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October 9, 2008

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Union Gas Limited - EB 2008-0273**

I am counsel to Union Gas Limited ("Union") in this matter. In its Notice of Application, dated September 16, 2008, the Ontario Energy Board ('Board") indicated that at issues day the Board would "hear arguments as to whether the application properly falls into section 42 (1) or section 36 of the Ontario Energy Board Act."

Union agrees that part of the relief sought in its Application, specifically in paragraph 12, is "rate related" in nature and therefore falls under section 36 (and section 23) of the Act.

I am attaching an amended Application in this matter which simply makes it clear that Union is relying on sections 23 and 36 of the Act in connection with the alternative relief sought.

I am also attaching a draft Issues List which Union proposes form the core of the issues at the hearing together with Union's evidence on this matter.

Yours very truly,

Michael Penny

Tel 416.865.7526
mpenny@torys.com

**MAP/nd**
**Enclosure**

8946798.1
11229-2064

# ONTARIO ENERGY BOARD

**IN THE MATTER OF** the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule. B);

**AND IN THE MATTER OF** an Application by Union Gas Limited for an order granting it leave to discontinue gas transmission to Natural Resource Gas Limited;

## AMENDED APPLICATION

1. Union Gas Limited ("Union") is a business corporation, incorporated under the laws of Ontario, with its head office in the Municipality of Chatham-Kent.

2. Union conducts an integrated natural gas utility business that combines the operations of selling, distributing, transmitting and storing gas within the meaning of the *Ontario Energy Board Act, 1998* (the "Act").

3. Natural Resource Gas Limited ("NRG") delivers gas to Union in firm daily even quantities pursuant to a Bundled T Gas Contract (the "BT Contract") first made as of October 2004.

4. Union re-delivers gas, as a gas transmitter, to NRG pursuant to an M9 Delivery Contract (the "Delivery Contract") first made as of October 2006.

5. Section 5.04 of the General Terms and Conditions of both the BT Contract and Delivery Contract provides as follows:

> **5.04 Financial Assurance**
>
> If at any time during the Term of this contract, Union has reasonable grounds to believe that Customer's creditworthiness under the Contract has become unsatisfactory, then Union may by written Notice request financial assurances from Customer in an amount determined by Union in a commercially reasonable

manner. Upon receipt of such Notice, customer shall have fourteen days to provide such financial assurances.

6. Union has reasonable grounds to believe that NRG's creditworthiness under the Contracts has become unsatisfactory. Union has held this belief for nearly a year and has attempted, without success, to obtain financial assurances from NRG.

7. Recently, on June 16, 2008, Union wrote to NRG to advise it that Union was forecasting a maximum exposure to NRG of $1,928,138.00 (the "Anticipated Maximum Exposure"). Based upon NRG's then available 2006 financial statements and other financial information, Union determined that it could grant NRG an unsecured credit facility of $600,000, leaving a balance of $1,328,138.00.

8. In its letter, Union advised NRG that it could satisfy the Anticipated Maximum Exposure in one of two ways. First, NRG could provide financial assurances in the amount of CDN $1,328,138, being the difference between the Anticipated Maximum Exposure and the unsecured line of credit Union had assigned to NRG (the "Financial Assurances"). The Financial Assurances could be provided in the form of a cash security deposit or a letter of credit. Second, NRG could make arrangements to change the renewal date of its BT Contract to an annual anniversary date of April 1, the effect of which would be to eliminate any credit issues arising from NRG's Banked Gas Account (the primary cause of NRG's credit exposure) on a going forward basis.

9. Union sought NRG's positive response to its request for Financial Assurances or a change to the terms of the BT Contract prior to June 23, 2008, with such assurances or the change in the renewal date of the BT Contract to be in place by July 30, 2008 failing which NRG would be in default under the General Terms and Conditions. Union informed NRG that such default would entitle Union to certain contractual remedies including suspension of service and/or termination of the Contract(s) between Union and NRG.

