

Centra Gas Manitoba Inc.

2019/20 General Rate Application

**Before the
Manitoba Public Utilities Board**

Evidence of Drazen Consulting Group, Inc.

on Behalf of Centra Gas Manitoba Inc.



DRAZEN CONSULTING GROUP
Energy & Regulatory Economics

**Project No. 181589
November, 2018**

Centra Gas Manitoba Inc.

2019/20 General Rate Application

Section I—Introduction and Overview

1 *Introduction*

2 **Q1 PLEASE STATE YOUR NAME AND BUSINESS ADDRESSES.**

3 A1 Mark Drazen, 225 S. Meramec Avenue, Suite 1033T, St. Louis, Missouri, USA, and 1405
4 Fairfield Road, Victoria, British Columbia, Canada.

5

6 **Q2 WHAT IS YOUR OCCUPATION?**

7 A2 I am a consultant in the field of public utility economics and regulation and a member of
8 Drazen Consulting Group, Inc.

9

10 **Q3 PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

11 A3 I have worked in this field since 1972 in rate cases, regulatory analysis, project planning
12 and negotiations throughout Canada (nine provinces and federal jurisdictions) and the
13 United States (41 states and federal jurisdictions). Our firm has been in this field since
14 1937. Clients have included utility customers, utilities and regulators. I have degrees in
15 mathematics and engineering from the Massachusetts Institute of Technology. Details
16 are given in **Appendix A.**

17

18 **Q4 ON WHOSE BEHALF ARE YOU SUBMITTING THIS EVIDENCE?**

19 A4 I am appearing on behalf of Centra Gas Manitoba Inc. (Centra).

20

21 **Q5 HAVE YOU REPRESENTED CENTRA PREVIOUSLY?**

22 A5 Yes. I prepared evidence on Centra's behalf in Centra's 2015/16 Cost of Gas Application
23 before the Public Utilities Board (PUB). I have worked for Centra in several TransCanada

1 Pipelines proceedings at the National Energy Board: RH-001-2016 (STS Modernization
2 and Standardization); RH-002-2017 (Herbert Long Term Fixed Price), RH-003-2017
3 (Dawn LTFP) and RH-001-2018 (2018-2020 Mainline Tolls).

4 5 **Overview**

6 **Q6 WHAT IS THE SUBJECT OF THIS EVIDENCE?**

7 A6 This evidence concerns the appropriate return on equity and level of net earnings for
8 Centra, both prospectively and retrospectively. This responds to comments and
9 concerns of the Board in previous cases:

10 *The Board notes that the current return on equity, based on the existing*
11 *approved formula, is not providing a fair return on equity. The Board had*
12 *previously established parameters for the formula including a range of 6% to*
13 *10% for the Government of Canada bonds yields. Current yields are well below*
14 *that level. The Board requests Centra to propose an update to the return on*
15 *equity that is reflective of an appropriate return in the current economic*
16 *climate. **The Board would like to ensure that an appropriate rate be used in***
17 ***the feasibility test and for the return on rate base determination.** (Order No.*
18 *85/13, pages 34-35, emphasis added)*

19
20 *The Board notes that Centra's total net income over the past three years on*
21 *a weather-normalized basis (meaning if the effects of weather are removed)*
22 *has been approximately \$9.5 million higher than what was approved by the*
23 *Board in the last General Rate Application. As such, the Board is not*
24 *finalizing the interim rates that Centra has been charging since that time and*
25 *will review them in the context of Centra's cost structure at the next General*
26 *Rate Application. (Order No. 108/15, page 4, emphasis added)*

27
28 *It should be noted that **the Board remains concerned that Centra may be***
29 ***over-earning income on a weather-normalized basis and Centra's total***
30 ***earnings may be in excess of what is required to assure the financial health***
31 ***of the utility.** However, this issue can be addressed by keeping the rates*
32 *previously approved on an interim basis in Order 89/13 as interim until the*
33 *next General Rate Application, at which time Centra's revenue requirement*
34 *can be thoroughly tested. (Order No. 108/15, page 17, emphasis added)*

