rates should not be set in such a manner as to increase any existing cross-subsidization. This principle will guide the Board in making decisions regarding rates in this decision.

However, the Board notes that the current revenue to cost ratios have a wide disparity with some significantly above 1.00 and others significantly below 1.00. These ratios have developed over many years and the principle of avoiding rate shock means that they should not be moved to 1.00 too quickly. The Board has kept in mind these conflicting objectives of fair and reasonable rates and avoiding rate shock as it has made its decisions on the revenue requirements for each class.

Street lights, unmetered service, interruptible service, water heater rentals, connection fees, pole attachments and “other services” provided by DISCO were not the subject of debate at the hearing. The Board has reviewed the rate adjustments to these services as proposed by DISCO and finds that they are appropriate.

That leaves the Residential, General Service I, General Service II, Small Industrial, Large Industrial and Wholesale classes. After careful consideration the Board has found that it would be appropriate, for most of those classes, to have an average rate increase of 5.9%. The Board therefore orders an average rate increase of 5.9% for the Residential, General Service II, Small Industrial and Wholesale classes.

The remaining two classes have revenue to cost ratios that are the furthest from 1.00. The Board finds that it is appropriate to make a modest improvement in both of these revenue to cost ratios.

General Service rates are those rates paid by customers who do not qualify for the Residential or Industrial rate classes. Typically these are small businesses and institutions. The class is divided into two groups, General Service II (all-electric class) who use electricity for all their energy needs and those who do not are in General Service I. The revenue to cost ratio is lower in General Service II. The all-electric class was closed to new customers in July of 2006.

There was little discussion about rates for General Service I at the hearing. However, the revenue to cost ratio is significantly above 1.00 and has been for a long time. Also, it has been generally agreed that the revenue to cost ratios for the General Service I and General Service II classes should be brought closer together. DISCO proposed to increase rates for General Service I 5.3%, or 1.1% less than the system average. The Board does not consider DISCO's proposal sufficient and orders that the average increase for General Service I be reduced to 4.0%, which is 1.9% less than the system average. The Board finds that an average increase of 4.0% for General Service I will provide a modest improvement in the revenue to cost ratio for that class and also move its revenue to cost ratio closer that of the General Service II class.

DISCO proposed to increase rates for the Large Industrial class 7.4 per cent. This was one percent higher than the average increase proposed. DISCO stated that a greater than average increase is warranted as an effort to reduce subsidization to the class.

Both the Public Intervenor and UM argued that the increase should be greater and that the Large Industrial class must make greater strides to reduce the subsidization they currently receive. The

Public Intervenor put forward the recommendation that the Large Industrial class should have a rate increase equal to 1.5 times the system average.

CME stated that the cost allocation study is flawed and that the revenue to cost ratio is actually within the .95 to 1.00 band. CME recommended that the Large Industrial class receive no more than the system average increase. This was supported by JDI.

The Board considers that ideally there would be significant movement in the revenue to cost ratio for the Large Industrial class towards 1.00. This would be consistent with the objective of having the class pay its costs. However, the Board has taken into account the principle of gradualism and the avoidance of rate shock, where possible. Accordingly, the Board finds that a modest movement in the revenue to cost ratio towards 1.00 for the Large Industrial class is appropriate at this time. The Board therefore orders an average increase of 6.9% for the Large Industrial class.

REVENUE REQUIREMENT FOR EACH CUSTOMER CLASS

The Board has taken the average rate increases as ordered above and calculated the revenue requirement for each customer class. This information is provided in Appendix C.

RATE DESIGN

All of the rates approved by the Board in the following sections are to be effective as of March 28, 2008.

RESIDENTIAL RATES

The amount of annual revenue required from the Residential class is $534.3 million. Residential rates have two main components; a service charge and an energy charge.

Service Charge

The service charge is a fixed amount per month that does not vary with energy usage. It is intended to recover those costs to serve customers that are not related to energy. Prior to the application, the service charge was $19.16 for urban customers and $21.00 for rural and seasonal customers. On June 8, 2007, the service charges increased by 9.6 per cent to $20.99 and $23.01 respectively. On August 28, 2007 they were lowered to $20.39 and $22.34 respectively. DISCO recommended the service charges be set at the levels that existed before the interim adjustments, that is, $19.16 and $21.00.