10. On June 27, 2008, having not received a response to its letter, Union again wrote to NRG seeking the Financial Assurances. In its June 27, 2008 letter Union informed NRG that it was Union's intention to file an application with the Board to request permission to

suspend service and/or terminate the Contracts between Union and NRG pursuant to section 42.(1) of the Act.

11. On July 2, 2008, NRG, through counsel, responded to Union to advise it that NRG would not provide the requested Financial Assurances, nor would it agree to a change in the renewal date of the BT Contract.

12. Union has been left with no alternative but to apply to the Board pursuant to Section 42(1) of the Act for an order granting Union leave to discontinue service to NRG until such time as it has provided the Financial Assurances. In the alternative, <u>under sections 23 and 36 of the Act,</u> Union requests an order, <u>as a condition of continued service</u>, that NRG be directed to provide the Financial Assurances within fourteen days of the date of the order. In the further alternative, Union requests an order <u>imposing, as conditions of continued service to NRG, an annual</u> renewal date <u>for</u> <u>NRG's</u> BT Contract of April 1 <u>and an adjustment to NRG's DCQ to target a zero (+/- 4%) balance as of March 31</u>.

13. Absent an order from the Board compelling NRG to provide the Financial Assurances or a change in the renewal date of the BT Contract, it can reasonably be expected that concerns regarding NRG's creditworthiness will recur on a yearly basis.

14. Union further applies to the Board for all necessary orders and directions concerning pre-hearing and hearing procedures for the determination of this application.

15. This application will be supported by written evidence. This evidence will be pre-filed and will be amended from time to time as required by the Board, or as circumstances may require.

16. The persons affected by this application are NRG and the customers resident or located in the municipalities, police villages and Indian reserves served by NRG, together with those to whom Union sells gas, or on whose behalf Union distributes, transmits or stores gas in its franchise area. It is impractical to set out in this application the names and addresses of such persons because they are too numerous.

17. The address of service for Union is:

Union Gas Limited
P.O. Box 2001
50 Keil Drive North
Chatham, Ontario
N7M 5M1

| | |
|---|---|
| Attention: | Mark Kitchen<br>Director, Regulatory Affairs |
| Telephone: | (519) 436-5275 |
| Fax: | (519) 436-4641 |
| E-mail: | mkitchen@spectraenergy.com |

- and -

Torys LLP
Suite 3000, TD Waterhouse Tower
P.O. Box 270
Toronto-Dominion Centre
Toronto, Ontario
M5K 1N2

| | |
|---|---|
| Attention: | Crawford G. Smith |
| Telephone: | (416) 865-8209 |
| Fax: | (416) 865-7380 |
| email: | csmith@torys.com |

DATED: August 1, 2008.

UNION GAS LIMITED

By its Solicitors

Torys
Suite 3000, Maritime Life Tower
P.O. Box 270
Toronto-Dominion Centre
Toronto, Ontario
M5K 1N2

| | |
|---|---|
| Attention: | Crawford G. Smith |
| Telephone: | (416) 865-8209 |
| Fax: | (416) 865-7380 |

**EB-2008-0273**

**ONTARIO ENERGY BOARD**

**IN THE MATTER OF** the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule. B);

**AND IN THE MATTER OF** an Application by Union Gas Limited for an order granting it leave to discontinue gas transmission to Natural Resource Gas Limited;

**ISSUES LIST**

1. Does Union have reasonable grounds to believe that NRG's credit worthiness under the prior contract has become unsatisfactory?

2. Was the amount of the financial assurance requested by Union determined in a commercially reasonable manner?

3. Has NRG failed to provide the financial assurances requested?

4. Can the need for financial assurances be avoided by the restructuring of NRG's Southern Bundled T Contract to provide for a March 31 year end?

5. Should the Board issue an order imposing conditions of service on NRG similar to those reflected in amendments proposed by Union in Union's letter to NRG dated August 27, 2008, which is attached as Appendix A?

6. Alternatively, should the Board issue an order requiring NRG, as a condition of Union's continued service, to provide the financial assurance Union has requested?