35
36 *The Board notes Centra's improved financial strength since the last General*
37 *Rate Application, with a debt to equity ratio of 65:35 as of March 31, 2015. In*
38 *past Orders, the level of net income was established at \$3 million based on, in*
39 *part, Centra's capital strength being above the Board-established debt to*
40 *equity target of 70:30. Centra's improved financial position is due in part to*
41 *colder than normal weather experienced during the last three years, as well as*

1 *other financial factors that have not been reviewed since the 2013/14 General*
 2 *Rate Application. These changed financial circumstances have caused Centra*
 3 *to earn \$9.5 million more than what is currently allowed by the Board on a*
 4 *weather-normalized basis.*

5
 6 ***The Board is of the view that the non-gas cost revenue requirement which***
 7 ***gives rise to Centra's allowed net income needs to be reviewed in the***
 8 ***context of a General Rate Application. (Order No. 108/15, page 34, emphasis***
 9 ***added)***

10

11 **Q7 WHAT ARE THE MAIN POINTS IN THIS EVIDENCE?**

12 A7 They are:

13 **Setting the net earnings target**

- 14 • Crown utilities require an appropriate level of net earnings to finance necessary
 15 capital expenditures.
- 16 • Centra’s capital needs over the next decade average \$70 million a year,
 17 reflecting its growing business and related operational requirements.
- 18 • Since 2006, the PUB has included an annual net earnings target of \$3 million in
 19 the authorized total cost of service.
- 20 • As a result of Centra’s growing business, going forward, \$3 million in net
 21 earnings will not enable Centra to maintain the 70/30 debt/equity ratio that the
 22 PUB has found to be appropriate.
- 23 • For stability and regulatory efficiency, it is desirable to have a method for setting
 24 the net earnings target that can be applied over several years.
- 25 • Actual earnings inevitably vary with weather, but such variations average out
 26 over time.
- 27 • Based on comparable utility data and a goal of 30% equity, a reasonable and
 28 effective approach over the next 5-10 years is to base net earnings on a deemed
 29 30% equity ratio and a return on equity in the range of 8.3%-8.5%.

30
 31 **2013-2015 earnings**

- 32 • Standard practice in the industry is to look at long-term results, not short-term
 33 snapshots. “Normal” weather is usually defined as a 20-30-year average. This is
 34 particularly relevant for Centra given the highly variable weather in Manitoba.
- 35 • Although earnings in 2013-2015 were much higher than \$3 million, this result
 36 was largely the result of a single extremely cold winter.
- 37 • In other years, Centra’s earnings were much lower and, on a long-term basis,
 38 Centra’s average actual annual earnings have been close to the \$3 million target.

Section II–Net Earnings for Financing

1 **Q8 WHY ARE NET EARNINGS NECESSARY?**

2 A8 The need for earnings is driven in greatest part by the utility’s need to finance capital
 3 expenditures. Utilities are “capital-intensive” enterprises. They need to invest large
 4 sums annually in order to serve growth, to maintain facilities and to replace old
 5 facilities. That continual need for investment requires ongoing additional financing.
 6 Part of that financing must come from net earnings.

7 An investor-owned utility has three sources of additional capital: (1) retained
 8 earnings; (2) equity capital from selling stock; and (3) debt capital from selling bonds.¹
 9 To attract equity capital in the financial market, the utility must offer a return on equity
 10 that is competitive with returns from other comparable investments. A Crown
 11 corporation, on the other hand, cannot sell stock. It has only two sources of capital:
 12 debt and net earnings. Moreover, net earnings are needed not just to provide some of
 13 the funds, but also needed to support the creditworthiness of the utility’s debt. In other
 14 words, net earnings provide assurance to bondholders that there will be funds to pay
 15 interest and principal on time even if revenues drop and/or operating expenses
 16 increase.

