Written Direct Testimony of David B. Charleson and Jamie D. LeBlanc

Q 1: Please state your names and positions.

A 1: My name is David Bryce Charleson. I am the General Manager of Enbridge Gas New Brunswick Inc., the general partner of Enbridge Gas New Brunswick Limited Partnership ("EGNB"). My Curriculum Vitae is attached as Exhibit A, Schedule 1.

My name is Jamie Donald LeBlanc. I am the Manager, Finance and Control for EGNB. My Curriculum Vitae is attached as Exhibit A, Schedule 2.

Q 2: What is the purpose of this pre-filed evidence?

A 2: As part of the Review of Issues Related to the Development Period for EGNB (NBEUB 2009-006), the Board considered whether EGNB's approved return on equity can be altered prior to the end of the Development Period. In that proceeding, parties brought forward arguments suggesting that any review of the return on equity should also consider capital structure and the cost of debt. In its Decision, after noting that "any review of the return on equity should also consider capital structure and the cost of debt because of their impact on the appropriate return on equity" (page 6), the Board found "that the return on equity, cost of debt and capital structure ("cost of capital items") can and should be reviewed during the Development Period" (page 7). The Board also found that a 10-year forecast would be of assistance as part of the evidence to be filed in connection with a review of the cost of capital items. The Board directed EGNB to file a 10 year forecast that "shall identify the number of customers and throughput for each class, the rates that EGNBLP expects to charge, the costs for each major expense category and all other relevant information. EGNBLP is to identify all key assumptions used in preparing the forecast" (page 8).

This evidence provides the information in support of the review contemplated by the Board in its December 1, 2009 Decision.

Cost of Capital

Q 3: What is EGNB's position regarding its cost of capital?

A 3: EGNB engaged Kathleen C. McShane to assess EGNB's cost of capital parameters and provide an opinion on this. She is the President of Foster Associates, Inc. and her evidence can be found in Exhibit B. Ms. McShane supports a debt to equity ratio that is capped at 50% equity as being appropriate for EGNB. In addition, Ms. McShane is recommending a return on equity ("ROE") of between 12.25% and 13.0% and a cost of debt that is 100 basis points above Enbridge Inc.'s cost of debt. Ms. McShane's recommendations are based on her assessment of the business, financial and regulatory risks faced by EGNB and the state of the capital markets.

EGNB supports Ms. McShane's recommendations that equity remain capped at 50% and the return on debt remain at 100 basis points above Enbridge Inc.'s cost of debt. Based on Ms. McShane's recommended ROE range, EGNB believes that an ROE of 12.75% would be appropriate. This proposal recognizes the lower cost of equity in the markets today, but also considers the significant business risks faced by EGNB in comparison to mature utilities and the results of Ms. McShane's "from first principles" approach, which directly measures the cost of equity based on current capital market conditions.

Q 4: What are the primary risks associated with EGNB's business that should be considered in assessing EGNB's cost of capital parameters?

A 4: Although these risks are somewhat interdependent at times, EGNB considers its primary risks in the following five categories:

- Market risk arising from the general characteristics of the New Brunswick marketplace.

- Competitive risk due to competition for customers from alternate energy source providers.

- Supply risk associated with the physical availability of natural gas and its ability to affect EGNB's operations.

- Regulatory risk related to the regulation of EGNB.

- Deferral Account recovery risk due to the size of the account.

Ms. McShane also provides her opinion on the specific risks facing EGNB as they relate to an appropriate cost of capital and capital structure for EGNB in her evidence.

Q 5: What are the specific market related risks that EGNB faces in the New Brunswick market?

A 5: EGNB believes there are three types of risks that it faces related to the New Brunswick market: overall market characteristics, economic conditions and awareness and acceptance of natural gas.

- The New Brunswick marketplace is characterized by a relatively small population and industrial base that is spread over a broad area in comparison to what is seen in many other natural gas markets. The dispersion of New Brunswick's population and industrial base makes it uneconomic to serve significant portions of the franchise area and more expensive to interconnect the areas of the franchise area that can be economically served. These market characteristics limit the potential for growth into communities not already served by EGNB, leading to a greater reliance on growth coming from the communities currently served by EGNB. This is demonstrated by the fact that there are currently 14 unserved communities that EGNB originally intended to serve based on the completion of two northern transmission laterals which subsequently proved uneconomic and were therefore never built.