DISCO's cost allocation study indicates that the average costs related to the service charge are $22.06. DISCO argued that it has been slowly increasing the service charge to match the costs indicated in its study, but that this was not an appropriate time for a further increase to the service charges. DISCO suggested that increasing the service charges would put an additional strain on low income households.

Dr. Sollows argued that the Board should either accept the figure produced by the cost allocation study or accept that the study is not accurate and choose any number the Board feels is appropriate.

VCSJ argued that the service charge is essentially a toll or tax on access to the province's electricity grid. VCSJ suggested that a high service charge has a greater impact per kilowatt-hour on low income and low volume electricity users than it does on customers with high energy consumption. VCSJ stated that had the service charge increased, in line with inflation since 1992, it would be $13.64 dollars.

Mr. Knecht stated that the service charge is dependent on the cost allocation study. He presented evidence that a re-allocation of some costs would result in a service charge of about $15. However, Mr. Knecht did not suggest lowering the service charge, because it would result in a larger increase in energy prices.

The Board notes that the revenue to cost ratio for the Residential class has been improving and that progress is being made on aligning the service charge with its underlying costs. The Board finds that the proposal by DISCO results in an appropriate balance of the revenue recovery as between the service charge and the energy charge.

The Board therefore approves service charges of $19.16 per month for residential urban customers and $21.00 per month for residential rural and seasonal customers.

Energy Charges

Prior to the interim adjustments, customers paid 9.04 cents per kilowatt-hour (KWh) for the first 1300 KWh per month and 7.16 cents per KWh for each KWh over 1300. This is a difference of 1.88 cents per KWh which equals a discount of 21 per cent. The second block is referred to as a declining block and results in lower average rates for those customers who use more electricity.

All parties involved in the hearing agreed that the declining block should be eliminated to ensure that customers are sent the proper price signal and pay their fair share of the costs.

In a December 21, 2005 ruling the Board made the following order:

> *"The Board agrees that the declining rate block should be eliminated as soon as possible. We are concerned over the possible rate shock that this might create for certain customers if the change occurs too quickly. The Board has analyzed the likely impacts and believes that it is appropriate to eliminate the declining rate block in three stages. Each stage should bring the declining rate block one-third of the way to the rate for the first block. The first adjustment should occur as part of the rate changes for the 2006/07 year. The remaining two adjustments can occur at the time of future general rate changes but the Board orders that the process must be completed within five years of this date."*

DISCO has proposed to decrease the current 21 per cent discount by 7 per cent, thus leaving a 14 per cent discount. DISCO has also committed to removing the declining block by December of 2010.

Mr. Larlee testified:

> *"Well I think ultimately it's subject to the ruling of this Board, but certainly under the existing ruling that this proposal was developed under, that is the plan, that there be a flat rate by 2010."(*Transcript p. 1754)

Certain intervenors argued that the PDVSA Settlement provides an opportunity to eliminate the declining block entirely at this time. CCNB recommended that the Board eliminate the declining block in order to send the proper price signals to consumers. EGNB supported elimination of the declining block as did VCSJ.

The Public Intervenor recommended the Board eliminate the declining block sooner than December 2010 but not at this time. The Public Intervenor requested the Board to order the removal of half the discount at this time and the full elimination of the discount by the start of April 2009.

The Board is concerned about the potential rate shock to those customers dependent on electricity for heating should the declining block be eliminated all at once. The Board, therefore, will not order the immediate elimination of the declining block in this decision.

However, the Board finds that some progress beyond that proposed by DISCO is appropriate and that the discount should be reduced by approximately 50%.

The Board therefore orders that the rate for the first 1300 KWh per month be set at 9.26 cents per KWh and the rate for any KWh per month in excess of 1300 be set at 8.37 cents per KWh.

The Board orders that the remaining declining block discount be eliminated by April 1, 2010.

Farms

Farms have been included in the residential class for many years. Some parties felt that farms may not be appropriately classified. DISCO has not proposed any changes to the classification of farms. DISCO argued any such change should only be done after more consultation and a hearing to deal with the matter.

The Board agrees that this matter should be dealt with as a separate proceeding where the appropriate input can be received from stakeholders.

The Board expects DISCO to submit a proposal on this matter prior to its next application for a rate increase.