17
 18 **Q9 HOW MUCH FINANCING DOES CENTRA NEED?**

19 A9 Centra’s capital requirements over the coming years are about \$70 million annually:

Table 1		
Centra Capital Requirements (\$Millions)		
	5 Years	10 Years
Property, plant & equipment	\$228	\$479
Intangible assets and other	63	123
Furnace replacement plan disposition	17	17
Repay maturing debt	<u>40</u>	<u>95</u>
Total	\$348	\$714

¹ Or borrowing through a parent corporation.

1 Some of the funds to finance these capital needs will come from depreciation expense
 2 recovered through customer rates, but most will have to come from additional debt and
 3 net earnings. As explained below, net earnings of \$3 million per year, which has been
 4 the authorized level for the last several years, will not be sufficient to finance the
 5 requisite portion of Centra’s future and growing capital requirements.

6
 7 **Q10 WHAT METHODS ARE USED TO DETERMINE THE AMOUNT OF NET EARNINGS NEEDED?**

8 A10 The most common is the “rate base/rate of return” (RB/ROR) method.² An alternative
 9 that Centra has used and the PUB has endorsed is the “cost of service” (COS) method.

10
 11 **Q11 HOW DO THESE METHODS DIFFER?**

12 A11 The RB/ROR method is more formulaic, whereas the COS approach relies more on
 13 judgment and is more flexible.

14 In the RB/ROR model, the utility calculates a “rate base” that comprises net
 15 plant, regulatory assets (e.g., deferred costs) and working capital. It then calculates a
 16 total “rate of return” which is the weighted cost of debt and “return on equity” (RoE).³
 17 This rate of return (or “cost of capital”) is multiplied by the rate base to determine gross
 18 operating income (i.e., income before interest charges). This method results in the RoE
 19 maintaining a relationship to the accumulated net earnings and, thereby, to the capital
 20 requirements.

21 The COS model, on the other hand, determines the net earnings by some other
 22 means. In the case of Centra, the PUB in the past set the net earnings target for
 23 2005/06 and 2006/07 based on pre-acquisition earnings. As time went on, this amount
 24 became less and less related to capital requirements. The \$3 million target remained the
 25 same for nearly 11 years while the equity (retained earnings) increased from \$27.4
 26 million at March 31, 2008 to \$75.6 million at March 31, 2018.

² Also called “return on rate base”.

³ There is, of course, room for judgment in the specification of capital structure (deemed versus actual) and in the methodology for determining return on equity.

1 Other cost components—operating expenses, depreciation and taxes—are treated
 2 much the same in both models.

3
 4 **Q12 CAN THE PUBLIC UTILITIES BOARD CONSIDER THE RESULTS OF BOTH METHODS?**

5 A12 Yes. Both methods can provide useful information. Ultimately, though, both methods
 6 should be applied in a way that maintains the utility’s financial health.

7 Other Crown and government-owned utilities (e.g., municipals) use the RB/ROR
 8 method and have been satisfied with the results. Using a percentage RoE provides a
 9 consistent method of calculating the dollar amount on an ongoing basis. It provides for
 10 growth in net earnings that should track the growth in net plant, thereby maintaining
 11 the debt/equity ratio.

12 Regarding the RB/ROR method, section 127 of *The Public Utilities Board Act* says:

13 *Determination of rates, tolls or charges*

14
 15 **127(1) The Board shall determine, from time to time, rates, tolls or other**
 16 **charges to be charged by a public utility or any person for selling, delivering,**
 17 **distributing, storing or transmitting gas within the Province, and in**
 18 **connection therewith shall determine, inter alia, the rate base and the rate**
 19 **of return on shareholder equity.**

20
 21 *Rate of return on shareholder equity*

22
 23 **127(2) In determining the rate of return on shareholder equity under**
 24 **subsection (1), the Board shall fix a rate of return that it determines to be in**
 25 **compliance with this Act. (emphasis added)**

26
 27 Of course, the essential issue is not the percentage RoE, but the overall results. In Order
 28 No. 135/05 the Board said:

29 *With respect to the level of net income allowed within revenue requirement,*
 30 *the regulatory test is not the rate of return on rate base but the net income*
 31 *deemed to be prudent for the utility’s financial health. (page 64)*

