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Mr. Paul Michaud, Manager Finance
Enbridge Gas New Brunswick LP
440 Wilsey Road, Suite 203
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Dear Paul:

We are in midst of completing our audit of the financial statements of Enbridge Gas New Brunswick Limited Partnership ("EGNBLP") and you have asked us to review the accounting policy concerning the capitalization of operating and maintenance (O&M) expenditures incurred during fiscal 2002 and 2003, if the policy should continue to be applied for fiscal 2004, and if the capitalization and amortization policies of these O&M expenditures are consistent with Canadian generally accepted accounting policies (GAAP) and other organizations similar to that of EGNBLP. Specifically, you asked us to consider whether these expenditures should continue to be capitalized and amortized as Property, Plant and Equipment (PP&E) or if an alternate capitalization treatment and/or amortization period would be appropriate.

Current Capitalization Policy of O&M Expenditures

EGNBLP's primary business activities are subject to regulation by the New Brunswick Board of Commissioners of Public Utilities ("PUB"). EGNBLP follows accounting practices prescribed by its regulators or stipulated in approved rate-making decisions that are subject to examination and approval by the PUB and are similar to those being followed by other enterprises in the gas distribution industry in Canada. Accordingly, the timing and recognition of certain revenues and expenses may differ from that otherwise expected under generally accepted accounting principles to non-regulated operations.

We have been requested to review the methodology employed during fiscal 2002 and 2003 by management concerning the allocation of O&M expenditures to property, plant and equipment ("PP&E") and as a period cost and to ensure the methodology was just, fair and reasonable in the circumstances and still applicable for fiscal 2004. It should be noted that there is little in

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the way of written industry standards, policies or guidelines concerning the capitalization of O&M expenditures. Each situation is very specific and the circumstances vary from organization to organization resulting in each organization developing their own guidelines as to the most rational allocation method.

As part of our year end audits (fiscals 2002, 2003 and 2004), we reviewed the capitalization policy with management. We identified the various departments within EGNBLP and noted all O&M expenditures were grouped into departments by category. We also reviewed with management the major expenses within each category in the development of the capitalization policy. We noted that the following capitalized O&M expenses which have been grouped by similar nature for fiscals 2002, 2003 and 2004:

a) staffing related (salaries, benefits, travel, training, recruitment, etc.);
b) fleet and rent;
c) office supplies and postage;
d) information technology;
e) customer billing;
f) consulting (legal, audit, taxation and treasury services);
g) regulatory;
h) sponsorships;
i) distribution operations & maintenance;
j) planning and technical services;
k) marketing programs (advertising and public relations); and
l) direct sales (including incentives)/

We noted during our review that the following O&M expenditures were capitalized to PP&E and expensed for fiscals 2002 and 2003 and proposed for 2004:

	Capitalized to PP&E $	**Expensed $**	**Total O&M expenditures $**	**Percent capitalized %**
2002	5,987,000	3,235,000	9,222,000	64.9
2003	11,184,000	1,765,000	12,949,000	86.4
2004 proposed	11,395,000	2,079,000	13,474,000	84.6

During our review, we also discussed with management the rational of capitalizing O&M to PP&E, discussed if the O&M expenditures were incremental and attributable to expanding the

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plant and obtaining new customers and reviewed with management if the methodology employed to capitalize O&M expenditures were consistent during throughout 2002, 2003 and 2004. Finally we reviewed with management the change in capitalization rates from 2002 to 2003 to determine if this was a change in accounting policy or a change in an accounting estimate.

Our conclusion from our review was that we found the methodology of allocating O&M expenditures between PP&E and expenses to be reasonable and supportable. The methodology was consistently applied by management throughout fiscals 2002, 2003 and 2004 and that the change in capitalization rates from fiscal 2002 to fiscal 2003 was considered a change in accounting estimate and did not require a retroactive change to the statements.