7. In the further alternative, should the Board issue an order granting Union leave to suspend service to NRG?

# PREFILED EVIDENCE

## Overview

1. This evidence is filed in support of an application by Union Gas Limited ("Union") for an order of the Board imposing conditions on bundled transportation service to Natural Resource Gas Limited ("NRG"), requiring NRG to provide financial assurances as a condition of continued service or, alternatively, in the absence of either of the above, granting leave for Union to discontinue service to NRG.

2. Union has reasonable grounds to believe that NRG's creditworthiness is no longer satisfactory. As it was entitled to do under the terms of the contract between the parties, Union sought financial assurances from NRG in an amount determined in a commercially reasonable manner. Union also proposed revised conditions of bundled transportation service that would avoid the need for financial assurances. Union's requests for financial assurances were denied as was Union's proposal for revised conditions of bundled transportation service. NRG is, therefore, in default under the contract. As a result, Union is entitled under the contract to suspend service. Suspension of service is a last resort. It is in the interests of all parties either to have revised conditions of bundled transportation service which avoid the need for financial assurances or to have the financial assurances provided.

3. The remainder of this evidence is organized as follows:

(1) The Contract;

(2) Union's Approach to Creditworthiness;

(3) NRG's Creditworthiness is Unsatisfactory; and

(4) Relief Sought.

## The Contract

4. NRG is obliged to deliver gas to Union in constant daily quantities ("DCQ") pursuant to a Bundled-Transportation Gas Contract (the "BT Contract") first made as of October 2004. The

contract year end is September 30. Under the BT Contract Union tracks the difference between NRG's DCQ delivered to Union and the fluctuating daily consumption of NRG's customers. NRG's 12 month BT contract starts October 1, with a balance typically close to zero (+/- 4%). Through the winter months, NRG's heat sensitive customer's burn more gas than is being delivered by NRG resulting in a draft, or negative Banked Gas Account ("BGA"). The largest negative balance in the BGA typically occurs in the month of March. In NRG's case, as described below, this represents a credit exposure to Union of approximately $1.9 million.

5. In the following spring and summer months, NRG's customers burn less gas than is being supplied by NRG to Union, thus NRG "repays" the negative position created in the winter and gradually brings the negative BGA balance back to zero by September 30.

6. Union re-delivers gas, as a transmitter, to NRG pursuant to an M9 Delivery Contract (the "Delivery Contract") first made in October 2006.

7. Section 5.04 of the General Terms and Conditions of both the BT Contract and Delivery Contract provides as follows:

> **5.04 Financial Assurance**
>
> If at any time during the Term of this contract, Union has reasonable grounds to believe that Customer's creditworthiness under the contract has become unsatisfactory, then Union may by written Notice request financial assurances from Customer in an amount determined by Union in a commercially reasonable manner. Upon receipt of such Notice, Customer shall have 14 days to provide such financial assurances.

8. Section 5.04 also provides that the financial assurances requested will not exceed, among other things, an amount equivalent to the value, as determined by Union, of any current projected negative BGA balance. Section 5.04 further provides that, in the event NRG fails to provide financial assurances when requested, the termination and suspension provisions in Section 3 of the General Terms and Conditions apply. These provisions provide, in relevant part, as follows:

> **3.01 Terminations By Either Party**

> … Subject to the other provisions of this contract, in the event of a breach, misrepresentation, non-observance or non-performance by any party to this Contract of any covenant, provision, representation, condition, continuing condition, restriction or stipulation contained in this Contract, the party not in default may give written Notice to the defaulting party requiring it to remedy such default. If the defaulting party fails to fully remedy the party not in default for all consequences of such default within a period of ten (10) business days from receipt of such Notice, this Contract may be terminated by Notice from the party not in default.
>
> . . .
>
> **3.02 Suspension of Service**
>
> If Customer is the defaulting party and the default is material, Union reserves the right to suspend any or all of the services and such suspension shall not relieve Customer from paying any charges.
>
> **An event of default giving rise to Union's right to suspend shall include a failure to pay Union when payment is due, a failure to provide financial assurances when required under Section 5.04, and a failure to deliver. In all cases, the materiality of the default shall be determined by the parties hereto, acting reasonably.** [Emphasis added]

**Union's Approach to Creditworthiness**

9. As a matter of routine business practice, Union conducts annual reviews of the financial condition of its customers, establishes credit limits and determines whether financial assurances may be required. Union also has the discretion to undertake ad hoc reviews at any time. Regular credit reviews are a necessary part of managing Union's credit risk and minimizing bad debt expense.

