# REPORT

IN THE MATTER OF an Investigation into the necessity for the 3% increase in the New Brunswick Power Distribution and Customer Service Corporation's charges rates and tolls which came into effect on April 1, 2009

**June 26, 2009**

NEW BRUNSWICK ENERGY AND UTILITIES BOARD

## MINISTER OF ENERGY'S DIRECTIVE

On February 27, 2009, the New Brunswick Power Distribution and Customer Service Corporation ("Disco") notified the New Brunswick Energy and Utilities Board ("the EUB") that Disco's Board of Directors had approved a three per cent rate increase, effective April 1, 2009. On that date all rate categories were increased by three per cent with the exception of the residential monthly service charges and the pole attachment fee, which remain unchanged.

The Electricity Act authorizes Disco to increase its rates without the approval of the EUB as long as the increase does not exceed the greater of three per cent or the percentage change in the average consumer price index. Since the increase did not exceed these parameters, Disco was not required to provide information to the EUB concerning the necessity for the increase.

The Minister of Energy ("the Minister") wrote the EUB on March 16, 2009, directing it, pursuant to subsection 24(1) of the Energy and Utilities Board Act, to investigate the necessity for the three per cent increase in Disco's charges, rates and tolls. The EUB has completed its investigation and its report follows.

## PROCESS

The EUB developed an investigation process that differs from that used for approval of a rate increase by Disco of greater than three per cent. The very nature of a rate hearing requires that an applicant's evidence be rigorously examined and tested and must allow for full public participation including evidence and is therefore a lengthier process. The timeframe for an investigation is shorter; the opportunity to submit written questions is reduced; and intervenors are not able to submit their own evidence. The investigation process was based on the need to provide a report to the Minister in a timely manner, the timing of related events and on the fact that the EUB has no authority to make any adjustment to the three per cent increase. An investigation process permits a reasonable review of Disco's information, but the degree of scrutiny is not as rigorous as that which occurs for a rate application.

The process used for the investigation included the following:

1. Disco was directed to file and make information available;
2. The public was invited to register and participate in the process;
3. Disco was directed to provide answers to written questions from registered participants and EUB staff;
4. A financial consultant was retained to examine certain specific items; and
5. A Public Hearing was held.

The panel for the public hearing component of this investigation consisted of five members of the EUB: Raymond Gorman, Chairman; Cyril Johnston, Vice-Chairman; and members Roger McKenzie, Constance Morrison and Robert Radford.

At the hearing on May 27, 2009, Darren Murphy, Vice President for Disco; Neil Larlee, Director of Energy Supply and Contract Management for Disco; and Lori Clark, Managing Director of Finance for the New Brunswick Power Holding Corporation testified on behalf of Disco.

The following “parties” registered and attended:

- J.D. Irving Pulp & Paper Group
- Gary Lawson
- N.B. Municipal Electric Utility Association
- Kurt Peacock
- Voice of Real Poverty

The EUB retained the services of Mr. Andrew Logan, CA, of Teed Saunders Doyle, as a financial consultant to review Disco’s forecasted Purchased Power Expense and the PDVSA Settlement Deferral Account. Mr. Logan’s review was conducted in accordance with the

Canadian Institute of Chartered Accountants Assurance Handbook. Details on the process used by Mr. Logan are described in his report.

Mr. Logan provided a report on his findings to the EUB on May 13, 2009. Copies were provided to Disco and the participants in advance of the hearing. Mr. Logan testified at the public hearing and provided an overview of his findings. No participant took issue with the report. A summary of Mr. Logan's conclusions and observations is provided in Appendix A. The full report is available on the EUB's website at www.nbeub.ca.

## CONCERNS EXPRESSED BY THE PARTIES

The EUB believes that concerns expressed by the registered parties, while not directly related to the investigation, would be beneficial for the Minister to review. The parties' complete comments can be found in the hearing transcripts at pages 147-154 for May 27 and pages 246-268 for May 28. The transcript is available on the EUB's website at www.nbeub.ca. A brief summary of those comments is presented below.

Concerns were expressed about the effect on the poor of any increase in residential electricity rates. The EUB was reminded that these ratepayers struggle to pay their bills at the best of times and that they do not have the financial ability to cope with increased costs.

It was noted that NB Power's no disconnect policy had been extended through the winter months until May. As a result certain customers were being disconnected starting in May after the no disconnect season ended. Parties raised concerns about how those customers would get re-connected.

Suggestions were made that the EUB's legislated authority over electricity rates should be changed. They stated that the EUB should be authorized to review the full operations of NB Power not just Disco's costs.

