Written Direct Testimony of David B. Charleson and Lori A. Stickles

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 Lori Ann Stickles. I am the Manager, Financial Services 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: The New Brunswick Energy and Utilities Board ("Board") has reviewed EGNB's regulatory financial results each year since EGNB began operations in 2000. Until the review of the 2009 Regulatory Financial Statements ("the 2009 review"), the Board had engaged an external consultant to review EGNB's financial results and provided a report to the Board. The Board then conducted a proceeding to determine the prudence of the expenditures and approve any addition to the Deferral Account.

In the 2009 review, the Board relied on evidence submitted by EGNB and intervenors to assess the prudence of EGNB's 2009 expenditures. The 2009 review also included a review of EGNB's 2011 Budget and a determination on whether the first "end of the Development Period test" had been satisfied. In its May 16, 2011 Decision, the Board indicated that "[t]he parameters around O&M spending established by the Board as well as the clarification of the test for capital additions should give clear instructions to all parties about what is expected in the review of 2011 spending." (page 17)

In the 2009 review Decision, the Board did not indicate that it intended to review EGNB's 2010 Regulatory Financial Statements and 2012 Budget differently than the manner used in the 2009 review. As a result, EGNB has prepared this evidence in support of the review of its 2010 Regulatory Financial Statements and commodity purchases and sales and 2012 Budget in a similar manner to the 2009 review.

Q 3: Has EGNB already submitted evidence in relation to any of these matters?

A 3: On March 15, 2011, EGNB filed its Commodity Sales report for the fiscal year ended December 31, 2009, 2010 Regulatory Financial Statements, 2010 Audited Financial Statements and Details of Adjustments for Regulatory Statements. Details of Bad Debt Expenses for 2010 were filed on March 16, 2011.

Q 4: Is EGNB providing revisions to any of this evidence at this time?

A 4: EGNB is filing revised 2010 Regulatory Financial Statements to reflect the orders of the Board in the 2009 review Decision. These revised statements can be found at Exhibit A, Schedule 3. A black-line of the statements showing the changes to the statements filed on March 15, 2011 can be found in Exhibit A, Schedule 4.

Q 5: What matters are EGNB addressing in this evidence?

A 5: EGNB is submitting evidence in relation to four areas:

1. comments on the 2010 Regulatory Financial Statements;

2. comments on the report submitted by Mr. Butler;

3. the 2012 Budget; and

4. the end of the Development Period tests.

2010 Regulatory Financial Statements

Q 6: What aspects of the 2010 Regulatory Financial Statements does EGNB wish to comment on?

A 6: There are a few areas of the 2010 Regulatory Financial Statements that EGNB believes warrant additional commentary. These are installation services and the prudence of EGNB's 2010 system expansion.

Q 7: What is EGNB's perspective related to installation services and the associated costs?

A 7: EGNB believes that installation services is an integrated part of EGNB's operations that are integral to the development of the natural gas distribution system in New Brunswick. It is for these reasons that all costs and revenues associated with installation services have formed part of EGNB's revenue requirement since their inception in 2003.

The Province initially established an "unbundled" model for New Brunswick's gas distribution franchise which precluded EGNB from both selling natural gas and providing installation services prior to 2003. The "unbundled" model failed to provide the natural gas industry with the ability to stimulate growth. This was recognized by the Province and in 2003 legislative changes were made to allow EGNB to provide system gas and installation services in a relatively unencumbered manner. EGNB was permitted to offer installation services without having to get prices approved by the Board. This recognized the competitive nature of these activities and the need to be able to offer competitive and responsive pricing.

It is clear that the primary goal of EGNB's entry into the installation services market in 2003 was to increase the utility's customer base by ensuring the availability of service, consistency of service, quality of work and safety of the industry and the public. In entering into this market, it was EGNB's expectation and understanding that costs associated with providing installation services would be included within the utility's costs. This expectation is supported by a letter from EGNB's General Manager at the time to the then Chair of the Board of Commissioners of Public Utilities, summarizing a meeting held to discuss installation services shortly after the legislation was changed to allow EGNB to provide customer services. A copy of this letter can be found in Exhibit A, Schedule 5. The letter states:

> "EGNB's involvement in the sale of natural gas and retail services (sale, installation and servicing of equipment) must be viewed in this context, i.e. these activities are part of the "utility" and their sole objective is to help develop and sustain the industry in order to improve the viability of the gas distribution activity. In other words, their sole function is to help "fill the pipes". As a result, EGNB embarks in these activities with the clear expectation that any surplus or shortfall resulting from these activities will be integrated with the results of the distribution activity, i.e. added to or deducted from the deferral account." (pages 1-2)

EGNB received no indication back from the Board that this would not be the case and has operated on that basis since it began providing installation services in 2003.