GENERAL SERVICE RATES

The Board has approved a revenue requirement for General Service I of $113.9 million and for General Service II of $120.5 million. The Board therefore approves the following rates for these classes:

General Service I:

Service Charge ($/month)	19.16
Demand Charge:	
First 20 kW	no charge
Balance kW ($/kW)	8.84
Energy Charge (¢/kWh)	
First 5000 kWh	11.05
Balance kWh	7.84

General Service II:

Service Charge ($/month)	19.16

Demand Charge:	
First 20 kW	no charge
Balance kW:	
LESSOR OF: $/kW	5.43
OR $/kWh	0.02715
Energy Charge (¢/kWh)	
First 5000 kWh	11.05
Next 5000 kWh	8.43
Balance kWh	8.43

SMALL INDUSTRIAL RATES

The Board has ordered a revenue requirement of $45.2 million for the Small Industrial class and therefore approves the following rates for this class:

Demand Charge: All kW ($/kW)	5.81
Energy Charge (¢/kWh)	
1st 100 kWh/kW	11.21
Balance kWh	5.27

LARGE INDUSTRIAL RATES

The Board has ordered a revenue requirement for the Large Industrial class of $299.1 million and therefore approves the following rates for this class.

Demand Charge: All kW ($/kW)	11.850
Energy Charge: All kWh (¢/kWh)	4.35
Start-Up rate (¢/kWh)	6.57
Equivalent kVA rental ($/kVA)	1.20

WHOLESALE RATES

The Wholesale class consists of the municipal utilities. The Board has ordered a revenue requirement of $99.9 million for this class and therefore approves the following rates for the Wholesale class:

Long Term

Demand Charge: All kW ($/kW)	11.89
Energy Charge: All kWh (¢/kWh)	5.54

OTHER RATES

The Board has reviewed DISCO's proposed changes and finds them to be reasonable. The Board, therefore, approves the changes as proposed by DISCO for Street Lights, Unmetered, Water Heater Rental, Connection Charges and Pole Attachment Fee.

OTHER MATTERS

DEMAND SIDE MANAGEMENT

The CCNB stated that DISCO had failed to develop and implement a successful Demand Side Management (DSM) program and that this directly affected the load forecast. The CCNB argued that a 1% reduction in the residential forecast would be a reasonable target to achieve from a successful DSM program and could lead to lower costs for DISCO. CCNB urged the Board to reduce the revenue requirement by $6 million to reflect the savings that could have been obtained. There was insufficient evidence on this point and the Board will not order the requested reduction.

The Board recognizes that DSM is a strategy used by many utilities in an effort to reduce costs and manage load growth. The Board is also aware that many jurisdictions do not have an agency similar to the Energy Efficiency and Conservation Agency of New Brunswick ("the energy

efficiency agency"). The Board expects future load forecasts to reflect the effect of DSM initiatives.

The decision to disallow the costs of the energy advisors should not be taken to mean that the Board sees no role for DISCO in DSM. DSM measures such as load shedding, peak shifting and others may assist in reducing the overall cost of providing electricity and in meeting environmental standards. The Board's concern is to avoid a situation where both DISCO and the energy efficiency agency are doing the same work. Should DISCO propose DSM related expenditures in future rate applications it will be necessary to demonstrate that they are not duplicative of the mandate assigned to the energy efficiency agency and that they are beneficial to DISCO and its customers.

AFFILIATE TRANSACTIONS

A number of intervenors commented on the issue of affiliate transactions. DISCO has two basic types of affiliate transactions; one being the PPAs for the supply and cost of electricity and the second being SLAs for the provision of labour and specific services.

With respect to the PPAs, DISCO submitted that it follows the terms and conditions of these contracts, administers the agreements prudently and respects the process that has been developed for the sale and purchase of electricity. Similarly, with respect to the SLAs, DISCO stated that the contracts are cost-based and are intended to maximize efficiencies. If services were not shared between the various companies, DISCO would have to hire additional staff and would incur additional costs.

There has been no evidence in this proceeding to support the view that DISCO has been imprudent in the administration of these affiliate transactions. Nonetheless, contracts of this nature are of particular concern to regulators. This concern arises from the fact that the transactions are not between parties at "arms length" and, as a result, create an opportunity for costs to shift from the unregulated company to the regulated company, thus creating an extra burden on the ratepayer.