EGNB is exposed to higher risk from the market characteristics due to the fact that a number of the significant loads within the province that could be economically served were granted single end use franchises (“SEUF”) prior to EGNB commencing operations. These SEUFs are estimated to represent as much as 80% of the natural gas consumed in the province today. Lack of access to these loads exposes EGNB to greater market risk than would otherwise be seen.

- As with most natural gas utilities, economic conditions affect natural gas consumption. However, given EGNB’s relatively small customer base and the limited economic diversity in its largest customers, EGNB is more susceptible to deteriorating economic conditions than larger more established natural gas distribution utilities. As EGNB is a greenfield utility, its investment has been incurred over a relatively short period and its ratebase is large in comparison to its ability to generate revenue. This results in the vast majority of EGNB’s revenue requirement being comprised of fixed operating and capital costs. Any reductions in overall throughput due to economic conditions result in these costs having to be recovered by fewer units of consumption. As a result, EGNB is significantly more impacted by this circumstance than older, more established, utilities.

- Natural gas is still a relatively new energy alternative for New Brunswickers. Although EGNB has made progress educating its market on natural gas, the comfort benefits of natural gas and its excellent safety record remain unknown or unproven in the minds of a significant number of EGNB's potential customers.

Q 6: What competitive risks does EGNB see alternate energy source providers presenting?

A 6: EGNB's success in growing its market is largely dependant on its competitive position opposite fuel alternatives. Leading up to EGNB's entry into the market, natural gas had a competitive advantage of 60% versus electricity (the dominant energy source in the market). Although the conversion cost of electric customers was high, this pricing advantage was expected to ensure EGNB's success in converting large numbers of potential customers. This price advantage evaporated quickly just as EGNB entered the market, and to date EGNB has had difficulty competing against electricity due to an insufficient value proposition of savings relative to the high cost of conversion.

The proliferation of electric baseboard heating, coupled with a competitive price advantage for natural gas that does not provide an effective payback period to offset the conversion cost of electric baseboard homes, poses a significant competitive threat to growth in the residential sector. Despite efforts to increase penetration, EGNB continues to struggle to make significant progress converting residential homes from electric baseboard heating. Also, the fact that electric baseboard heating has remained the predominant heating solution for homes in areas where natural gas is not yet available makes future conversions of these homes, when gas may be made available, more challenging. This also limits future expansion to reach new construction opportunities that may be available as these developments grow further away from the existing distribution system.

Similarly, in the commercial electric market, the cost of conversion for a large number of opportunities is high relative to the potential savings. The level of incentives required to make such a conversion prior to the end of the useful life of the appliance provide a reasonable payback to the customer cannot be justified when compared to the incremental revenue that will be received. This leaves EGNB waiting for equipment to fail before conversion can be shown as beneficial for potential customers.

EGNB's capture rate of new construction, on or near main, has been improving and is now estimated at 45% for residential and 90% for commercial. Success in the residential new construction market has been hampered by the cost and increased complication of installing a central heating system compared to electric baseboard heat. As noted above, these challenges in the residential sector create risks to future residential growth.

The economics of conversion from oil have been relatively in line with expectations at the time of EGNB's proposal. Residential oil conversion success has, however, been hampered by a large number of oil equipment replacements and lease options that were offered just before and as EGNB entered the market. Similar to the commercial electric market above, EGNB must now wait for equipment to age or fail to gain access to the majority of these customers.

Q 7: To what extent does EGNB face supply risk today?

A 7: The natural gas being supplied by Enbridge Utility Gas ("EUG") and the two other marketers in New Brunswick originates primarily from the Sable Offshore Energy Project ("SOEP"), the production of which over the long term remains unproven. The introduction of supply from Corridor Resources within New Brunswick, and the completion of the Emera Brunswick pipeline, connecting the Canaport LNG facility to the U.S. northeast gas market, has improved the diversity of supply and has reduced the supply risk faced by EGNB since 2000. However, EGNB's supply choices remain somewhat limited and therefore any problems experienced by SOEP could negatively impact the price of natural gas supply to EGNB's customers. Such negative impacts harm the competitive position of natural gas against competing fuels.

