

REPORT TO

THE NEW BRUNSWICK

ENERGY AND UTILITIES BOARD

PURCHASE AND SALE OF NATURAL GAS

BY

ENBRIDGE GAS NEW BRUNSWICK

DURING 2007

MAY, 2008

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Introduction

I have been retained by the Board to review and report on the activities of EGNB in purchasing and selling natural gas in New Brunswick during 2007. I have conducted similar reviews of these activities for the years 2003, 2004, 2005 and 2006. Reports were issued for each of those years and all have been accepted by the Board.

Legislation enables Enbridge Gas New Brunswick (EGNB) to distribute natural gas in New Brunswick and also to purchase and sell natural gas in New Brunswick. Legislation also requires the New Brunswick Energy and Utilities Board (the Board) to regulate the distribution activities of EGNB. The distribution of natural gas is operated by EGNB as a regulated utility (regulated EGNB) and the name Enbridge Utility Gas (EUG) has been established as the brand name for EGNB's activities in purchasing and selling natural gas in New Brunswick.

EGNB has established separate accounts under the EUG name and all of the transactions related to its purchase and sale activities in New Brunswick are accrued in these accounts. These separate accounts, however, continue to be embedded within the EGNB accounting system and so EUG is essentially a department of EGNB.

All comments, opinions and recommendations in the Report are based on my review and assessment of data and information provided by EGNB personnel and by J. Aucoin C.A. of Teed, Saunders, Doyle & Co., Financial Consultants retained by the Board. Discussions with J Aucoin covered many aspects of EGNB/EUG activities, including the adequacy of the separation between regulated EGNB and EUG and the potential for cross-subsidy between the two.

It was agreed that the use of separate UEG Accounts within the EGNB system continues to provide a reasonable separation between the activities of regulated EGNB and the purchase and sale of natural gas activities of EUG.

Legislation and Regulations

EGNB's right to distribute gas in New Brunswick and the Board's mandate for regulation of the EGNB distribution system are established by Provincial Legislation. Permission was given for EGNB to purchase and sell gas in New Brunswick in the *Gas Distributor Marketing Regulation – Gas Distribution Act, 1999*. These Regulations imposed certain conditions on EGNB regarding its natural gas purchase and sale activities and also extended the Board's jurisdiction to include some oversight of these activities. The Regulations became effective on May 22, 2003, and as of that date EGNB was authorized to purchase and sell gas in New Brunswick.

The above Regulations were updated by the *Consolidated Regulations dated April 1, 2006* (the Consolidated Regulations). Sections of the Consolidated Regulations that are relevant to EUG and this Review are:

“3(1)(e) within six months after beginning to sell gas, a distributor shall file with the Board a Gas Purchasing Plan that complies with section 5;”

“3(1)(f) on or before the thirty-first day of March in each year, a gas distributor shall file with the Board for its review a financial report that complies with Section 6;”

“Standard offer”

“4(1) Subject to subsection (2), a gas distributor that sells gas shall make available an offering having a term of one year where the price of gas to be charged to customers shall be calculated by the gas distributor forecasting the

average price of gas for the following twelve months, which price shall be based upon the cost to the gas distributor of purchasing gas and selling gas to its customers.”

“4(2) For the purposes of subsection (1), the difference between the estimated cost of purchasing and selling gas and the actual cost of purchasing and selling gas for a month shall be included in the forecasted price of gas for the twelve month period that follows the month in which the difference is determined.”

“Alternative offers”

“4.1 A gas distributor may offer alternative pricing and contract terms for gas sales to customers if its revenues from such gas sales are equal to or greater than the gas distributor’s cost of purchasing and selling gas to such customers.”

The sections of the Consolidated Regulations relevant to the Board are:

“3(1) (d) a gas distributor shall post the following on its internal website and publicize the following in any manner required by the Board:

- (i) the price that the gas distributor charged customers for gas in each of the preceding twelve months;
- (ii) the price that the gas distributor is charging customers for gas for the current month; and
- (iii) the price that the gas distributor is forecasting to charge customers for gas for the following twelve month period:”

“6(1) A financial report shall be in a form provided by the Board and shall include the following information for the twelve-month period ending on the thirty-first day of December prior to the report:

(a) the expenditures related to and revenue from the sale of gas:”

“6(2) The Board shall review a financial report filed pursuant to paragraph 3(1)(f) to satisfy itself that:

- (a) The gas distributor is not cross-subsidizing between the sales of gas and the distribution of gas
- (b) the prices charged by the gas distributor of gas and customer services are reasonable and sufficiently competitive to protect the interests of the customers
- (c) the price charged by the gas distributor to customers for gas has been calculated in accordance with section 4. and
- (d) the gas distributor has purchased gas for sale to customers in accordance with its Gas Purchasing Plan filed pursuant to paragraph 3(1)(e).”

“6(3) After reviewing a financial report filed pursuant paragraph 3(1)(f), the Board may make any order or give any direction under section 71 of the Act that it considers necessary.”