Application of Generally Accepted Accounting Principles (GAAP)

We have noted above that the methodology employed by management of EGNBLP to allocate O&M expenditures between PP&E and as a period cost (expense) appears fair, reasonable and supportable. However, you have also requested us to comment if the capitalization of O&M to PP&E and the related amortization, as noted above, is consistent with Canadian GAAP. We offer the following comments:

As you know, we believe that the proper way to think of accounting for regulated companies is to first apply "normal" GAAP and then to apply regulatory differences as regulatory assets or liabilities where there is a different way of matching costs and revenues. Section 1100 of the CICA Handbook outlines the definition of a rate regulated operation which EGNBLP meets that definition. Section 3061 of the CICA handbook provides further guidance and a framework for PP&E for regulated and non-regulated operations.

Section 3061 of the CICA handbook provides the following definition of PP&E:

.03 *The definitions that follow have been adopted for the purposes of this Section.*

.04 ***Property, plant and equipment*** *are identifiable tangible assets that meet all of the following criteria:*

(a) *are held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other property, plant and equipment;*

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(b) *have been acquired, constructed or developed with the intention of being used on a continuing basis; and*

(c) *are not intended for sale in the ordinary course of business.*

Furthermore, rate-regulated PP&E is defined as:

.10 ***Rate-regulated property, plant and equipment*** *are items of property, plant and equipment held for use in operations meeting all of the following criteria*

(a) *The rates for regulated services or products provided to customers are established by or are subject to approval by a regulator or a governing body empowered by statute or contract to establish rates to be charged for services or products.*

(b) *The regulated rates are designed to recover the cost of providing the services or products.*

(c) *It is reasonable to assume that rates set at levels that will recover the cost can be charged to and collected from customers in view of the demand for the services or products and the level of direct and indirect competition. This criterion requires consideration of expected changes in levels of demand or competition during the recovery period for any capitalized costs.*

EGNBLP meets these criteria and the guidelines of Section 3061 of the CICA handbook outline that PP&E should be recorded at cost, which is defined as:

.05 ***Cost*** *is the amount of consideration given up to acquire, construct, develop, or better an item of property, plant and equipment and includes all costs directly attributable to the acquisition, construction, development or betterment of the asset including installing it at the location and in the condition necessary for its intended use.*

It is important to note that the cost of an item of PP&E includes direct construction or development costs (such as materials and labour), and all other costs directly attributable (which includes overhead costs) to the construction or development activity. Section 3061 of the CICA handbook allows development costs and overhead costs directly attributable to the construction or development activity as elements of PP&E. The main question is if the capitalized O&M expenditures being incurred by EGNBLP are directly attributable to the

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construction of the gas distribution lines or the development activity versus an intangible asset. An intangible asset is defined as an asset, other than a financial asset, that lacks physical substance.

While there is no-Canada wide standard that exist for the capitalization of overhead (O&M) expenses to PP&E or as an intangible asset, there are industry specific accounting practices that may provide some guidance. The main thrust of capitalizing overheads as part of the overall cost of PP&E or to a development project is a means of ensuring that all costs associated with the construction or development activity have been captured and appropriately included.

1. For large, long-term development projects, such as offshore oil and gas projects, (Sable Island, Hibernia, and the Terra Nova offshore oil and gas projects) the operators were allowed by the regulators to capitalize all expenditures/expenses (including O&M expenses) incurred to the date that the projects were fully developed and had operated for a period of time.

2. In the mining industry, all costs, direct and indirect, are capitalized until the mine which is being constructed reaches commercial production (which can be months to a few years after commencement of production).

3. Recently, other gas distribution companies have capitalized certain significant levels of development/start-up costs including Heritage Gas in Nova Scotia.