10. Union issues Internal Risk Ratings (IRRs) which are the company standard for describing counterparty credit risk. IRRs are counterparty credit ratings derived by internal credit analysts from qualitative and quantitative assessments of the customer's creditworthiness. The analysis includes a review of the customer's business, the industry in which it operates, the latest financial statements with comparative year end results; any external credit ratings from Moody's, S&P or any other reliable rating service, Dunn & Bradstreet reports, links to main sites or

sources of credit review information; payment history with Union, customer correspondence and other relevant credit information. All of this information is incorporated into a commercial credit assessment product created by Moody's called Moody's RiskCalc. Moody's RiskCalc is decision support tool used by many businesses to assist in evaluating an entity's credit risk.

**NRG'S Creditworthiness is Unsatisfactory**

11. NRG's 2006 credit review was based on 2005 financial statements and resulted in an internal credit rating of BBB- and an unsecured credit limit of $3 million. This evaluation was consistent with previous years.

12. In August 2007, however, Union obtained a copy of NRG's audited financial statements for year end September 30, 2006. The 2006 statements were accompanied by a qualified auditor's opinion which was cause for concern. These statements and the qualified opinion are attached as Exhibit 1.

13. The auditor's opinion was qualified because the company had Class C retractable shares outstanding with a redemption value of about $13.5 million. The auditor noted that Canadian generally accepted accounting principles required NRG to present shares that are retractable at the option of the shareholder as a liability on the balance sheet. NRG, however, had presented these shares as shareholders' equity. The auditor noted: "If the shares were classified as liabilities, then the total liabilities would increase by $13,461,418 and share capital would decrease by $13,461,418."

14. As can be seen from the financial statements, decreasing NRG's shareholders' equity by $13.5 million and increasing its liabilities by $13.5 million has the effect of reducing shareholders equity to a deficit of $9.1 million. In fact, therefore, NRG has negative shareholders equity, which provides no protection for creditors.

15. In addition, the 2006 audited financial statements also revealed that, during 2006, NRG took out a demand loan with the Bank of Nova Scotia which it secured by a pledge of all of NRG's present and future assets, property and undertaking. This meant, as described in more detail below, that everything the company owned (including cash collected from NRG's

customers in payment for gas borrowed from Union under the Bundled T Contract) was pledged to the Bank in priority to any Union claims.

16. NRG's 2006 current assets of about $3 million are less than its current liabilities of about $8.4 million. This would mean, for example, that if the bank demanded payment of the loan (about $6.5 million) there would not be sufficient current assets to repay the bank loan, much less to repay the cost of the gas NRG borrows from Union by March 31 of the heating season.

17. On the basis of the review of NRG's 2006 financial statements the new Bank security over all of NRG's assets and the evaluation of credit risk using the Moody's RiskCalc model, the credit rating for NRG was reduced to B- and the unsecured credit limit available to NRG was reduced to $600,000. (Union has reviewed NRG's 2007 financial statements and recalculated Union's credit exposure using current information on gas prices. There has been no material change in Union's calculation of its credit exposure or to the calculation of the required Financial Assurances.)

18. The credit limit of $600,000 is approximately equal to the total delivery revenue earned in a year by Union from NRG. Any additional unsecured credit increases Union's exposure beyond this annual revenue. Over the winter, NRG typically incurs significant indebtedness to Union as a result of the negative balance in its BGA. NRG's assets in the winter months include cash collected from NRG's customers for the sale of gas which NRG has effectively "borrowed" from Union. These funds, however, together with all of NRG's other property, assets and undertaking, have been pledged to the Bank of Nova Scotia as security for Bank indebtedness with priority over any Union claims. In these changed circumstances, Union could not prudently continue to provide the same level of unsecured credit to NRG as it had done in the past.

