SECTION 4.0

SEP Test Proposal

The economic justification of EGNB's capital expansion program has been a topic of discussion and review at the Board for a number of years. In the Matter of a Review of EGNB's Financial Results and Natural Gas Sales at December 31, 2009, a significant amount of time at the hearing was spent discussing potential methods to evaluate EGNB's system expansion spending. Although a number of approaches were examined, a portfolio approach based on a set of defined inputs was approved by the Board. Since the Decision dated May 16, 2011, the System Expansion Portfolio (SEP) Test has been used annually by the Board to evaluate the reasonableness of EGNB's system expansion activities.

> *"The Board directs that projected annualized revenue from expansion must exceed cost by at least two percent. The Board may alter this margin in future years. The Board will determine the prudence of expansion costs on this basis. This calculation for the prudence of expansion costs is to be included in the notes to the Regulatory Financial Statements."* (p. 15)

In the Decision to Matter 175 dated September 20, 2012, the Board ordered an adjustment to the test as follows:

> *"While the Board accepts that the system expansion test was passed in 2011, the Board finds that the percentage by which revenues must exceed costs should be increased from two percent to four percent in future years. The system expansion test will be modified accordingly.*
>
> *The Board will continue to monitor this issue to determine what additional changes may be necessary in the future."* (p. 6)

The SEP Test has been used as the primary test without significant modifications. EGNB passed the test each year until 2016.

As the test calculates a ratio based on the actual capital spent on an annual basis by EGNB to expand its gas distribution system and the forecasted annualized revenues for the attached customers in the same calendar year according to the specific set of criteria and inputs, the timing of when the connected customers initiate gas service becomes a critical factor that determines the outcome of the test. When EGNB evaluates the feasibility of an individual project on its own merits, timing within the calendar year cannot always be managed.

When a large capital project is undertaken by EGNB in a calendar year and is simply energized for a single small customer or for the supply of construction heat instead of for the anchor load that justified the original decision to proceed with the project, an imbalance in the SEP Test results will occur as the impact of the large capital costs are not properly matched with the revenue from the anchor load originally anticipated. When EGNB evaluates the underlying economics of an individual project, it evaluates all the incremental costs and revenues to be generated by the new customers who will be attached. EGNB then makes the decision whether to proceed, request from the customer a contribution in aid of construction, or decline the customer connection request. Although customer attachment timing is a consideration, EGNB's economic justification for a system expansion project is primarily determined by using all the costs of a project and all revenues from customers reasonably anticipated to initiate gas service (including contractually signed customers) at the time the project is evaluated. All other customers attached after the project is undertaken are considered "bonus" customers, which adds real economic value to the project and to all customers served from EGNB's gas distribution system.

In the Decision to Matter 371 dated December 13, 2017, the Board stated:

> *"If EGNB wishes to propose modifications to the Board's method of evaluating the prudence of expansion projects, it should file a proposal in a future application."* (p. 4)

As a result of these potential timing issues, EGNB is proposing a modification to the SEP Test. As the SEP Test has been vetted and examined in detail for many years, EGNB does not want to abandon the test altogether as the calculations and inputs are clearly understood. It simply believes that a modification is in order to allow for timing issues.

EGNB proposes to continue using the current SEP Test with one change - using a 3-year rolling average of incremental capital costs and revenues associated with its system expansion activities during each 3-year period. Each year, EGNB would prepare the annual SEP Test as is typically calculated with the usual cost and revenue inputs. EGNB would also provide a 3-year average computation for the latest 3-year period. If the SEP Test results based on the 3-year average was at or above the 1.04 level, the Board would accept EGNB's capital investment for system expansion purposes for the most recent year as being reasonable and economically justified. This approach would maintain the integrity of the existing SEP Test and would accommodate and minimize the negative impact of the mismatch between the incremental capital costs and revenues associated with EGNB's system expansion activities created by the time lag in initiating gas service to its newly connected customers. Better matching of revenues to costs is a sound accounting and economic principle as agreed by Mr. Robert Knecht and cited by the Board in the Decision to Matter 371:

> *"Mr. Robert Knecht, in evidence filed by the Public Intervener, agreed that EGNB's revised method of matching revenues and costs is a sound accounting and economic principle"* (p.4)

If the SEP test result based on the 3-year average was below the 1.04 level, the Board could consider the particular circumstances and determine if the capital investments were, in any event, reasonable or economically justified. If the Board believes a disallowance is still warranted, the disallowance would be sufficient to bring the 3-year average to a passing score of 1.04 and the disallowance would affect the final year of the 3-year period.

The tables below present the SEP Test results using a 3-year rolling average for 2014-2016, 2015-2017 and 2016-2018.