4. Regulatory research findings by Shaw, Stone & Webster Management Consultants, Inc. indicate that capitalized overhead and related expenses are subject to scrutiny and review by rate setting regulatory bodies in Canada. Regulatory bodies appear to treat the issue of capitalization rates on a company specific basis that considers the individual characteristics of each company. It appears that most regulated utilities capitalize a certain amount of O&M and it appears widely accepted. Their findings further indicate that higher capitalization rates are used and are more associated with higher growth and development stage circumstances.

In the case of EGNBLP, it is clear that the distribution system is far from fully developed and that material O&M costs have been incurred to increase utilization of the distribution system compared to average O&M costs of a mature gas distribution company to maintain its distribution system. In discussions with management, it was determined that the level of O&M costs being incurred is excessive to support existing customers and the existing infrastructure. All of the incremental O&M costs are being incurred to develop EGNBLP's primary business activity, the distribution of natural gas. As such, the O&M expenditures

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appear to be directly attributable to, and in support of, EGNBLP's development activities and the construction of new distribution lines throughout New Brunswick. These O&M expenditures appear to have attributes that more closely resemble tangible or physical assets than intangible assets as the expenditures incurred relate to the actual development and expansion of the PP&E.

From a regulatory perspective, we believe our conclusion is consistent with a recent rate hearing by Enbridge Gas Distribution (EGD) with the OEB. While the situation deals with a mature gas distribution market, the conclusion of the OEB was to treat non-capital expenditures for GAAP as PP&E. A summary of the situation is outlined below:

> EGD has contracted with Accenture over 10 years to implement and maintain a work asset management system (Envision Project) which will radically change the manner in which field work is planned, executed and monitored. The total cost of the project is approximately $120 Mm and, at the end of the 10- year period, EGD may either find a new maintenance partner, or renew with Accenture at market rates.
>
> The first phase of the project was completed and included the implementation of the work and asset management system, which also included the replacement of legacy work scheduling systems and replacing these with tools that seek to maximize field force productivity. The total cost at December 31, 2004 was expected to be approximately $20 Mm, which included system implementation costs (internal and external labour), training, coding and licence fees.
>
> Under Section 3062 of the CICA handbook, EGD wanted to capitalize implementation costs (internal and external coding and interface work), and software costs. However, under regulated regime, these costs are very much considered incidental to laying pipe in the ground.
>
> During the 2005 rate case, EGD sought approval to undertake the EnVision project and recover all costs incurred from ratepayers. The resulting OEB decision allowed EGD to recover 90% of the cost over the life of mains and service installation, with the remaining 10% expensed. From a regulatory perspective, the cost incurred to date are treated in the same way as any overhead incurred to put pipe in the ground.

Clearly, this is a departure from strict, non regulatory GAAP. However, EGD is in a regulatory regime and therefore, it was proposed that the accounting follow the established practice of capitalizing costs in accordance with the regulator's set recovery timetable and noting the accounting policy in the notes. EGD therefore proposed to expand its capitalization policy note to explain the treatment of EnVision costs as capital assets included in PP&E in accordance with the treatment prescribed by the regulator.

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For purposes of the annual audit of the financial statements of EGNBLP for December 31, 2004, we are in agreement that the methodology employed to allocate O&M expenditures to PP&E to be consistent with fiscal 2003 and that the methodology appears to be fair and reasonable. Also, we acknowledge that O&M expenditures capitalized to PP&E to be in accordance with Canadian GAAP during the Development Period as defined by the PUB.

Amortization Policy of Capitalized O&M

It is EGNBLP's accounting policy that capitalized O&M be allocated to the applicable PP&E category and therefore is to be amortized on the same basis as the related PP&E. The majority of the capitalized O&M expenditures have been added to Distribution Mains category of property, plant and equipment which are amortized on a straight-line basis at an annual rate of 2.43%. The following amortization rates for PP&E have been approved by the PUB:

NB PUB USOA	Description	Method of Depreciation	Annual Depreciation Rate
0473000	Street Services	Straight Line	3.83%
0474000	Meters & Regulators	Straight Line	3.83%
0475000	Distribution Mains	Straight Line	2.43%
0477000	Stations	Straight Line	4.40%