19. Between September 2007 and June 2008, Union attempted, by email and through telephone communications, to contact NRG to discuss the changed financial circumstances and the provision of financial assurances or, at a minimum, the scheduling of a meeting to discuss such assurances. All attempts by Union in this regard were effectively ignored. Union's phone calls were not returned. Scheduled meetings were cancelled by NRG without explanation.

20. Accordingly, on June 16, 2008, Union wrote to NRG indicating that Union was now forecasting a maximum exposure from NRG of $1,928,138 (the "Anticipated Maximum Exposure"). This exposure primarily consists of a forecasted BGA of $1,778,305 based upon Union's Ontario Landed Reference Price ("Reference Price"). Union's forecast does not take into account fluctuations in gas prices or usage and assumes that NRG will continue to make timely payments on all accounts. Union multiplies the cumulative negative BGA forecast by the Reference Price to determine the BGA exposure. The June 16, 2008 letter is attached as Exhibit 2.

21. In this letter, Union advised that NRG could satisfy Union's Anticipated Maximum Exposure in one of two ways. First, NRG could, as contemplated by section 5.04(c) of the BT Contract, provide financial assurances in the amount of CDN $1,328,138, being the difference between the Anticipated Maximum Exposure and the unsecured line of credit of $600,000 for which NRG had qualified (the "Financial Assurances"). The Financial Assurances could be provided in the form of a cash security deposit or a letter of credit.

22. Second, NRG could make arrangements to change the renewal date of its BT Contract to an annual anniversary date of April 1. As a transition, Union proposed a new eight month contract commencing August 1, 2008 under which the quantity of gas delivered by NRG until the end of March, 2009 would equal the quantity consumed by NRG's customers, such that the BGA as at April 1 would be zero (+/- 4%). This would avoid a negative BGA balance in March 2009, thus eliminating Union's financial exposure and, therefore, the need for Financial Assurances. Under Union's proposal, the BT Contract could thereafter renew for a 12-month period starting April 1, 2009. An April contract renewal date, together with adjusted DCQ obligations which target a zero balance as at March 31, eliminates any credit issues on a going forward basis because the BGA would never be in a negative balance.

23. Union's June 16, 2008 letter asked for NRG's response to the request for Financial Assurances or a change to the terms of the BT Contract before June 23, 2008, failing which NRG would be in default under the General Terms and Conditions.

24. Finally, Union advised that, failing a satisfactory response, Union would bring an application for leave to suspend service to NRG on account of NRG's default.

25. Union did not receive any response to this letter. As a result, on June 27, 2008 Union again wrote to NRG seeking confirmation that NRG would provide the requested Financial Assurances or agree to change the BT Contract. This letter is attached as Exhibit 3.

26. Only on July 2, 2008 NRG did respond, through counsel, that it was not prepared to provide the requested Financial Assurances or agree to new contract delivery and balancing parameters. This letter is attached as Exhibit 4.

27. On August 27, 2008, due to the passage of time, Union sent a BT Contract renewal package to NRG. The transitional BT Contract renewal was now proposed to start October 1, 2008 and expire on April 1, 2009. Under this BT Contract renewal, NRG's required daily deliveries of gas would match NRG's forecast consumption in the period thereby again eliminating the forecasted negative BGA position and the need for Financial Assurances. This letter is attached as Exhibit 5.

28. On September 5, 2008 NRG responded, through counsel, that NRG would not sign the BT Contract renewal and would continue with the existing contractual arrangement pending a Board decision in Union's application. This letter is attached as Exhibit 6.

