Enbridge Gas New Brunswick (EGNB) Response to matters arising from NBEUB 2009-007 Decision dated November 13, 2009 Cost Allocation Methodology

In its November 13, 2009 decision, the Board stated at page 6:

"EGNBLP is billed annually for costs allocated to it from its corporate head office. In 2008 this amounted to $1.024 million. These bills are then allocated between EGNBLP's regulated and non-regulated business according to a cost allocation methodology originally developed in 2002. This methodology was not reviewed by this Board. The TSD report recommends reviewing this allocation methodology. EGNBLP believes the methodology remains appropriate but agrees that a review may be warranted. The Public Intervenor also supports a review of the allocation methodology.

The Board will accept the costs as presented in the 2008 financial results but orders EGNBLP to file a report that describes the current methodology and any proposed changes within 180 days of this decision."

Background

EGNB is a small utility, but being small does not make it significantly less complex than a large well established gas utility. However, as a small utility, EGNB lacks the economies of scale that may be achieved by a larger utility. Also, EGNB is relatively new, continuing to operate within a Development Period. Given that EGNB is not a mature utility, in a number of ways its business can be more complex than larger well established utilities. For example, EGNB would be challenged to raise debt on its own and must rely on Enbridge Inc.'s ("Enbridge") credit rating and resources, where a large, mature utility is capable of raising debt in its own right. Due to its complexity and lack of scale, EGNB relies on various Enbridge entities to help it effectively and efficiently operate its business.

It is common for large businesses, like Enbridge, to operate a number of smaller business entities in areas where it has significant experience and knowledge as part of its overall business portfolio. These smaller entities operate in various geographic and economic environments and compete against other businesses in those areas. One of the main competitive advantages a smaller entity like EGNB has is the depth of resources, expertise and financial strength of the larger business. Enbridge knew when it established EGNB that it had a strong base of knowledge and expertise that it could use to provide, on a fully allocated cost basis, cheaper and often superior services to EGNB than a similar business could purchase from outside providers. This knowledge and strength extends from the senior leadership of Enbridge through to staff within the corporate office and affiliates. Enbridge's expertise in the gas distribution business was one of the main reasons that the Province chose to award it the gas distribution franchise. The Province also knew that Enbridge had the financial strength to support the development of a new distribution utility.

The wealth of knowledge, expertise and financial strength that Enbridge has developed, and maintains, has a cost and this cost is part of the overall cost of running each of its businesses individually and as a whole. It is Enbridge's policy to directly charge costs incurred by specific business units whenever possible. However, certain costs must be allocated between business units and between the corporate office and business units. This allows management to properly assess the financial performance of each line of business.

Current Methodology

The manner in which Enbridge currently allocates costs to its operating entities is explained in detail in its internal "Cost Allocation Methodology" policy document. A copy of this document is attached to the confidential response to Public Intervenor Interrogatory No. 5(6) to Teed, Saunders, Doyle in the NBEUB 2009-007 proceeding. This allocation process is the first step in EGNB's current methodology for determining which corporate costs are recovered through its revenue requirement.

The second step of the current methodology was developed when the Board's financial consultant, Mr. Easson, reviewed the costs allocated to EGNB by Enbridge as part of the 2004 annual review process. Mr. Easson believed that, in his judgment, certain costs allocated to EGNB were not costs that EGNB would reasonably incur if it were a stand alone entity. Mr. Easson also indicated to EGNB a belief that the annual amount by which these costs could increase should be limited. This review formed the basis on which EGNB has identified the corporate allocated costs to be recoverable in rates since that time.

Issues with Current Methodology

EGNB accepted Mr. Easson's assessment at that time and began eliminating some categories of costs from regulation altogether and adopted a process to limit the increases to the remaining amounts annually. As a result, over time, EGNB has been precluded from recovering an increasing amount of allocated costs that it believes legitimately form part of the overall cost of operating its business or that ratepayers derive benefit from. EGNB believes that Mr. Easson focused too heavily on the individual line items allocated by Enbridge and did not fully recognize the benefits that accrue to EGNB and its customers from being part of Enbridge.

The complete elimination of certain costs at that time meant that costs legitimately attributable to EGNB were borne by EGNB's investors. Over time, the amount borne by EGNB investors has grown as the cost capping mechanism has held costs recovered further and further below actual costs incurred. The attached Appendix shows the costs allocated to EGNB by Enbridge in 2008 and compares them to the amounts the current methodology allowed EGNB to recover in its 2008 revenue requirement.

Proposed Methodology Changes

EGNB believes that it, and its customers, gain significant benefit from being part of Enbridge, beyond discrete line items within an allocation of costs, and that Enbridge forms part of the overall management and pool of resources that EGNB relies on to operate effectively. Further, EGNB believes that the cost allocation methodology policy that Enbridge applies to all of its operating entities to allocate head office costs is fair. As a result, EGNB believes that it should be allowed complete recovery of all costs allocated by Enbridge based on the Enbridge Cost Allocation Methodology.

While EGNB applied the current methodology to its 2009 regulatory financial results, EGNB believes that the Enbridge Cost Allocation Methodology should be applied to 2009 financial results and beyond. EGNB proposes that a change to the cost allocation methodology be addressed as part of the 2009 financial review. If the Board supports this proposal, EGNB would file adjusted 2009 financial results reflecting the changes it is proposing and supporting information for the changes as part of the 2009 review proceeding.

Appendix

Name		2008 Corporate Allocations		In 2008 Revenue Requirement	Percentage of Total
Audit Services	$	24,612	$	10,072	40.9%
Benefits and Pensions		4,265		-	0.0%
Business Taxes		2,278		-	0.0%
CEO		29,610		-	0.0%
CFO		14,038		-	0.0%
CIO		43,454		37,959	87.4%
Corp Law General Expense		6,930		5,060	73.0%
Corp Secretarial Legal Fees		22,770		21,945	96.4%
Corporate Admin.		35,729		31,699	88.7%
Corporate Aviation		53,241		-	0.0%
Corporate Controller		57,716		36,313	62.9%
Corporate HR		32,380		13,006	40.2%
Corporate IT Operations		64,525		17,498	27.1%
Corporate IT Projects		9,306		9,306	100.0%
Corporate Law		8,693		8,693	100.0%
Depreciation		149,841		97,559	65.1%
Directors Fees and Expenses		52,965		-	0.0%
EFS Support		184,041		138,513	75.3%
EGD		5,145		3,171	61.6%
Employee Benefits		125,116		-	0.0%
Employee Development		18,522		-	0.0%
Enterprise Architecture		19,450		-	0.0%
EPI Direct Charge		74,566		-	0.0%
Financial Risk Management		57,427		55,965	97.5%
Group VP Corp. Resources		13,783		-	0.0%
HRIS Services		17,090		-	0.0%
Industry Association Fees		10,200		5,212	51.1%
Insurance Premiums		178,858		178,858	100.0%
Labour Relations		5,004		-	0.0%
Other Employee Benefits		154,688		-	0.0%
Public Affairs & Corp. Comm.		101,116		81,636	80.7%
Records Management		14,296		-	0.0%
Rent & Leases		47,631		-	0.0%
Stock Based Compensation		233,595		195,223	83.6%
Tax Services		7,769		1,578	20.3%
Total Compensation		22,606		20,390	90.2%
Treasury		38,186		38,186	100.0%
Additional Charges:					
Scholarship program		12,000		12,000	100.0%
Benefit reconciliation charge		4,250		4,250	100.0%
Total	**$**	**1,957,692**	**$**	**1,024,092**	**52.3%**