32
 33 The COS method has more flexibility to account for exceptional conditions, when
 34 the RB/ROR method may be too rigid in such circumstances. A Crown utility’s necessary

1 RoE is not tied to current market conditions, since it does not seek outside equity
 2 capital. If need be the regulator can consider other measures of financial health.⁴

3 Thus, the COS method can be used in tandem with the RB/ROR method. In any
 4 event, the RoE should be at a level that is: (1) within the range of general practice; and
 5 (2) meets the financial needs of Centra.
 6

7 **Q13 HOW DID YOU ANALYZE THE ISSUE?**

8 A13 I used a two-step process. The first step was to determine the equity returns that have
 9 been approved for other gas distributors and consider whether any adjustments—at
 10 least directionally—are appropriate to reflect differences from Centra. The second was
 11 to test the results of a range of RoE values over a ten-year forecast, to determine the
 12 level needed to keep the utility financially healthy.
 13

14 **Q14 WHAT RETURNS ON EQUITY HAVE BEEN DETERMINED BY OTHER REGULATORS?**

15 A14 Ranked in order of RoE, they are:

Table 2			
Authorized Return on Equity—Canadian Gas Distributors			
Utility	Province	RoE	Target Equity
SaskEnergy	SK	8.30%	37.0%
AltaGas Utilities	AB	8.50%	39.0%
ATCO Gas	AB	8.50%	37.0%
FortisBC Energy	BC	8.75%	38.5%
Gaz Métro	QC	8.90%	38.5%
Enbridge Gas Distribution	ON	9.00%	36.0%
Union Gas Limited	ON	9.00%	36.0%
Gazifère	QC	9.10%	40.0%
PNG Ft. St. John/Dawson Creek	BC	9.25%	41.0%
Pacific Northern Gas (PNG)	BC	9.50%	46.5%
PNG Tumbler Ridge	BC	9.50%	46.5%
Enbridge Gas New Brunswick	NB	10.90%	45.0%
Heritage Gas	NS	11.00%	45.0%
Sources: See Attachment 1.			

⁴For example, the RB/ROR method, as conventionally applied, may result in earnings too low to support financing of a large construction program. This was the case in the U.S. in the 1980s, when some electric utilities had very large nuclear construction programs. The earnings that would have resulted from the standard RB/ROR method were too low to issue debt under their bond indentures.

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Three things stand out in this listing:

- The only other distributor that is a Crown corporation is SaskEnergy, which has the lowest allowed return on equity.
- There is a fairly tight grouping of returns in the 8.5%-8.9% range for a diverse group of utilities. This can be interpreted as a similar outlook by several different regulators.
- All the distributors have target equity ratios higher than Centra’s 30%. A higher equity ratio implies a lower risk.

Q15 WHAT RISK FACTORS DO OTHER UTILITIES FACE THAT MIGHT IMPLY THAT THEY HAVE A HIGHER RISK THAN CENTRA?

A15 One is market competition. The highest returns are for Enbridge New Brunswick and Heritage Gas, both of which are relatively new distributors that face economic challenges. PNG was identified by the British Columbia Utilities Commission as requiring a higher risk premium than its low-risk benchmark.

A potential source of risk for an investor-owned utility is that the regulator will disallow some costs. That disallowance would fall onto the equity owners, thereby reducing their earnings. The situation is different for a Crown utility. Centra’s ultimate owners are the citizens of Manitoba, who are also its ratepayers. A disallowance after the fact, therefore, falls on the ratepayers as there is no private shareholder owner to penalize financially. In fact, the effect on ratepayers may be direct. Since a Crown utility’s earnings are needed to finance capital additions, an after-the-fact reduction in earnings (because of a disallowance) may have the effect of increasing the need for future earnings.