Given the very sensitive nature of affiliate transactions, many jurisdictions have developed rules or procedures that govern such contracts in order to ensure fair pricing for the consumer. These rules are also of value to the utility in allowing it to demonstrate the consistent interpretation and application of policies that are fair and transparent.

Given the value of having such guidelines in place, DISCO is directed to develop rules and policies in relation to the use and implementation of affiliate transactions, before the next rate review. The Board is of the view that these rules will provide assurance to all parties that such transactions will be fair and equitable in the future.

STANDBY RATES

EGNB asked the Board to order a hearing for the development of a Standby Rate for those larger customers that generate their own electricity. The rate would apply to customers willing to pay DISCO to supply electricity to them only in cases of emergency should their own supply fail. DISCO testified that the Interruptible/Surplus rate serves the same purpose.

The Board believes that discussion of a Standby Rate is a proper topic for consideration in a cost allocation and rate design hearing.

DEFERRAL ACCOUNT – PDVSA SETTLEMENT

The Board’s decision of August 23, 2007 approved the use of a deferral account by DISCO in connection with the PDVSA Settlement. Although, the use of a deferral account mechanism was not to be subject to further review at the full public hearing, the amounts that would flow into and out of the deferral account were only approved on a prima facie basis. The amounts used to establish the deferral account were based on estimates provided by DISCO and were not subject to a full review at the hearing in August. These amounts were to be subject to full examination in the fall. This is confirmed by the following exchange:

"MR. MORRISON: As a result of yesterday's confidentiality hearing and the outcome of that, Distribution Corporation recognizes that the Intervenors only yesterday received the details contained in the evidence filed with the Board in confidence. We appreciate the difficulty this poses to the parties with respect to scrutinizing the financial details. Distribution Corporation is therefore proposing a procedure to enable the Board to approve the deferral account and thereby facilitate the immediate realization of the benefits of the settlement for customers while at the same time ***preserving the ability of the Intervenors to question the actual amounts flowing into and out of the deferral account.*** *In this way benefits can begin to flow to customers immediately. And DISCO is not put at risk of under-recovering as a result of a reduction at this time in the interim rate. Therefore Distribution Corporation proposes to establish – proposes that the Board establish a deferral account to manage the timing differences between the amounts flowing to DISCO through the Coleson Cove tolling agreement on account of the PDVSA settlement and the benefits to be distributed to customers through reduction in the Revenue Requirement – over the term of the tolling agreement. …*

And we believe that ***by proceeding in this manner essentially on a prima facie basis*** *if you will that questions concerning the actual details of some of the financial details can be dealt with during the course of the full hearing into this matter in November, and in the intervening period the Intervenors can ask IRs with respect to the matters that are raised around the deferral account.*

CHAIRMAN: Just for clarification purposes then, what you are asking for is the approval of a deferral account for the remaining term of the tolling agreement. But the numbers that are plugged into that would be subject to scrutiny at the full hearing. Is that essentially what you are telling us this morning?

MR. MORRISON: That is correct." (Transcript pp. 510-12 emphasis added)

During the full public hearing, the use of a deferral account in connection with the PDVSA Settlement was not an issue. However, various parties did take issue with the amounts that would flow into and out of the deferral account. These parties submitted that significant changes should be approved by the Board.

DISCO, on November 20, 2007, filed new information concerning the deferral account. The new evidence contained refinements to the calculations and was accompanied by two reports from external auditors Deloitte & Touche commenting on the accounting treatment of the settlement and the result of specific testing procedures applied to the calculations. The adjustments identified by DISCO involved:

the calculation of the settlement value;

the calculation of the interest savings;

the interest rate assumptions;

the new freight price exposure;

the reduced heavy fuel oil exposure;

the deferral account – interest rate;

the deferral account – levelized benefit; and

the deferral account – application of interest costs.

These proposed adjustments were reviewed at the full public hearing and have been examined by the Board. The Board finds that the adjustments proposed by DISCO in its November 2007 evidence are reasonable and should be reflected in the deferral account, with one exception. The Board has not approved the proposed adjustment to the deferral account levelized benefit. The benefit for 2007/2008 remains at $36.8 million as discussed in this decision and as previously ordered by the Board.

Various intervenors raised an issue concerning how the PDVSA Settlement benefits should be shared between the customers of DISCO and the shareholder of DISCO. They argued that DISCO's proposed distribution of the benefits was not fair to its customers.

