SECTION 3.0

2016 Budget

3.0 2016 Budget

As part of a COS model, the establishment of the revenue requirement is critical in the development of distribution rates. A utility's cost of service rates are typically established to align with the fiscal year of the utility. This allows the utility to properly prepare annual forward year projections of costs and throughput, which are the key inputs to establish cost of service rates, and thereby align such projections with the rate setting period. For the purpose of this Application, Cost of Service distribution rates have been developed based on the revenue requirement of the 2016 Budget.

EGNB's 2016 Budget has been prepared taking into consideration historic trends, current market conditions, the current economic environment and EGNB's current operations.

EGNB continues to transition its operations in response to constraints imposed by legislative changes, volatility in gas prices, and the erosion of the public distribution system as a result of rate payers within the public utility's service area moving to alternative fuel options, such as compressed natural gas and propane which continues to be brought into the market in greater capacities and lower prices.

Customer Attachments

The 2016 Budget is based on the attachment of 107 new customers. EGNB has estimated the loss of 84 customers (customers no longer on the distribution system as at December 31, 2016 due to permanent removal of service, red locks due to non-payment, seasonal locks, or other temporary locks) in 2016 resulting in a total of 23 net new customers in 2016. EGNB has plans to offer an incentive program to attract new customers and a customer retention program to mitigate lost customers for 2016.

Depreciation Study

During 2015, EGNB examined various initiatives to reduce the costs of operating the public natural gas utility. Based on discussions with other utility professionals, it was suggested that examining EGNB's depreciation rates and comparing them with other similar utilities could provide beneficial results. EGNB engaged Gannett Fleming to thoroughly examine the assets of the public utility in order to identify opportunities for reducing the depreciation expense and the revenue requirement.

The results of the study have been significant in reducing the revenue requirement. The 2015 Depreciation expense in the Cost of Service Model was $10.87 Million. For 2016, the budgeted Depreciation expense is $8.6 Million. Refer to Schedule 3.9 - Gannett Fleming Depreciation Study for additional information on the study and methodology.

Incentives Program and Customer Retention Program

Growing and maintaining the customer base are both important factors to maintaining low distribution rates. Two programs are included in EGNB's 2016 Budget in order to address customer numbers. Firstly, $100K will be used to provide incentives to approximately 50 new attachments in the Small General Service class for new home construction or residential retrofit markets on or near the current pipeline infrastructure. Incentives may be offered directly to the customer and/or provided directly to a builder/developer/contractor and will provide benefits to rate payers by recovering costs over a broader customer base.

Secondly, up to $500K will be used as a commercial customer retention program to protect the public utility's revenue and customer base from additional erosion due to competitive threats. The program will be identical to the 2015 Customer Retention Program except that it will be funded by rate payers. This program was successful in offering customized solutions to at-risk customers, protecting the customer base and preventing dozens of accounts from leaving the system which would have resulted in increased rates for the remaining customers.

Corporate Allocations

Since the last rate application filing almost 18 months ago, Corporate Allocations has undergone some modifications. Some allocations identified as new below are in fact merely allocations split out of previously approved allocations. Additionally, some Corporate Allocation items have zero amounts claimed in the 2016 Budget. As a result, the table below includes nineteen new allocations. The amounts allocated to the revenue requirement for these new corporate allocations were established using the criteria set out in support of EGNB's 2013 Rate Application and the percentages set out in the following table:

	Cost Allocations	Type of addition	% Allocated to Revenue Requirement
1	**Cost Allocations**	**Type of addition**	**% Allocated to Revenue Requirement**
2	**Corporate Development Management**	New	25%
3	**Records Management Law**	New	25%
4	**Risk Assessment**	New	100%
5	**Corporate Performance Management**	New	100%
6	**IT Infrastructure Shared Services Service Support**	New	100%
7	**IT Infrastructure Shared Services Network**	New	100%
8	**IT Infrastructure Shared Services Core Infrastructure**	New	100%
9	**Core Infrastructure**	New	100%
10	**Network Operations**	Split from approved allocation	100%
11	**Desktop Services**	Split from approved allocation	100%
12	**IT LP Acquisitions**	New	100%
13	**Productivity Services**	Split from approved allocation	100%
14	**IT ES Desktop Services**	Split from approved allocation	100%
15	**Enterprise Operations**	New	100%
16	**HR Change Management**	New	50%
17	**HR (Business Unit/Dept Costs)**	New	50%
18	**HR Employee Services**	New	100%
19	**HR PMO**	New	100%
20	**Record Management Program**	New	100%

Details of the corporate allocations listed above can be found in Schedule 3.7 - Corporate Allocations Report.

Miscellaneous Revenue

EGNB has addressed the Miscellaneous Revenue discussions in the last rate hearing and has budgeted increases to this item. The Miscellaneous Revenue of ($937K) in the 2016 Budget contains amounts for SEUF Fees ($400K), Late Payment Penalties ($303K), Agent Billing and Collections ("ABC") Revenue ($193K), Transactional Services ($36K) and Interest Income on Maritimes & Northeast Pipeline Firm Service Agreement security deposit ($6K).

ABC Revenue is determined based on the number of ABC customers at the approved 2015 ABC rates plus inflation applied at 2.4%. Interest income revenue is based on term deposit and average rate received. Late Payment Penalties and Transactional Services are based on the average of the prior two years of actual revenues.

Capitalization Study

EGNB capitalizes certain O&M items based on whether the expense relates to existing customers (expensed) or if the expense relates to growth and future customers (capitalized). Since 2010, EGNB has adjusted capitalization rates from time to time based on the operations of the business and capitalization studies filed and reviewed by the Board.