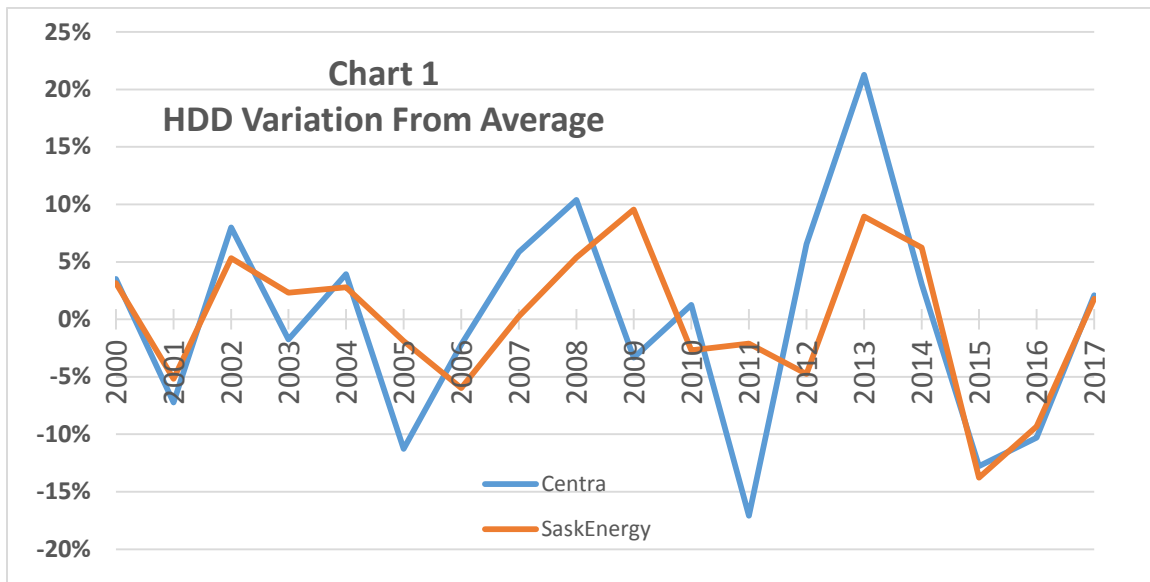
Q16 WHAT ARE THE SIMILARITIES AND DIFFERENCES IN RISK FACTORS AS BETWEEN CENTRA AND SASKENERGY?

1 A16 Like Centra, SaskEnergy is a Crown corporation. As such, it is the utility that is most
 2 similar to Centra and the two utilities should have the same risk with respect to
 3 potential disallowances.

4 Both Centra and SaskEnergy borrow money through their respective provinces.
 5 SaskEnergy is owned by Saskatchewan’s Crown Investments Corporation. It, too,
 6 benefits from lower cost borrowing. As such, SaskEnergy and Centra should have similar
 7 borrowing risk.

8 Centra has greater risk than SaskEnergy of variability in weather (as measured by
 9 heating degree-days) and has, as a result, greater variability in earnings risk. See Chart 1.

10



11

12 Finally, Centra has a weaker capital structure. SaskEnergy’s long-term target
 13 equity ratio is 37%-42% and its actual equity ratio at March 31, 2018 was 44%.⁵ Centra's
 14 target equity ratio, per the PUB’s decisions, is 30%.

15

16 **Q17 WHAT DO THESE DIFFERENCES IMPLY REGARDING THE RETURN ON EQUITY FOR**
 17 **CENTRA RELATIVE TO SASKENERGY?**

18 A17 Since Centra faces higher risk, it is logical for Centra to have a somewhat higher return
 19 on equity than SaskEnergy.

⁵ SaskEnergy 2017/18 Annual Report, page 34.

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Q18 HOW DID SASKENERGY DETERMINE ITS PROPOSED RETURN ON EQUITY?