**Relief Sought**

29. Union seeks an order pursuant to sections 23 and 36 of the *Ontario Energy Act, 1998* imposing conditions of service on NRG, whereby: 1) bundle T service to NRG will be on an April 1 to March 31 annual cycle; 2) NRG will be obliged to deliver sufficient quantities of gas between November 1, 2008 and March 31, 2009 to achieve a zero (+/- 4%) balance in its BGA as of March 31, 2009. Union calculates NRG's required DCQ for the November 1, 2008 to March 31, 2009 period to be 2,759 GJ based on actual 2007 / 2008 consumption for this period; and, 3) thereafter, NRG's DCQ will be set to target a zero balance (+/- 4%) on each succeeding March 31st. Union calculates NRG's required DCQ for a full year cycle to be 1,454 GJ based on the most recent 12 months of actual consumption.

October 9, 2008

30. In the alternative, Union requests an order that, as a condition of continued service, NRG be directed to provide the Financial Assurances within 14 days of the date of the Board's decision in this matter.

31. In the further alternative, failing either of the above, Union requests an order pursuant to section 42 (1) of the *Ontario Energy Act, 1998* granting Union leave to discontinue service to NRG until such time as it has revised the conditions of bundled T service with an April 1 renewal date or provided the Financial Assurances.

October 9, 2008

# NATURAL RESOURCE GAS LIMITED

# FINANCIAL STATEMENTS

# SEPTEMBER 30, 2006

NEAL, PALLETT & TOWNSEND LLP

CHARTERED ACCOUNTANTS
633 Colborne Street
Suite 300
London, Ontario
N6B 2V3

Telephone: (519) 432-5534
Fax: (519) 432-6544
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Partners:
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Barrie J. Neal F.C.A.*
David J. Pallett C.A.*
Douglas Plummer C.A.*
John D.R. Prueter C.A., M.B.A.*
Piyush Shah C.A.*
Jonathan R. Townsend C.A.*
L.J. Sandy Wetstein C.A.*

*Professional Corporation*

# AUDITORS' REPORT

To the Board of Directors
Natural Resource Gas Limited

We have audited the balance sheet of Natural Resource Gas Limited as at September 30, 2006 and the statements of income, deficit, and cash flows for the year then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

The company has issued and outstanding Class C shares with a redemption value of $13,461,418. Canadian generally accepted accounting principles require that the company present and classify shares that are retractable at the option of the shareholder as a liability on the balance sheet. The company has presented these shares as part of Shareholders' equity. If the shares were classified as liabilities, then the total liabilities would increase by $13,461,418 and share capital would decrease by $13,461,418.

In our opinion, except that the Class C shares of the company have been presented as part of Shareholders' equity rather than as a liability, these financial statements present fairly, in all material respects, the financial position of the company as at September 30, 2006 and the results of its operations and changes in its financial position for the year then ended in accordance with the basis of accounting disclosed in the summary of significant accounting policies.

Neal, Pallett & Townsend LLP

London, Canada
December 20, 2006

Neal, Pallett & Townsend LLP
Chartered Accountants
Licensed Public Accountants

# NATURAL RESOURCE GAS LIMITED

Balance Sheet

As at September 30

| | | 2006 | | 2005 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash | $ | **683,120** | $ | 45,526 |
| Accounts receivable (note 5) | | **2,075,375** | | 1,455,365 |
| Inventory | | **153,510** | | 121,524 |
| Prepaid expenses | | **6,921** | | 7,207 |
| Income taxes recoverable | | **83,647** | | - |
| Deferred charges | | **154** | | 149 |
| | | **3,002,727** | | 1,629,771 |
| Property, plant, and equipment (note 1) | | **9,430,278** | | 9,428,346 |
| Other assets: | | | | |
| Franchises and consents (note 2) | | **71,817** | | 79,087 |
| Deferred financing costs (note 3) | | **43,014** | | 17,234 |
| Deferred charges (note 4) | | **191,928** | | - |
| | | **306,759** | | 96,321 |
| | $ | **12,739,764** | $ | 11,154,438 |

See accompanying notes to the financial statements.