The total value of the PDVSA Settlement was calculated at $333.4 million and included both cash and an in-kind portion. DISCO proposed that its shareholder should receive $46.7 million from the settlement. The remaining amount of benefits, $286.7 million, would flow to DISCO

and ultimately to the benefit of DISCO's ratepayers. DISCO stated that this would compensate its shareholder for costs that it absorbed and that were never passed on to the customers. The $46.7 million would fully reimburse the shareholder for the costs that it incurred.

Many intervenors took issue with DISCO's proposed treatment of the $46.7 million. CME, JDI, UM and the Public Intervenor all argued that the ratepayers were not being fully compensated for the costs that had been incurred on their behalf and that it was inequitable for the shareholder to recover 100% of its cost, while the customers recovered less than 100%.

CME argued that the ultimate loss to the customers must be the value included in the lawsuit. They recommended that $7 million go to the shareholder and $40 million to the benefit of DISCO's customers. This benefit should be recognized over a short time frame (no more than 5 years). JDI supported the CME recommendation.

UM proposed that the $46.7 million be shared based on the actual Orimulsion™ costs incurred at Coleson Cove and concluded that if DISCO was unable to provide such specific cost information, then the $46.7 million should be split on a 50/50 basis.

The Public Intervenor took issue with an amendment to the PPAs, dated November 20, 2007, that allocated a portion of the benefits from the PDVSA Settlement to DISCO's shareholder. The original agreement allocated 100% of any damages received to DISCO and also required DISCO to pay all legal fees associated with the lawsuit. The revisions were made retroactive to the date of the settlement (August 2, 2007). The Public Intervenor argued that it was imprudent for DISCO to agree to modify the PPAs and that this was clearly a case of preferential dealing among affiliated companies. The Public Intervenor concluded that the original wording should govern the situation and that all of the benefits should go to DISCO and ultimately to the ratepayers.

The Board finds that it is appropriate that the PDVSA Settlement benefits be shared in a fair manner and that this can be accomplished by sharing the benefits in the same proportion as the costs. This requires the Board to determine the cost incurred, with respect to the use of Orimulsion, by each of the shareholder and the customers.

The Board finds, based on the evidence, that the cost incurred by the shareholder was $46.7 million.

Mr. Todd stated at page 3 of his report (Exhibit A - 14):

> *"The actual capital cost of the refurbishment ended up being $497 million higher than the original cost estimate for refurbishing the plant as an oil-fired facility that would meet only the minimum environmental standards."*

Ms. MacFarlane, under cross-examination by Dr. Sollows, confirmed that the capitalized cost of the Coleson Cove refurbishment did not include the $47 million related to the fuel delivery system. This $47 million cost was incurred by the shareholder. DISCO's customers are responsible for paying the capital costs of the Coleson Cove plant. The Board, therefore, finds that the costs incurred by the customers related to the use of Orimulsion were $497 million.

The $46.7 million cost incurred by the shareholder and the $497 million cost incurred by the customers gives a total cost related to the use of Orimulsion of $543.7 million. The benefits from the PDVSA Settlement are $333.4 million and this equals 61.3% of the total cost.

The Board therefore finds that each of the shareholder and the customers should receive 61.3% of the cost that they incurred, related to Orimulsion, from the PDVSA Settlement benefits.
The cost to the shareholder was $46.7 million and their share is therefore $28.6 million. The remaining benefits are to be credited to the customers. Appendix D summarizes these calculations.

The adjustments discussed above do not affect the revenue requirement for 2007/2008. However, they will affect the operation of the deferral account in future years. The Board therefore orders that DISCO recalculate the deferral account and file the results with the Board for its review and approval. This recalculation is to be based on the following:

1. The benefit to customers in 2007/2008 is to remain at $36.8 million as previously ordered by the Board.

2. The actual cash flows used to calculate the entries for the deferral account are to be based on:

    a. The amount of benefit to be credited to the shareholder from the PDVSA settlement is $28.6 million; and

    b. The adjustments to the following items, as proposed by DISCO in its November 2007 evidence:

        the calculation of the settlement value;

        the calculation of the interest savings;

        the interest rate assumptions;

        the new freight price exposure;

        the reduced heavy fuel oil exposure;

        the deferral account – interest rate; and

        the deferral account – application of interest costs.