A18 It used a similar procedure of aligning with the returns of other gas distributors. This has been its approach for several years. The report of the Saskatchewan Rate Review Panel in 2008 said:

*SaskEnergy originally targeted a Rate of Return on Equity (ROE) of 9% in its Application. **SaskEnergy stated that this rate of return is comparable with those granted by regulatory authorities to regulated utilities in other jurisdictions in Canada.***

* * *

In their report the Consultants note that during their review of the 2007 Delivery Rate Application a survey of rates of return granted to utilities in Canada in 2006 showed Rates of Return on Equity from 8.9% to 9.5%. The Consultants state that the findings in the survey are good indicators that the 9% forecast by SaskEnergy in the original application was reasonable, while noting that ROE is outside the Panel’s Terms of Reference.⁶ (emphasis added)

Most recently, in its September 28, 2018 Application for new rates, SaskEnergy explained:

*SaskEnergy requires an average increase of 3.7% beginning April 1, 2019. This increase is necessary to mitigate a revenue shortfall of \$10.0 million and that will provide an **8.3% return on equity (ROE)** and a net income of \$33.5 million over the application period. **This aligns with the industry comparable, regulated ROE target of 8.3% set by Crown Investments Corporation (CIC).** (page 2, PDF 4/70, emphasis added)⁷*

*The net income estimate of \$33.5 million for the application period, as provided in Schedule 4.6, reflects the level of earnings that will provide SaskEnergy with an appropriate return on investment as measured by the rate of return on equity. **The rate of return on equity is targeted at 8.3% for the application period. This level of return is comparable to industry average as evidenced in the recent rate of return levels allowed by the various regulatory authorities that provide regulatory oversight for natural gas utilities operating in other jurisdictions in Canada.** (page 29, PDF 31/70, emphasis added)*

⁶ Saskatchewan Rate Review Panel Report to the Minister of the Crown Investments Corporation of Saskatchewan, October 2, 2008, page 4, PDF 5/200.

http://www.saskratereview.ca/docs/Report_SkEnergy_Oct0708.pdf

⁷ <http://saskratereview.ca/docs/saskenergy2018/final-saskenergy-2018-commodity-and-delivery-rate-application.pdf>

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Q19 WHAT WAS THE NEXT STEP IN DETERMINING THE APPROPRIATE LEVEL OF EARNINGS FOR CENTRA?

A19 I then analyzed the impact on total cost and equity ratio over the next ten years of a range in RoE. This considered returns at three levels, 8.3%, 8.5% and 8.7%.

Q20 WHY DID YOU ANALYZE THE EFFECT OVER TEN YEARS IF THE APPLICATION COVERS ONLY TWO YEARS?

A20 The goal is to determine a basis for net earnings that is sustainable over several years. “Sustainable” means that the method can be applied in a consistent fashion and that the results meet the desired financial goals, both short-term and long-term. Looking at any one or two years does not necessarily give an accurate picture of costs over the longer term. For example, Centra has debt repayment obligations in 2020 and 2023 and plans the Furnace Replacement Program disposition post-2020. That makes cash requirements higher in those years. Analyzing results over a several-year period averages out such variations and gives a better picture of whether the RoE will meet Centra’s long-term future growing capital requirements.

In addition, a method that is projected to maintain the utility’s financial health over several years when applied consistently over a longer-term period promotes regulatory efficiency. That is, as long as conditions have not drastically changed, the PUB does not need to re-analyze the issue in depth in every rate case.⁸

⁸ This was the goal of many regulators, including the PUB, in establishing RoE formulas based on interest rates. That approach worked until interest rates declined to all-time lows.

1 **Q21 WHAT IS THE LEVEL OF NET EARNINGS AT THESE RETURN ON EQUITY LEVELS AS**
 2 **COMPARED TO THE \$3 MILLION AMOUNT THAT HAS BEEN USED UP TO NOW?**

3 A21 Net earnings would be (year ending March 31):

Table 3										
Net Earnings (\$Millions)										
Basis	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
8.3% RoE	\$5.6	\$5.8	\$5.7	\$6.0	\$6.7	\$7.2	\$7.4	\$8.6	\$8.4	\$9.1
8.5% RoE	6.0	6.2	6.3	6.5	7.2	7.7	7.9	9.4	9.2	9.9
8.7% RoE	6.4	6.7	6.7	7.0	7.9	8.3	8.5	10.0	9.8	10.7
\$3 million	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0	\$3.0

4
 5 To put this in context, the total distribution cost of service in 2019 is about \$150 million;
 6 in 2023 it is forecast to be about \$165 million (see Centra Appendix 3.1, page 1 of 5).
 7 Hence, the net earnings component with a RoE of 8.3%-8.7% is about 5% of the total
 8 distribution cost.