EGNB notes that should these supply options fail, EUG and the other marketers could backhaul natural gas out of the U.S. northeast gas market. However, the addition of backhaul tolls would negatively affect pricing for EGNB customers. Also, looking to the future Deep Panuke is expected to attach supply to the market. However, the size and reliability of gas deliveries from Deep Panuke remain to be proven.

Q 8: Why does EGNB believe there are risks associated with the regulatory environment?

A 8: As a regulated entity, EGNB is dependent on the decisions of the New Brunswick Energy and Utilities Board ("Board"). These decisions shape and guide the future operations of EGNB. While these decisions provide a certain level of confidence for EGNB regarding the manner in which it is to manage its business and the ability to recover the associated costs, there is always the potential for the Board to reach a different conclusion based on information provided within a given proceeding. EGNB recognizes that the Board is not necessarily bound by prior decisions. The potential for a change in regulatory direction from the Board introduces a level of risk to the business.

The regulatory framework on which EGNB has based its operations, and investors have invested their money, was established by the Board in 2000. Among other things, the 2000 rates hearing established the concept of a Development Period, a cost of capital structure, market based rates and the regulatory deferral. Despite challenges, EGNB has operated in accordance with the parameters set at that time because it continues to believe these parameters are its best chance to attain long term sustainability.

During recent regulatory hearings there has been increased pressure by intervenors to re-open the fundamentals of EGNB's regulatory framework. To date, the Board has upheld these fundamentals. However, the attention created by the regulatory proceedings weakens confidence in EGNB's business model, which can directly impact EGNB's ability to attract investment and new customers and increases its overall risk.

As part of the Development Period Issues proceeding Decision, the Board has indicated that it has not "limited its ability to modify any aspect of the regulatory framework during the Development Period or following the Development Period" (page 7). EGNB cannot forecast what type of change may be implemented as a result of future Board proceedings or the impact it may have on EGNB's operations. However, the fact that such changes may be considered profiles the risk that is introduced from the regulatory environment. This risk is heightened by the current review of EGNB's cost of service study ("COSS") as noted by the Board in its June 3, 2010 Decision regarding EGNB's light fuel oil rate, where it stated that, once the COSS and cost of capital hearings are complete, "the Board will possess sufficient information to determine whether a cost component should be considered in fixing rates or whether a different method should be used." (page 4)

Q 9: What are the specific risks related to the Deferral Account?

A 9: The most significant risk associated with the Deferral Account is the ability for EGNB to recover the balance in rates over time due to the size of the deferral. When EGNB was awarded the franchise, the Deferral Account was expected to peak at $13 million in 2007 and be recovered within the initial franchise period, ending in 2019. The Deferral Account is currently $155 million and EGNB's latest forecast predicts that it will peak at approximately $173 million in 2011 and that recovery of this balance will extend beyond 2040.

Both the growth in the Deferral Account and the risk associated with its recovery is largely impacted by all of the other identified risks. However, EGNB believes it is important to recognize the impact on EGNB's overall risk that the size and recovery period of the Deferral Account represents. Continued growth in revenues and a sustainable competitive advantage against alternate energy sources will be required to provide EGNB a reasonable opportunity to recover the full Deferral Account balance.

Q 10: What are EGNB's overall conclusions regarding these risks?

A 10: EGNB believes that its business still faces significant risks. Some of these risks are more pronounced as EGNB continues to work towards developing the business to the point it is sustainable for the long term, while others will likely remain risks the business will face for a longer period of time. Given these risks, EGNB believes that the recommendations of Ms. McShane regarding EGNB's cost of capital are appropriate and EGNB supports the adoption of the recommended 50% cap on equity and a cost of debt that is 100 basis points above Enbridge Inc.'s cost of debt. EGNB also believes that these risks support an ROE of 12.75%, which falls within the range recommended by Ms. McShane.

10 Year Forecast

Q 11: Has EGNB prepared a 10 year forecast?

A 11: Yes. A copy of this forecast can be found in Exhibit C, Schedule 1. EGNB has presented the forecast in a format that is similar to its regulatory financial statements for ease of reference.

Q 12: What assumptions have been used in the preparation of this forecast?

A 12: A table of the assumptions used in the preparation of the forecast can be found in Exhibit C, Schedule 2.

*** I have no further questions