Item		2014 Actual	2015 Actual	2016 Actual	2016 Avg (2014-2016)
	Capital				
1	Main	$ 857	$ 652	$ 1,084	$ 864
2	Service Line/ Meter	934	1,162	755	950
3	Sales Incentive	-	-	35	12
4	Meter	286	118	545	316
5	O&M Capitalized to Main	1,080	647	679	802
6	O&M Capitalized to Service Line / Meter	1,951	1,461	1,481	1,631
7	O&M Capitalized to Meters & Regulators	582	547	416	515
8	**Total Capital**	5,690	4,588	4,995 #	5,091
9	**Cost of Capital**	8.01%	7.81%	7.69%	7.84%
	Depreciation Rates				
10	Main	2.43%	2.43%	1.64%	2.17%
11	Service Line	3.83%	3.83%	1.74%	3.13%
12	Meter	4.46%	4.46%	7.63%	5.52%
13	Sales Incentives	20.00%	20.00%	20.00%	20.00%
14	**Net Annual Impact on Revenue Requirement**				
15	Energy (GJs)	137,365	83,424	37,536	86,108
16	Revenue	$ 782	$ 770	$ 413	$ 655
17	Less:				
18	Depreciation: Mains ((item 1 + item 5) * item 10)	47	32	29	36
19	Depreciation: Service Line (item 2 + item 6) * item 11)	110	100	39	81
20	Depreciation: Sales Incentive (item 3 * item 13)	-	-	7	2
21	Depreciation: Meter & Regulator (item 4 + item7) * item12	39	30	73	46
22	Cost of Capital (item 8 * item 9)	456	358	384	399
23	Annual Impact	$ 130	$ 250	$ (119)	$ 91
24	**SEP test**	**119.89%**	**148.16%**	**77.59%**	**116.12%**

	Item		2015 Actual	2016 Actual	2017 Actual	2017 Avg (2015-2017)
	Item	**Capital**				
	1	Main	$ 652	$ 1,084	1,763	$ 1,166
	2	Service Line/ Meter	1,162	755	1,644	1,187
	3	Sales Incentive	-	35	74	36
	4	Meter	118	545	314	326
	5	O&M Capitalized to Main	647	679	1,117	814
	6	O&M Capitalized to Service Line / Meter	1,461	1,481	1,133	1,358
	7	O&M Capitalized to Meters & Regulators	547	416	305	423
	8	**Total Capital**	4,588	4,995	**6,350**	5,311
	9	**Cost of Capital**	7.81%	7.69%	7.51%	7.67%
		Depreciation Rates				
	10	Main	2.43%	1.64%	1.64%	1.90%
	11	Service Line	3.83%	1.74%	1.74%	2.44%
	12	Meter	4.46%	7.63%	7.63%	6.57%
	13	Sales Incentives	20.00%	20.00%	20.00%	20.00%
	14	**Net Annual Impact on Revenue Requirement**				
	15	Energy (GJs)	83,424	37,536	46,590	55,850
	16	Revenue	$ 770	$ 413	487	$ 557
	17	Less:				
	18	Depreciation: Mains ((item 1 + item 5) * item 10)	32	29	47	38
	19	Depreciation: Service Line (item 2 + item 6) * item 11)	100	39	48	62
	20	Depreciation: Sales Incentive (item 3 * item 13)	-	7	15	7
	21	Depreciation: Meter & Regulator (item 4 + item7) * item12	30	73	47	49
	22	Cost of Capital (item 8 * item 9)	358	384	477	407
	23	Annual Impact	$ 250	$ (119)	$ (147)	$ (7)
1	24	**SEP test**	**148.16%**	**77.59%**	**76.76%**	**98.81%**

	Item		2016 Actual	2017 Actual	2018 YTD November	2018 Avg (2016-2018)
	Item	**Capital**				
	1	Main	$ 1,084	1,763	$ 827	$ 1,225
	2	Service Line/ Meter	755	1,644	944	1,114
	3	Sales Incentive	35	74	141	83
	4	Meter	545	314	510	456
	5	O&M Capitalized to Main	679	1,117	621	806
	6	O&M Capitalized to Service Line / Meter	1,481	1,133	1,287	1,300
	7	O&M Capitalized to Meters & Regulators	416	305	578	433
	8	**Total Capital**	4,995	**6,350**	4,907	5,417
	9	**Cost of Capital**	7.69%	7.51%	7.51%	7.57%
		Depreciation Rates				
	10	Main	1.64%	1.64%	1.64%	1.64%
	11	Service Line	1.74%	1.74%	1.74%	1.74%
	12	Meter	7.63%	7.63%	7.63%	7.63%
	13	Sales Incentives	20.00%	20.00%	20.00%	20.00%
	14	**Net Annual Impact on Revenue Requirement**				
	15	Energy (GJs)	37,536	46,590	132,526	72,217
	16	Revenue	$ 413	487	$ 1,137	$ 679
	17	Less:				
	18	Depreciation: Mains ((item 1 + item 5) * item 10)	29	47	24	33
	19	Depreciation: Service Line (item 2 + item 6) * item 11)	39	48	39	42
	20	Depreciation: Sales Incentive (item 3 * item 13)	7	15	28	17
	21	Depreciation: Meter & Regulator (item 4 + item7) * item12	73	47	83	68
	22	Cost of Capital (item 8 * item 9)	384	477	368	410
	23	Annual Impact	$ (119)	$ (147)	$ 595	$ 109
2	24	**SEP test**	**77.59%**	**76.76%**	**209.73%**	**119.15%**

EGNB proposes to use this revised SEP Test for regulatory reporting purposes starting with the 2017 test year.