9

10 **Q22 WHAT WAS THE NEXT STEP IN YOUR ANALYSIS?**

11 A22 The next step was to check the impact on capital structure to see if the selected RoE
 12 levels satisfy the PUB’s 70/30 capital structure target.

13

14 **Q23 WHAT DOES THIS SHOW FOR CENTRA?**

15 A23 The equity ratio at March 31, 2018 was 31.7%. Forecast equity ratios are:

Table 4										
Equity Ratio										
Basis	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
8.3% RoE	31.9%	31.2%	30.3%	29.8%	29.7%	29.7%	29.7%	29.9%	30.1%	30.3%
8.5% RoE	31.9%	31.3%	30.5%	30.0%	30.0%	30.1%	30.2%	30.4%	30.6%	31.0%
8.7% RoE	32.0%	31.4%	30.7%	30.2%	30.3%	30.4%	30.6%	30.8%	31.2%	31.6%
\$3 million	31.7%	30.6%	29.4%	28.5%	28.0%	27.5%	27.1%	26.7%	26.3%	26.0%

16

17 Maintaining a 30% equity ratio requires a RoE slightly higher than 8.3%. Continuing to
 18 use a \$3 million target return would mean that the equity ratio will fall below 30% and

1 keep declining. This happens because \$3 million in net earnings is not enough to fund
 2 30% of cash requirements.

3 If net earnings are kept at \$3 million, Centra will require more debt, which has a
 4 cost. By 2023, Centra will require \$20 million more borrowing in the “\$3 million” case
 5 than in the “8.7% RoE” case. By 2028, the difference is \$50 million. Higher debt means
 6 higher finance cost and ultimately higher debt repayment cost.

7

8 **Q24 PLEASE SUMMARIZE YOUR ANALYSIS.**

9 A24 A review of natural gas distributors in Canada shows that the only other Crown
 10 corporation, SaskEnergy, uses a RoE of 8.3%. Centra has higher risk than SaskEnergy
 11 because of greater income variability and a lower equity ratio. Therefore, I analyzed the
 12 impact on Centra of RoEs of 8.3%, 8.5% and 8.7%. This showed that calculating Centra’s
 13 revenue requirement using a deemed⁹ 30% equity ratio and 8.5% RoE would meet its
 14 financial needs and result in overall distribution cost increases of about one percentage
 15 point higher than the current \$3 million earnings target.

⁹ “Deemed” means that the revenue requirement is calculated using a 70/30 capital structure, even if the actual capital structure is different than 70/30.

Section III–Analysis of 2013-2015 Earnings

1 **Q25 WHAT IS YOUR UNDERSTANDING OF THE PUB’S CONCERN IN ORDER NO. 108/15**
 2 **REGARDING EARNINGS DURING THE YEARS 2013 TO 2015?**

3 A25 The PUB said:

4 . . . [T]he Board remains concerned that Centra may be over-earning income
 5 on a weather-normalized basis and Centra’s total earnings may be in excess
 6 of what is required to assure the financial health of the utility.
 7

8 It appears that there are two issues here. One is retrospective: was Centra “over-
 9 earning” in the past? The other is prospective: whether “earnings may be in excess of
 10 what is required to assure the financial health of the utility”.
 11

12 **Q26 PLEASE COMMENT ON THE CONCERN THAT CENTRA WAS “OVER-EARNING” IN THE**
 13 **YEARS 2013-2015.**

14 A26 It is inevitable and expected that a gas utility’s income will fluctuate. As is the case with
 15 any gas distribution utility, earnings will vary depending primarily upon weather. In fact,
 16 Centra may be exposed to greater variability than many other utilities because of
 17 Manitoba’s weather and the high percentage of space heating load.¹⁰ Isolating the
 18 results for two or three years does not give an accurate picture.