In February 2015, EGNB prepared a Capitalization Study in order to review rates and practices and make adjustments for the 2016 Budget. The Capitalization Study reviews several aspects and allocators to EGNB's O&M to determine the percentage by department of O&M that should be capitalized to property, plant, and equipment and, as such, amortized over the life of the asset which attracts the monthly spend.

The study was reviewed by PricewaterhouseCoopers LLP and can be found in Schedule 3.11.

Marketing and Sales Expenses

Marketing and Sales O&M has been discussed in past hearings. In preparing the 2016 Budget, additional focus on these two cost items has taken place including a thorough review in the Capitalization Study. EGNB has budgeted lower Sales and Marketing expenses for the 2016 test year. Additionally, Marketing and Sales O&M capitalization rates have also been reduced as a result of the previously discussed capitalization study.

Executive Risk Insurance

In its April 17, 2014 Decision, the Board disallowed $111K of Executive Risk Insurance premiums allocated by Enbridge Inc. to EGNB for the first time, stating at page 10:

> *"Executive Risk Insurance is insurance which mitigates the personal responsibility of EGNB's representatives. This allocation was approved in 2012 but the methodology for calculating this allocation was more recently modified, resulting in an increased allocation to EGNB in the amount of $111 thousand. Mr. Knecht, in his evidence, submits that while Enbridge now allocates this cost based on the number of directors, one would expect that personal responsibility risk would be more related to the overall size of the business. Mr. Knecht recommends that the increased cost of the executive risk insurance be excluded from the revenue requirement. The Board agrees with Mr. Knecht and an adjustment of $111 thousand is ordered."*

In the following Rates Decision dated December 23, 2014, the Board again disallowed $159,798. At page 7 it stated:

> *In 2013, the Board approved approximately 18.3% of the allocated amount and will do the same for 2015. The Board will therefore set the executive risk insurance cost for 2015 at $35,793 which represents 18.3% of the 2015 forecasted allocation of $195,591.*

EGNB is included in the comprehensive insurance program that is maintained by Enbridge Inc. for its affiliates and features insurance coverage that is consistent with coverage considered customary and appropriate for its industry class. As a result of the previous decisions, EGNB has sourced additional information from Marsh Canada Limited. This information can be found in Schedule 3.8 – Executive Risk (Marsh Documentation 2015) and supports EGNB's argument that if Executive Risk Insurance was purchased independent of Enbridge Inc., the premiums would be significantly higher ($355K quoted by Marsh vs. $97K) than the premiums allocated by Enbridge Inc. for 2016.

Additionally, EGNB obtained information with respect to Executive Risk Insurance/Directors and Officers Insurance from Board Matter 272, NB Power's most recent General Rate Application. In NBP (EGNB) IR #6, NB Power confirmed the following information detailed below:

- 2014/15: Limit $75 million – premium $.19 million
- 2013/14: Limit $25 million – premium $.12 million
- 2012/13: Limit $25 million – premium $.12 million

The details above show similarities with EGNB in that both the coverage and premiums increased substantially. Marsh suggested in Schedule 3.8 that coverage in the amount of $75M would have an estimated cost of $170K which compares well with the amount provided by NB Power of $190K. Also, from 2012 to 2015, NB Power paid approximately the same amount of annual insurance premiums as allocated to EGNB, but has been receiving less than 50% of the coverage that is provided to EGNB for similar premiums during that time. For the 2016 Budget, NB Power is paying significantly more for only 30% of the coverage that EGNB obtains. This evidence clearly demonstrates value for the premiums EGNB is paying and provides support for the evidence provided by Marsh which indicates that if EGNB were on its own and not using

Enbridge Inc's affiliate insurance program, EGNB would be paying more than it currently is paying in premiums and would obtain significantly lower coverage.

As a result of the information outlined above and provided in schedule 3.8, whether the allocation methodology relating to the number of directors is appropriate or not, is not the real issue. As a result, EGNB has included Executive Risk Insurance premiums in the 2016 Budget for the full amount of $97K allocated by Enbridge Inc.

<u>Annual Customer review and contract demand process</u>

During the last Hearing, significant time was spent discussing EGNB's Annual Customer Review and Contract Demand setting process. This process determines an existing customer's rate class, contract demand and ratchet provision, if applicable. The details and process can be found in Schedule 3.10 - Customer Annual Review Process. The main contributors to cause contract demand levels to change are weather and customer business activity, both of which are beyond EGNB's control, the process allows for a systematic methodology to examine the results of these factors on customer consumption and make adjustments to contract demand for budgeting purposes.

The following documents have been provided in support of the 2016 Budget:

- Schedule 3.4 - 2016 Budget Assumptions
- Schedule 3.5 - 2016 Budget
- Schedule 3.6 - 2016 Budget to 2015 Budget Explanations
- Schedule 3.7 - Corporate Allocation Report
- Schedule 3.8 – Executive Risk (Marsh Documentation 2015)
- Schedule 3.9 - Gannett Fleming Depreciation Study
- Schedule 3.10 - Customer Annual Review Process
- Schedule 3.11 – PWC EGNB Capitalization Study

2015 Forecast

The 2015 Forecast provides the bridge year for the development of the 2016 Budget. The following documents have been provided in support of the 2015 Forecast:

- Schedule 3.1 - 2015 Forecast
- Schedule 3.2 - 2015 Budget
- Schedule 3.3 - 2015 Forecast to Budget Explanations