The Board has not approved the proposed adjustment to the deferral account levelized benefit as contained in DISCO's November 2007 evidence. The benefit for 2007/2008 remains at $36.8 million as discussed in this decision and as previously ordered by the Board. The annual benefits for the years after 2007/2008 are to be in equal amounts for each year and to be calculated on the basis of the above order.

APPENDIX A

REVENUE REQUIREMENT for 2007/2008

	Proposed by DISCO	Approved by Board
Purchased power	$1,098.4	$1,061.6
Transmission	65.9	65.9
OM&A	106.0	105.4
Amortization	41.9	41.9
Taxes (excluding PILT)	12.7	12.7
Interest	39.2	39.2
Net earnings	6.4	2.5
PILT	3.4	1.4
TOTAL	$1,373.9	$1,330.6

APPENDIX B

REVIEW of 2007/2008 REVENUE REQUIREMENT & INTERIM RATES

	At Current Rates	Rate Increase	At New Rates	Increase in Revenue
Original Proposal by DISCO				
Revenue from "Customer Classes"	$1,165.1	9.6%	$1,276.8	$111.7
Revenue from Other Sources	96.5		97.1	0.6
TOTAL	$1,261.6		$1,373.9	$112.3

PDVSA Settlement provides $36.8 million benefit in 2007/2008

	At Current Rates	Rate Increase	At New Rates	Increase in Revenue
Revenue Requirement as Revised by the Board				
Revenue from "Customer Classes"	$1,165.1	6.4%	$1,240.0	$74.9
Revenue from Other Sources	96.5		97.1	0.6
TOTAL	$1,261.6		$1,337.1	$75.5

Board reduces revenue requirement for 2007/2008 by $6.5 million

	At Current Rates	Rate Increase	At New Rates	Increase in Revenue
Final Revenue Requirement as Approved by the Board				
Revenue from "Customer Classes"	$1,165.1	5.9%	$1,233.5	$68.4
Revenue from Other Sources	96.5		97.1	0.6
TOTAL	$1,261.6		$1,330.6	$69.0

APPENDIX C

REVENUE REQUIREMENT BY CUSTOMER CLASS

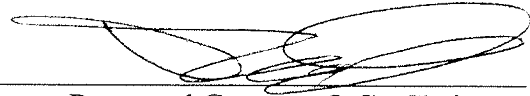
Customer Class	Revenue At Current	$ Increase	Revenue At Final	% Increase
Residential	504.5	29.8	534.3	5.9
GS I	109.5	4.4	113.9	4.0
GS II	113.8	6.7	120.5	5.9
S. Industrial	42.7	2.5	45.2	5.9
L. Industrial	279.8	19.3	299.1	6.9
Wholesale	94.3	5.6	99.9	5.9
Street Lights	19.1	0	19.1	0
Unmetered	1.4	0.1	1.5	7.2
Firm Energy Sub-total	1,165.1	68.4	1,233.5	5.9
Interruptible	59.2	0	59.2	0
Water Heater	15.6	0.5	16.1	3.0
Connection	2.7	0.1	2.8	3.0
Pole attach	2.1	0	2.1	0
Other	16.9	0	16.9	0
TOTAL	1,261.6	69.0	1,330.6	

APPENDIX D

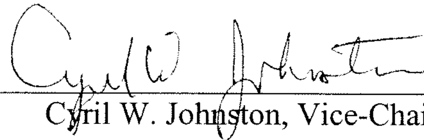
ADJUSTMENT to the PDVSA SETTLEMENT BENEFITS

Shareholder costs for Orimulsion	$46.7 million
Customer costs for Orimulsion	$497.0 million
Total costs for Orimulsion	$543.7 million
PDVSA Settlements benefits	$333.4 million
Ratio of benefits to costs	61.3%
Portion of benefits to shareholder	$28.6 million

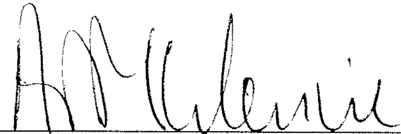
Dated at the City of Saint John, New Brunswick this 22nd Day of February, 2008.



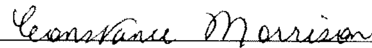
Raymond Gorman, Q.C., Chairman



Cyril W. Johnston, Vice-Chairman



Roger McKenzie, Member



Constance Morrison, Member

Yvon Normandeau, Member

Don Barnett, Member