Certain Parties expressed concern with the corporate culture within NB Power. They emphasized that NB Power must take a more business-like approach in its response to the economic challenges that exist today.

One of the registered parties suggested that an office of a consumer advocate should be established to provide assistance to customers dealing with NB Power.

## BUDGET PROCESS

The budget process for Disco for 2009/2010 began in June 2008. The final budget was developed in October and forecasted a 2009/2010 loss for Disco of $93.9 million. This loss included the additional estimated revenue of approximately $36 million that would result from the three per cent increase in rates that took effect on April 1, 2009. Disco's Board of Directors approved the budget on December 12, 2009.

In preparing the budget, Disco made an assumption that the New Brunswick Gross Domestic Product ("GDP") would grow by 2.3% in 2009/2010. By December 2008, expectations concerning the Provincial economy had changed considerably and GDP was not expected to grow at all in 2009/2010. The change in the GDP assumption caused Disco to significantly lower its forecast of customer demand for 2009/2010.

Information concerning changes in customer demand was provided to Disco's Board of Directors prior to their approving the budget in December. Despite this reduction in demand the budget was not revised to reflect the significant change to the assumption about the GDP. Disco explained that no change was made to the budget because the reduction in customer demand did not result in a significant financial impact. Disco maintained that the reduction in revenues due to lower demand would largely be offset by a reduction in costs due to the fact that less energy would be needed to supply customers.

The EUB believes that the official budget should always contain the best estimates for each revenue and expense item, regardless of the impact on the net income (loss).

## DECISION TO IMPLEMENT THE THREE PER CENT INCREASE

The decision to increase Disco's rates by three per cent, effective April 1, 2009, was made at a meeting of its Board of Directors on February 4, 2009. At that time, Disco was aware that the Pt. Lepreau Generating Station (Pt. Lepreau) refurbishment project was several months behind schedule and that it might not return to service until March 2010. The timing of the return to service of Pt. Lepreau has a significant impact on the forecast of net earnings (loss) for 2009/2010.

The costs related to the refurbishment of Pt. Lepreau are not being charged to customers while the plant is out of service. These costs are being recorded by Disco in a deferral account. Once Pt. Lepreau returns to service these costs will be charged to customers spread over the remaining service life of Pt. Lepreau.

In preparing its budget, Disco assumed that Pt. Lepreau would return to service on October 1, 2009. As a result, the budget included charges related to Pt. Lepreau. Should Pt. Lepreau not to return to service in 2009/2010, actual costs would be reduced by approximately $20 million. This $20 million in costs would not be eliminated but would be deferred to future years. For further details on the calculation of the $20 million please refer to Appendix A.

Despite the forecasted delay in the completion of the Pt. Lepreau refurbishment and the resulting deferral of approximately $20 million in costs for 2009/2010, Disco still decided to increase its rates by three per cent. Disco explained that even if Pt. Lepreau were not to return to service in 2009/2010, the three per cent increase was still required given the very significant loss that was forecast for 2009/2010 in the approved budget.

Disco is required to provide information to Electric Finance Corporation both with respect to its budget and to any proposed increases to its rates. The EUB believes that a decision to increase rates should be made as close to the effective date of the increase as possible and based on the most current information available. Such an approach could reduce or possibly even eliminate the need for a potential increase if a favourable development were to occur near the time of the planned increase. If an unfavourable development were to occur potentially creating financial hardship, the legislation permits Disco to apply for approval of an interim rate increase if necessary.

## REVIEW OF THE 2009/2010 FORECAST

### *Fuel and Purchased Power*

Purchased Power expense for 2009/2010 was forecasted to be $1,194.7 million which represents approximately eighty-four per cent of Disco's total expenses. For the previous year this expense was estimated to be $975.6 million. The forecast for 2009/2010 is $219.1 million greater than for the previous year which is an increase of more than twenty-two per cent year over year.

Mr. Logan, who reviewed Disco's forecasted purchased power expense, made the following conclusion in his report:

> "Based on the review procedures conducted and the results obtained, nothing has come to our attention that would cause us to believe that DISCO's forecasted purchased power expense for the fiscal year ended March 31, 2010 is materially misstated. Further, the amount forecasted appears reasonable and plausible based on the results of our work."

Mr. Logan expressed an opinion that if Pt. Lepreau does not return to service in 2009/2010, there would be a reduction in costs of approximately $20 million. No party took issue with Mr. Logan's estimate of the cost savings. The EUB accepts all of Mr. Logan's conclusions concerning Disco's purchased power expense.