The Review and Results

The main objectives for each of the reviews of EGNB purchasing and selling activities have been:

To review and assess the EUG/EGNB accounts and activities associated with the purchase and sale of gas during the preceding fiscal year to determine if EGNB had complied with the Consolidated Regulations; and

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To offer advice and assistance, where appropriate, on other area of the Board's responsibility as set out in the Consolidated Regulations.

These objectives governed the review of EGNB activities during 2007.

Paul Hamilton again forwarded the basic financial and operating data considered relevant to the review several weeks prior to the visit to Fredericton. Again this proved to be very useful as it allowed an early start to the review and for requests for clarification and further information to be sent to EGNB before the visit to Fredericton. It also allowed preparation for the detailed review and discussions in Fredericton during the week of March 24, 2008. Preparing in advance and having the requested information waiting at the EGNB offices reduced the time required in Fredericton by one day.

During the Fredericton visit answers were obtained from EGNB staff to all questions and concerns regarding EGNB/EUG Accounts as well as the activities of EGNB staff, affiliated companies and consultants in the purchase and sale of gas that were carried out on behalf of EUG. The following are the major items covered during the review.

The review of the overall operations of EUG activities during 2007 showed that there had been no significant changes in EUG operations compared to 2006. As previously noted, EUG does not have any direct employees and all of the day-to-day activities are handled either by EGNB employees or EGNB affiliated companies under contract to EGNB. All agreements and contracts relating to EUG activities are negotiated and signed by EGNB staff. Day-to-day administration of these agreements and contracts is provided by either EGNB staff or EGNB affiliated companies. The agreements and contracts include; contracts for gas purchase, assignment of capacity from sellers, load balancing sales, contracts for management of daily operations and load balancing on

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Maritime and Northeast Pipeline (M&NP) plus all agreements or contracts for sales to end users.

Ms. S. Black had been responsible for EUG operations since 2003. As of November 2007, however, Ms. Black was no longer an employee of EGNB and her duties and responsibilities with respect to the gas purchase and sales activities were re-assigned. As a result a revised listing was requested from EGNB to show the specific tasks required for all of the day-to-day activities of EGNB/EUG in purchasing and selling natural gas and the person responsible for each task. This list showed that Paul Hamilton continues as the EGNB employee who undertakes most of the EUG day-to-day activities with the duties and responsibilities of Ms. S. Black being largely assumed by Mr. J. LeBlanc.

Since the change in personnel occurred late in 2007 it was agreed that the salary allocation should remain unchanged for 2007. For 2008 the charge from EGNB to EUG for salaries is to be changed to reflect the base salaries of the new personnel. The amounts charged to EUG in future years should be changed to reflect changes to the base salaries of the EGNB personnel involved in EUG operations.

Financial information related to both EGNB and EUG was provided by EGNB employees and also by Jeff Aucoin. This indicated that Gas Sales and Costs had increased from \$13.062 million in 2006 to \$14,391 million in 2007. It also showed that the balance in the Purchased Gas Variance Account (PGVA) increased from \$1.207 million on December 31, 2006 to \$1,971 million on December 31, 2007. It was confirmed that, depending on the balance in the PGVA, EUG continues to either pay interest to EGNB or be credited by EGNB with interest.

The review of the gas supply and load balancing contracts showed that EUG had contracted for sufficient supplies of natural gas to meet the demands of its

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customers. It also showed that EUG had successfully balanced daily flows on M&NP by selling all gas that was surplus to the needs of its customers. I am satisfied that the costs associated with the purchase of gas and the sale of gas for load balancing purposes were properly reflected in the EUG accounts during 2007.

As noted in previous Reports, EGNB has contracted with an affiliated company Enbridge Operational Services (EOS) for management of daily EGNB/EUG activities on M&NP. Details of the services provided by EOS to both EGNB and EUG were described in a previous Report. EGNB staff confirmed that neither the contract nor the services provided by EOS had changed during 2007. I am satisfied, therefore, that the charges to EUG for the services provided by EOS in 2007 were reasonable.

Discussions with J. Aucoin disclosed that although EGNB carries an allowance for bad debt none of this is charged to EUG even though some of that allowance almost certainly relates to gas sales. It was thought that the EGNB Agency Billing and Collection (ABC) service, for which EGNB charges EUG a fee, would relieve EUG from responsibility for bad debts. However, this could not be confirmed since a copy of the ABC Agreement could not be found. In addition, an attempt to analyze the bad debt allowance revealed that the data available is insufficient to determine what amount, if any, would be attributable to EUG customers.

The overall amount of bad debt is relatively small so the amount that relates to EUG customers could be immaterial. However, as this might be considered a cross-subsidy it was agreed that EGNB should investigate the ABC Agreement further and change its record keeping for bad debts so that the required information will be available for analysis next year.

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Information provided by EGNB personnel indicated that, in addition to the Off-Peak Offer that had been available to EUG customers during 2006, two new Alternative Offers were added in 2007. The new offers were a Variable Rate Offer and a One-Year Fixed Price Offer.