Secondary goals of providing installation services included the development of industry experience by hiring recent graduates out of trade school and increasing the number of contractors providing service. EGNB has made good progress on its goals. EGNB currently serves approximately 11,000 distribution customers and continues to add new customers daily. Also, when EGNB began flowing gas there were seven HVAC contractors providing natural gas installation whereas today there are more than fifty. EGNB believes the original goals of EGNB's entry into this market remain important to the long term viability of the overall natural gas industry and must be the primary focus of its installation services activities.

EGNB continually evaluates and adjusts its installation services activities in response to trends in the market. Given the ability of other market participants to serve the commercial sector, EGNB has effectively stopped performing installation services for this segment of the market. Also, EGNB has been reducing the amount of residential installation services, with more work being performed by third party HVAC contractors, either directly or as a subcontractor for EGNB. EGNB expects this evolution to continue, with EGNB narrowing its focus to areas of the market where the availability of service, consistency of service, quality of work and safety of the industry and the public is not at the level to support continued growth.

Q 8: Does EGNB believe that analyzing installation services on a "full-cost" basis is the most relevant means of assessing installation services?

A 8: EGNB believes that a full-cost analysis of installation services does provide the Board with a perspective on costs associated with EGNB's installation services. However, this analysis may also overstate the role that installation services plays within EGNB's revenue requirement. When costs are allocated on a full-cost basis, portions of costs are allocated to installation services based on reasonable allocators. These include costs associated with labour, facilities, equipment, supplies and other overheads. In many of these cases, these costs would not vary if EGNB were not to perform installation services. As a result, EGNB believes the most appropriate means of assessing the financial implications of installation services on EGNB's revenue requirement is to assess these activities on a marginal cost basis, where only the costs that would be eliminated if installation services were no longer performed would be factored in.

However, any assessment of installation services must also consider the core principles behind EGNB performing these activities. As noted above, EGNB entered into these activities to support growth and the development of the natural gas distribution system in New Brunswick.

Q 9: How do the costs and net margin compare for installation services on a marginal cost basis to the full cost analysis seen on page 14 of the 2010 Regulatory Financial Statements?

A 9: As seen on page 14, the allocated expenses associated with installation services in 2010 were $1.6 million on a full cost basis. On a marginal cost basis, the total costs would be $0.8 million. If installation services were considered on a marginal cost basis, the resulting net margin from installation services in 2010 would be $0.2 million.

Q 10: Has EGNB conducted any assessment of its 2010 expansion costs?

A 10: Based on the direction provided in the 2009 review Decision related to Capital Additions, EGNB has included the calculation of the prudence of its 2010 expansion costs in the 2010 Regulatory Financial Statements at page 15. As demonstrated by the calculation, the annual positive impact on the revenue requirement of EGNB's 2010 capital expansion was $0.8 million. As the annualized revenue exceeds the annualized costs by 28%, EGNB believes this clearly demonstrates the prudence of its 2010 capital expansion activities.

Purchase and Sale of Natural Gas Report

Q 11: Moving to the report prepared by Mr. John Butler of J.C. Butler Management Ltd. titled "Report to the New Brunswick Energy and Utilities Board on the Purchase and Sale of Natural Gas by Enbridge Gas New Brunswick During 2010", do you have any comments on Mr. Butler's findings regarding potential cross-subsidization between standard offer customers and partner's equity found on pages 13 and 14 of his report?

A 11: EGNB does not dispute Mr. Butler's finding or recommendation related to the allocation of salaries charged from EGNB to EUG. EGNB has made an adjustment to transfer $38,844 from partner's equity to the Purchase Gas Variance Account in the 2010 Regulatory Financial Statements to reflect this finding and ensure that there is no cross-subsidy between standard offer customers and partner's equity.

2012 Budget

Q 12: What evidence is being provided in relation to EGNB's 2012 Budget?

A 12: As neither the Board nor any party identified any required changes to the presentation of EGNB's 2011 Budget in the 2009 review, EGNB has relied on the format of the evidence it brought forward in that proceeding.

EGNB's 2012 Budget, in Regulatory Financial Statement format, can be found in Exhibit A, Schedule 6 and an associated explanation of the 2012 Budget can be found in Exhibit A, Schedule 7. Assumptions used in preparing the 2012 Budget can be found in Exhibit A, Schedule 8.

Q 13: Has EGNB made any changes to the manner in which it capitalizes Operating and Maintenance ("O&M") costs in its 2012 Budget?