### *PDVSA Settlement Deferral Account*

Mr. Logan also reviewed the calculations associated with the PDVSA Settlement Deferral Account. The PDVSA account was created to ensure that the benefits from the settlement concerning the use of Orimulsion are properly shared with Disco's customers. With respect to the PDVSA account Mr. Logan concluded:

> "Our review of the PDVSA Settlement Deferral account indicated that all Board orders have been properly implemented. Our review produced no evidence that would indicate that the assumptions used and the methodologies implemented are not reasonable. We would conclude that the levelized benefit included in the forecast for 2009/10 is plausible in the circumstances."

*Operations, Maintenance and Administration ("OM&A")*

Disco categorizes OM&A as Direct OM&A, Inter-company, Shared Services and Corporate Services. During the public hearing various parties raised concerns with the increase in the OM&A budget. For 2009/2010, the OM&A budget forecasted an increase of $15.8 million over 2008/2009 and almost all categories within the Direct OM&A budget were forecast to increase for 2009/2010. The parties also expressed concern that Disco had exceeded its budget for Direct OM&A for the previous two years.

Questions were raised about the necessity to increase staff, the forecasted increase in wages and benefits, travel costs and the price estimates for gasoline and diesel fuel. Disco stated that it had carefully reviewed its forecast of expenses and maintained that the cost was necessary in order to be able to provide reliable, safe and environmentally responsible service.

For 2009/2010, Disco budgeted for an increase in wages and benefits, excluding overtime, of approximately 6.6% for its unionized employees and 6.5% for its non-unionized employees. Increases in wages include wage and merit increases and job reclassification. Disco's budget included an across the board wage increase of three per cent for its non-union staff that was granted in February of 2009. This occurred at a time when Disco was aware that the economy was suffering from what it described as a once in a lifetime downturn. Contract provisions for unionized employees also included a three per cent increase.

The investigation revealed that Disco's budget included an additional three per cent wage increase for its non-union staff effective February 2010. At the public hearing Disco stated that its Board of Directors had not provided any direction to management concerning compliance with the Provincial government directive on wage freezes. In light of the "once in a lifetime economic downturn" and the Government policy directive, ratepayers would have expected not just Disco, but all of the NB Power companies to follow the Provincial Government's lead.

Subsequent to the conclusion of the public hearing phase of this investigation, the EUB received confirmation that the wage freeze would apply to all employees of Disco. Its implementation would follow the manner of implementation throughout the rest of the civil service. It is noted that the wage freeze is subject to Disco's Board of Directors rescinding an earlier decision granting its employees a wage increase effective February 2010. The EUB is unaware of whether NB Power as a whole has adopted the Government's wage freeze policy. If it did then the cost reduction would be significant and most of the savings would be passed on to Disco to the benefit of its ratepayers.

*Other Expenses*

The EUB has reviewed the forecasts for transmission, amortization, taxes, interest and special payments in lieu of income taxes and finds those forecasts to be reasonable.

## CONCLUSION

The EUB has considered Disco's Information Package, Mr. Logan's report, Disco's responses to written questions and all of the comments made at the public hearing.

The EUB believes that the best forecast for 2009/2010 was the financial update that was provided to Disco's Board of Directors at their February 2009 meeting. That update reduced the forecasted loss for Disco to approximately $67 million. It included the effect of the three per cent increase in rates that occurred on April 1, 2009, a revised in-service date for Point Lepreau and a revised load forecast.

The EUB finds that the only possible further adjustment to the revised forecast would be from reductions to OM&A. There were questions raised by the intervenors and the EUB concerning the possibilities of reductions in expenses for OM&A. Despite the fact that there may be some savings on OM&A, the EUB does not believe it is reasonable to expect that such savings would eliminate the budgeted loss of $67 million.

The EUB therefore concludes that it was necessary for Disco to increase its charges, rates and tolls by three per cent on April 1, 2009

Dated at the City of Saint John, New Brunswick this 26th day of June 2009.

Raymond Gorman, Q.C., Chairman

Cyril W. Johnston, Vice-Chairman

Roger McKenzie, Member

Constance Morrison, Member

Robert Radford, Q.C., Member

## APPENDIX “A”

## Excerpts from Mr. Logan’s Report.

### 1. Forecasted Purchased Power Expense $1,194.7 Million

***Conclusion***

Appendix II details the individual components of the total forecasted purchased power expense of $1,194.7 million. Each component of this expense has been reviewed in the previous sections. Based on the review procedures conducted and the results obtained, nothing has come to our attention that would cause us to believe that DISCO’s forecasted purchased power expense for the fiscal year ended March 31, 2010 is materially misstated. Further, the amount forecasted appears reasonable and plausible based on the results of our work.