To allow tracking of the revenues and costs associated with the Alternative Offers EGNB had added new EUG Accounts for each alternative offer during 2007. These accounts included revenues and costs, as well as overhead items, related to each Alternative Offer.

During 2007 the revenues from the Off-peak and Variable Rate Offers exceeded the total cost of purchasing and selling gas to those customers. As such EUG was in compliance with the Consolidated Regulations with respect to these Offers during 2007.

The Fixed Price Offer however, runs from November 1, 2007 to October 31, 2008 and its compliance with the Consolidated Regulations can not be determined until the end of the period. This offer involved EGNB/EUG fixing the price for the volumes of gas that customers who accepted the offer were forecast to consume during this one-year period. As it is unlikely, however, that those customers will consume the exact amount of fixed price gas that EUG has under contract, EUG will either have fixed price gas to sell or need to buy more gas. Depending on the market price when EUG needs to balance these volumes it is possible that costs could exceed revenues. Since this information will not be known until November 2008 this issue will be revisited during the 2008 review. At that time it may be necessary to consider if the wording in the Consolidated Regulations can be interpreted as meaning that the costs and revenues from all Alternative offers can be aggregated to meet the test. If so it is possible that any losses on the Fixed Price Offer could be offset by gains from other alternative offers.

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It was confirmed that during 2007 the positive differences between revenues from the Alternative Offers and the cost of purchasing and selling that gas was transferred to the PGVA and included in the determination of future rates for the Standard Offer.

As noted in previous Reports the charges to the EUG LUF Account result from a calculation by EOS of the true-up required among marketers who ship gas to their customers through any of the eight M&NP delivery meters. This true-up is required to balance the difference between nominations into the pipeline and the volumes consumed by the customers of each marketer at each M&NP meter location. EGNB sends invoices to other shippers on M&NP with respect to this true-up but due to an on-going dispute with M&NP as to the accuracy of its meter readings, some of these invoices remain unpaid and the shippers are reluctant to acknowledge the accuracy of EGNB invoices.

This dispute involves other shippers as well as EGNB and current information is that it could be resolved shortly. Since EOS has used the same methodology to calculate the true-up volumes it is expected that the outstanding invoices will be settled in due course.

As required by the Consolidated Regulations, at the end of each month EUG produces a forecast of its operations for the following year and calculates the Standard Offer Price that should be charged for gas in each of the following twelve months. This price calculation includes the recovery or disposal of the most recent actual PGVA balance over the following 12 months. I am satisfied that the changes previously agreed to have been incorporated into the methodology used for forecasting and calculating future gas prices during 2007. As noted earlier, margins from the Alternative Offers were also incorporated into these calculations, consistent with the Consolidated Regulations.

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As noted, areas where a potential could exist for cross-subsidy between EUG and Regulated EGNB were closely examined and discussed with J. Aucoin C.A. Other than the bad debt allowance no new areas were identified.

The Regulations require EGNB to publicize the following in any manner that the Board may require:

- The price charged customers for gas in each of the preceding twelve months;

- The price for the current month; and

- The price forecast for the following twelve month period.

Prices for the current month as well as the previous twelve months (in fact back to May 2003) were found on the EGNB website. Rate schedules were also found on the website and each includes “Enbridge Utility Gas Current & 12 Month Forecasted Rate (\$/GJ)”. This portion of the rate schedule for each customer class shows the Selling Price for the current month and also the forecast rate for the following twelve months. I am satisfied therefore, that EGNB is publicizing the information required by the Regulations and in a manner that should satisfy the Board.

I am satisfied that the hedging activity during 2007 did not contravene any part of the Legislation and/or Regulations and the review demonstrated that the results are being recorded appropriately in the EUG accounts.

Throughout the review, Paul Hamilton and all other EGNB employees involved were fully cooperative and made every effort to be available when required. All queries and questions were answered with any additional financial and operating data needed to support their answers being provided within a reasonable time.

EUG Prices and Competition

Section 6(2) (b) of the Consolidated Regulations require that the Board be satisfied that “the prices charged by the distributor for gas and customer services are reasonable and sufficiently competitive to protect the interests of the customers.” As noted in previous Reports the “customer services” are not part of the purchase and sale of gas and as such are excluded from this review. In addition, the word “reasonable” and the term “to protect the interests of the customers” are subject to interpretation.

The following comments and opinions are, therefore, intended only to provide assistance to the Board with respect to Section 6(2) (b) of the Consolidated Regulations. When assessing if prices are “reasonable and sufficiently competitive to protect the interests of the customers” the Board may wish to consider that, in spite of competition from other marketers and a complex New Brunswick natural gas market, EUG sales continued to grow during 2007. I conclude from this that the EUG prices were sufficiently competitive and that the interests of the customers were protected.

Conclusions

Based on my review of EGNB/EUG gas purchase and sales activities during 2007, my analysis of EUG accounts, the calculation of future rates by EUG and my discussions with J. Aucoin and EGNB personnel, I have concluded that EGNB/EUG was in compliance with the Consolidated Regulations throughout 2007.

Signed by J. C. Butler P. Eng.

In Oakville, Ontario on May 29, 2008