Table 5
Net Earnings

<u>Year</u>	<u>Actual</u>	<u>Weather Normalized</u>
2002/03	(\$2.0)	(\$6.7)
2003/04	(7.9)	(6.8)
2004/05	(1.6)	(4.2)
2005/06	(5.4)	2.2
2006/07	1.1	2.2
2007/08	5.9	1.0
2008/09	8.6	1.4

¹⁰ 2014 was the coldest winter in the last couple of decades.

2009/10	(1.0)	1.9
2010/11	6.6	6.6
2011/12	(5.8)	7.2
2012/13	7.8	3.7
2013/14	19.8	5.3
2014/15	11.0	10.2
2015/16	(1.4)	9.3
2016/17	3.9	12.8
2017/18	6.8	6.2
Average 2003-2018	\$2.9	\$3.3

Colder than average
Warmer than average

1
2 Centra has had years with high earnings and years with losses, as shown in Table 5.
3 Looking at the long-term results shows that earnings over the period 2003-2018¹¹ have
4 averaged \$2.9 million actual and \$3.3 million normalized.
5 It is inevitable and expected that in some years a gas utility’s earnings will be less
6 than the amount included in the test year revenue requirement and in some years the
7 earnings will be more. Such variations do not mean that it is “under-earning” or “over-
8 earning” in any year. The important questions are whether the utility’s earnings over
9 time are adequate to maintain its financial health.

¹¹ Pre-2003 earnings reflected different accounting assumptions.

Section IV–Conclusions

1 **Q27 PLEASE SUMMARIZE YOUR RECOMMENDATIONS.**

2 A27 They are:

- 3 • For stability and regulatory efficiency, it is desirable to use a method of setting
4 RoE that can be applied on a consistent basis over several years.
- 5 • An earnings target of \$3 million annually will not be sufficient to meet Centra’s
6 growing future capital needs.
- 7 • A sustainable basis for net earnings reflecting Centra’s growing business
8 requirements is an 8.5% return on a deemed 30% equity ratio.
- 9 • Looking at earnings over short (2-3 year) periods does not give an accurate
10 picture of financial results.
- 11 • Centra’s actual net earnings have averaged about \$3 million over the long run,
12 and Centra’s equity ratio has been close to the 30% target equity ratio, so there
13 should be no concern about “over-earning”.

14

15 **Q28 DOES THAT CONCLUDE YOUR EVIDENCE?**

16 A28 Yes, it does.

Experience of Mark Drazen

Mr. Drazen has worked since 1972 on economic analysis of energy and utility service, pricing in regulated and deregulated utility markets, contract negotiations, and strategic planning throughout the United States and Canada. His experience covers electric, natural gas, oil pipeline, telecommunications, transportation, waste and water utilities in nine Canadian Provinces (Alberta, British Columbia, Manitoba, New Brunswick, Newfoundland and Labrador, Nova Scotia, Ontario, Québec and Saskatchewan) and in 41 states in the U.S. (Alabama, Alaska, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Massachusetts, Michigan, Minnesota, Missouri, Montana, New Jersey, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin and Wyoming).

He has appeared as an expert witness before courts, federal, provincial and state regulatory agencies (including the National Energy Board, the Canadian Radio-Television and Telecommunications Commission, the Federal Energy Regulatory Commission and the Federal Communications Commission).

Drazen Consulting Group offers economic, project planning, regulatory consulting and litigation support services to clients that include industrial utility users, municipalities, schools, hospitals, utilities and government agencies. The founding firm (Michael Drazen and Associates) was established in 1937.

The firm's work covers all aspects of utility regulation (and deregulation), including revenue requirements, cost of capital, cost analysis, pricing, valuation, performance-based regulation and industry restructuring.

Mr. Drazen is a graduate of the Massachusetts Institute of Technology, with the degrees of Bachelor of Science in Mathematics, Master of Science in Electrical Engineering, and Electrical Engineer.

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