***Other Observations***

Perhaps the most critical assumption made in preparing these forecasts was the back-in-service date of October 1, 2009 for the PLGS. Preparation of the preliminary background information used to establish this forecast would have begun late in the summer of 2008 and at that time, the best estimate for completion was October 1, 2009. This assertion is not disputed. The process used to set annual operating budgets for the NB Power group is extensive and lengthy. We reviewed this process in our report from last year’s rate investigation. The process requires foundational assumptions to be set early in the process and the re-start date is certainly one of them.

We could not, however, complete our analysis without considering the potential impact of a postponement of the back in-service date. During the course of our review, we noted several areas which may be impacted if PLGS does not return to service on October 1, 2009. This is by no means a complete analysis of the impact of a delay, but rather ancillary observations made while conducting our review.

Amortization of PLGS Deferral Account

The current year forecast includes a charge of $3.7 million for the initial amortization of the deferral account. If the PLGS was not to re-start on October 1, 2009, this amount would be reduced accordingly and eliminated if the re-start date was after March 31, 2010.

Vesting Energy Charge

The contribution to fixed costs is calculated using the forecasted energy required from GENCO to service the in-province load to a maximum threshold of 12,000,000 MWh of energy. The current year forecast includes an estimate of 10,952,100 MWh however if PLGS does not restart as planned, additional supply will be required from GENCO. We note that in 2008/09, the maximum threshold was used in the calculation while PLGS was out of service for the entire fiscal year. Assuming a restart date after March 31, 2010, it would seem plausible that the threshold would once again be achieved. This would increase the contribution to fixed costs charge from GENCO to DISCO by $8.1 million (12,000,000 less 10,952,100 x $7.72/MWh).

Export Benefit Credit

The export benefit credit figure of $31.7 million assumes that load supplied from the re-started PLGS will allow for energy sales to third parties during the second half of the fiscal year. If PLGS fails to start production before March 31, 2010, approximately $16.0 million of the export benefit to DISCO could be in jeopardy. Unlike past years where this credit was predetermined by the Vesting PPA, the recent amendment now allows for an adjustment if the PLGS re-start date is missed.

Impact on Embedded Costs

The forecast includes a charge of $162.1 million for actual energy production from PLGS for the second half of the fiscal year. This amount, as discussed previously, is a product of the expected energy production of 2,540 GWh at a budgeted rate of $64.06, less a $600,000 credit for ancillary services. The forecast also includes a notional charge for PLGS of $86.1 million determined on an assumed production amount as if PLGS had been operating in the same condition as prior to the refurbishment. These costs, calculated under the NuclearCo PPA, are forecasted at $248.2 million.

If the plant does not restart before March 31, 2010, the notional amount of supplied energy would increase to 3,804 GWh[1] at the rate of $54.47/MWh increasing the embedded cost amount to $207.2 million. There would be no charge for actual production. The total costs calculated under the NuclearCo PPA would be decreased by $41.0 million.

This analysis is somewhat limited in that it does not consider the impact on the Vesting Energy Price due to a reduced capacity from PLGS for the entire fiscal year. Additionally, the incremental supply costs borne by GENCO would be added to the deferral account for future recovery from the rate payers. The delay, therefore, would not create an absolute savings, but a deferral of costs to future periods.

Summary

These potential impacts are summarized as follows:

| | Area Identified | Potential Impact (Assume PLGS in-service date after March 31, 2010) |
|---|---|---|
| 1 | Amortization of PLGS Refurbishment Deferral Account | ($3,700,000) |
| 2 | Vesting Energy Charge – Contribution to Fixed Costs | 8,100,000 |
| 3 | Export Benefit Credit | 16,000,000 |
| 4 | NuclearCo PPA – Impact on Embedded Costs | (41,000,000) |
| Total potential reduction of DISCO's PURCHASED POWER EXPENSE | | ($20,600,000) |

[1] See DISCO information package, April 30, 2009, Appendix B, Amendment No.3, Schedule A (describing new Schedule 6.2 to the Vesting PPA, Item 5)

## 2. PDVSA Settlement Deferral Account

### Conclusion

Our review of the PDVSA Settlement Deferral account indicated that all Board orders have been properly implemented. Our review produced no evidence that would indicate that the assumptions used and the methodologies implemented are not reasonable. We would conclude that the levelized benefit included in the forecast for 2009/10 is plausible in the circumstances."