Determining the useful life of an asset and amortization period (section 3061 of the CICA handbook):

.28 *Amortization should be recognized in a rational and systematic manner appropriate to the nature of an item of property, plant and equipment with a limited life and its use by the enterprise. The amount of amortization that should be charged to income is the greater of:*

(a) the cost less salvage value over the life of the asset; and
(b) the cost less residual value over the useful life of the asset. [DEC. 1990]*

.29 *Property, plant and equipment is acquired to earn income or supply a service over its useful life. An item of property, plant and equipment, other than land that normally has an unlimited life, has a limited life. Its useful life is normally the shortest of its physical, technological, commercial and legal life. Amortization is the charge to income that recognizes that life is finite and that the cost less salvage value or residual value of an item of property, plant and equipment is allocated to the periods of service provided by the asset. Amortization may also be termed depreciation or depletion.*

.30 *The cost of an item of property, plant and equipment made up of significant separable component parts is allocated to the component parts when practicable and when*

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estimates can be made of the lives of the separate components. For example, initial leasing costs may be identifiable as a separable component of the cost of rental real estate and engines may be a separable component of an aircraft.

.31 *Different methods of amortizing an item of property, plant and equipment result in different patterns of charges to income. The objective is to provide a rational and systematic basis for allocating the amortizable amount of an item of property, plant and equipment over its estimated life and useful life. A straight-line method reflects a constant charge for the service as a function of time. A variable charge method reflects service as a function of usage. Other methods may be appropriate in certain situations. For example, an increasing charge method may be used when an enterprise can price its goods or services so as to obtain a constant rate of return on the investment in the asset; a decreasing charge method may be appropriate when the operating efficiency of the asset declines over time.*

.32 *Factors to be considered in estimating the life and useful life of an item of property, plant and equipment include expected future usage, effects of technological or commercial obsolescence, expected wear and tear from use or the passage of time, the maintenance program, results of studies made regarding the industry, studies of similar items retired, and the condition of existing comparable items. As the estimate of the life of an item of property, plant and equipment is extended into the future, it becomes increasingly difficult to identify a reasonable basis for estimating the life.*

EGNBLP amortization policy for capitalized O&M, as outlined above, is to first capitalize the O&M to specific categories of PP&E. The O&M allocated to the applicable PP&E category is then amortized on the same basis as the related PP&E. The majority of the capitalized O&M expenditures have been recorded to Distribution Mains category of property, plant and equipment which are amortized on a straight-line basis at an annual rate of 2.43%. The question that arises is the capitalized O&M a separate component of the physical asset and if so, should it be amortized on a different basis than Distribution Mains.

We have already concluded that during the Development Period, as defined by the PUB, the incremental O&M expenditures allocated to PP&E pursuant to management's reasonable capitalization methodology appears to be directly attributable to, and in support of, EGNBLP's development of new distribution lines throughout New Brunswick. These O&M expenditures appear to have attributes that more closely resemble tangible or physical assets than intangible assets as the expenditures incurred relate to the actual development and expansion of the PP&E. It would seem reasonable that the change in the business approach by EGNBLP with regard to the new construction (construction of new mains only takes place when it is deemed economical to do so) also supports that costs incurred to attract new customers in new areas are costs incurred to develop the gas distribution infrastructure in that area.

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We agree with EGNBLP's amortization policy of capitalized O&M expenditures. The policy is consistent with Canadian GAAP and supported by the recent decision of the OEB regarding the EGD's EnVision project as outlined above that O&M cost are not a separate component of PP&E and should be amortized on the same basis as the PP&E to which the O&M expenditures relate.

Should you have any questions concerning our findings please do not hesitate to contact us.

Yours very truly,

PricewaterhouseCoopers LLP

André M. Boudreau, CA
Partner
Audit and Assurance Group

AMB/clb
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