A 13: Yes. Given the concerns expressed by the Board in the 2009 review Decision related to capitalization, EGNB has eliminated the capitalization of O&M to Development O&M in its 2012 Budget, with the exception of some incentives, which EGNB proposes to capitalize as part of property, plant and equipment ("PP&E"). While EGNB does not believe it has reached the end of the Development Period, as specified by the Board's tests, it had already begun a transition to reduce its capitalization of Development O&M. This was undertaken as EGNB recognized an expectation that there would be reduced capitalization of development related costs as the end of the Development Period approached. By advancing this transition, EGNB believes that it will provide the Board and other parties with greater clarity regarding the post-Development Period operating costs of EGNB, as these O&M expenses are expected to continue in support of the ongoing growth of the natural gas distribution system.

Q 14: On what basis does EGNB believe the O&M costs that it is continuing to capitalize are allowed by generally accepted accounting principles ("GAAP")?

A 14: Capitalization of O&M expenses that are attributable to the construction of the gas distribution system is a normal practice for natural gas utilities across Canada, and is supported by the CICA Handbook Section 3061.05, which states that PP&E should be recorded at cost, with cost being 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. Cost includes any asset retirement cost accounted for in accordance with ASSET RETIREMENT OBLIGATIONS, Section 3110.*

EGNB's capitalization to PP&E is focused strictly on costs associated with its construction activities. As a result, EGNB believes that the proportion of O&M capitalized to PP&E in 2012 is attributable to construction of the distribution system and appropriate.

As noted above, EGNB is proposing that some incentives continue to be capitalized. Incentives are paid to encourage the conversion of equipment to natural gas. The majority of these incentives are paid to attract new customers to the system and are directly attributable to its expansion, as they are only paid when the customer is attached. As a result, EGNB believes that it is appropriate and consistent with GAAP to continue capitalizing incentives that result in new mains, services and meters being installed. EGNB also believes they are appropriately included as part of PP&E if other capitalization to Development O&M ceases.

Q 15: Is EGNB proposing an O&M target be used for its 2012 Budget?

A 15: No. While EGNB understands the merits of establishing a target for O&M spending as the Board has done for EGNB's 2011 O&M expenditures, EGNB continues to believe that the use of such a target is problematic and may not drive the desired outcomes.

EGNB acknowledges the difficulty in establishing an O&M target within the framework of market-based rates. However, a target that is established based on overall throughput also faces challenges. The value of each GJ of consumption will vary by customer, as there are significant differences in the rates charged to different rate classes. Also, there may not be a strong relationship between O&M spending and throughput. For example, a significant increase in throughput due to increased production in manufacturing facilities would not be seen by EGNB as an opportunity to spend more on O&M. Similarly, a significant reduction in throughput due to reduced production in manufacturing facilities would not result in any reduction to EGNB's operating costs. While EGNB understands the Board is looking to make EGNB more accountable for its throughput forecasts, there are factors such as these that are beyond EGNB's control.

EGNB continues to believe that it is premature to establish targets for O&M and that such targets are best put in place when EGNB is operating more like a mature utility, especially in terms of its rate setting mechanism.

Q 16: Recognizing EGNB does not support the use of an O&M target for 2012, what would the O&M target per GJ be in 2012 if the approach used by the Board for the 2011 Budget was applied to 2012?

A 16: Given the total O&M budget of $17.2 million and forecast throughput of 6,081 TJs, the O&M target would be $2.84/GJ.

Q 17: What conclusions does EGNB expect the Board to reach regarding the 2012 Budget?

A 17: EGNB is seeking a similar outcome to the 2009 review, where the Board provided specific direction regarding EGNB's operating and capital budgets and plans for 2011. Such direction is of assistance to EGNB and should limit the amount of review required on a retrospective basis when the 2012 actual financial results are reviewed.

<u>End of Development Period Tests</u>

Q 18: Does EGNB believe that the first test for the end of the Development Period was satisfied in 2010?

A 18: No. The Board provided additional clarity on the manner in which the first test for the end of the Development Period is to be performed in the 2009 review Decision. The Board directed EGNB to "include in its expenses any capitalized O&M expenses which will remain as ongoing costs after the development period ends" (page 16) and "that there must be a calculation of the amortization of the deferral account." (ibid) For the purpose of evaluating the first test, the Board directed EGNB to assume an amortization period of 30 years at this time, until a full review is conducted to determine the appropriate amortization period for the Deferral Account.

The first test for the end of the Development Period as specified by the Board in its December 1, 2009 Decision is that: "Are the full costs equal to or below the currently available revenues?" (p. 6) As seen on page 16 of EGNB's 2010 Regulatory Financial Statements at Exhibit A, Schedule 3, the full costs, determined on the basis identified by the Board in the 2009 review Decision, exceeded revenues in 2010 by $34.8 million. This clearly demonstrates that the first test was not satisfied in 2010. As a result, EGNB requests that the Development Period be extended at least until the review of EGNB's 2011 financial results is completed.

EGNB notes that based on the clarification of the first test provided by the Board in the 2009 review Decision, EGNB no longer has a concern regarding the second test for the end of the Development Period.

*** I have no further questions