GAZIFÈRE INC.
EVIDENCE TO SUPPORT GAZIFÈRE DEBT ISSUANCE PROCESS AND COST OF BORROWING
2012 Rate Case (Phase III)

This evidence is provided to describe in more detail the methodology used to determine Gazifère's debt costs.

General Approach

Gazifère derives the cost of debt using a forecast 10-year Government of Canada bond plus a corporate credit premium estimated by an independent financial institution with expertise and knowledge of Canadian debt capital market conditions. It is industry standard to use the 10 year term when quoting corporate debt. The financial institution estimates the premium based on the assumption that Gazifère is a stand-alone entity without a credit rating. It is common regulatory practice to have a utility's cost of debt determined on a stand-alone basis when a corporate parent provides that entity's funding.

Process of Estimating the Premium on Cost of Debt

When estimating the premium that should be applied to the cost of debt, the financial institution assesses several factors. These factors include:

- Premiums of comparable companies in the industry
- Nature of the business and nature of the entity's assets
- Financial strength of the entity
- Size of the entity
- Size of the potential debt issue and market access

Several of the above factors warrant further discussion:

1) Size of the entity

The size of an entity is relevant because a smaller entity faces greater exposure to one-time events. This factor is supported by the fact that rating agencies generally will assess the size of entity when determining a credit rating. An excerpt from a Dominion Bond Rating Service ("DBRS") report elaborates on how the size of an entity can have an impact on the entity's ability to maintain future interest and debt principal payments:

> While bigger is not necessarily better, a larger equity base can also provide additional comfort from one time hits, and larger credits often have more funding options in time of stress.

A smaller entity thus has a higher risk profile from a credit perspective than a larger entity, which results in an additional premium applied by the debt market to the cost of debt.

2) Size of the potential debt issue and market access

The size of the debt issue will impact the market accessibility of the entity. To access liquid public debt markets, an entity typically requires a credit rating and the principal amount of the debt will need to be of a sufficient size to justify the expense of issuing the debt and maintaining on-going financial reporting and disclosure obligations under securities legislation and regulations. An entity with no credit rating that issues a small tranche of debt will not be able to cost-effectively access liquid public debt markets. As such, a private placement transaction will be the primary funding alternative for an unrated entity issuing small tranches of debt.

In general, by nature the private placement market contains a smaller buyer universe than for a public transaction. As such, investors for private placements will tend to have more negotiating power and the credit spread will be a key area of negotiation between the borrower and the investors. Thus issuing debt in the private placement market will typically result in an additional premium applied to debt costs due to the illiquid nature of the market. Gazifère has relied upon an independent credit assessment by RBC Capital Markets, a leading Canadian Investment Bank (See exhibit G-26, document 4.2). RBC has included a private placement premium in their credit spread estimate of 20 – 25 bps.

<u>Benefit to Gazifère of Borrowing from Enbridge Inc.</u>

Gazifère does borrow from its parent, Enbridge Inc. to meet long-term funding requirements. This arrangement results in certain benefits to Gazifère that are not included in the corporate credit premium included in the debt costs. Enbridge does not pass through to Gazifère any debt issue commission costs or other fixed fees that Enbridge Inc. actually incurs, and Gazifère would incur on a stand-alone basis in a debt issue. These fixed fees include legal, filing and auditor fees that are independent of the issuance size.

If issuance fees were to be incurred by Gazifère on a small debt issue, these fees would result in 40 bps of premium being added to the debt costs. The potential impact on Gazifère debt costs for 2012 is illustrated below, using the June 2011 indicative credit spread provided in the RBC Capital Markets report:

	Debt Costs (%)	Potential Debt Costs (%)
GOC 10-year bond rate per June 2011 Consensus Forecast	3.60%	
Premium	<u>2.60</u>	
Debt Cost	**6.20%**	
Avoided additional Fees: (amortized over life of debt)		
Commission & fixed fees		<u>0.40</u>
Potential Effective Debt Cost		**<u>6.60</u>**
Benefit to Gazifère by borrowing from Enbridge Inc.		**0.40% per year for 10 years or approximately $200,000 over 10 years**