# NATURAL RESOURCE GAS LIMITED

Balance Sheet

As at September 30

| | 2006 | 2005 |
|---|---|---|
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities: | | |
| Demand debenture payable | $ - | $ 118,000 |
| Accounts payable and accrued liabilities (note 5) | **1,445,775** | 1,864,792 |
| Income taxes payable | - | 58,560 |
| Deferred revenue | **187,251** | 146,729 |
| Customer deposits | **280,974** | 105,045 |
| Term note payable (note 6) | **6,454,484** | - |
| Current portion of long-term debt (note 8) | - | 387,780 |
| | **8,368,484** | 2,680,906 |
| Long-term debt (note 8) | - | 2,335,629 |
| | **8,368,484** | 5,016,535 |
| Shareholders' equity: | | |
| Share capital (note 9) | **13,461,439** | 15,500,020 |
| Deficit | **(9,090,159)** | (9,362,117) |
| | **4,371,280** | 6,137,903 |
| | **$ 12,739,764** | $ 11,154,438 |

See accompanying notes to the financial statements.

# NATURAL RESOURCE GAS LIMITED

Statement of Deficit

Year ended September 30

| | | **2006** | | 2005 |
|---|---|---|---|---|
| Balance, beginning of year | **$** | **(9,362,117)** | $ | (9,761,070) |
| Net income for the year | | **271,958** | | 398,953 |
| Balance, end of year | **$** | **(9,090,159)** | $ | (9,362,117) |

See accompanying notes to the financial statements.

# NATURAL RESOURCE GAS LIMITED

Statement of Income

Year ended September 30

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Gas commodity revenue | $ | **8,947,781** | $ | 7,342,777 |
| Gas commodity cost | | **8,757,743** | | 7,132,905 |
| Gross margin on commodity | | **190,038** | | 209,872 |
| Distribution revenue | | **3,529,715** | | 3,704,162 |
| Distribution costs | | **494,736** | | 544,676 |
| Gross margin on distribution | | **3,034,979** | | 3,159,486 |
| Other sales | | **1,162,561** | | 1,208,357 |
| Other costs | | **683,797** | | 779,635 |
| Gross margin on other sales | | **478,764** | | 428,722 |
| Other revenue | | **123,199** | | 79,137 |
| Total gross margin | | **3,826,980** | | 3,877,217 |
| Expenses | | **3,375,022** | | 3,204,264 |
| Income before provision for income taxes | | **451,958** | | 672,953 |
| Provision for income taxes (note 7) | | **180,000** | | 274,000 |
| Net income for the year | $ | **271,958** | $ | 398,953 |

| | | | | |
|---|---|---|---|---|
| Included in expenses are the following: | | | | |
| Amortization of deferred financing costs | $ | **22,013** | $ | 6,196 |
| Amortization of deferred charges | $ | **21,326** | $ | - |
| Amortization of franchises and consents | $ | **7,270** | $ | 7,270 |
| Amortization of property, plant and equipment | $ | **690,084** | $ | 657,232 |
| Interest on long-term debt | $ | **141,393** | $ | 320,867 |
| Interest on short-term debt | $ | **251,352** | $ | 4,164 |

See accompanying notes to the financial statements.

# NATURAL RESOURCE GAS LIMITED

Statement of Cash Flows

Year ended September 30

| | 2006 | 2005 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income for the year | $ **271,958** | $ 398,953 |
| Items not affecting working capital: | | |
| Amortization | **740,693** | 670,698 |
| Changes in non-cash working capital: | | |
| Accounts receivable | **(620,010)** | (165,929) |
| Inventory | **(31,986)** | 8,738 |
| Prepaid expenses | **286** | 16,712 |
| Income taxes recoverable (note 13) | **(83,647)** | - |
| Accounts payable and accrued liabilities | **(419,017)** | 143,989 |
| Income taxes payable (note 13) | **(58,560)** | 117,538 |
| Deferred revenue | **40,522** | 27,791 |
| Deferred charges | **(5)** | 32,646 |
| Customer deposits | **175,929** | 2,831 |
| | **16,163** | 1,253,967 |
| Cash flows from investing activities: | | |
| Additions to property, plant, and equipment | **(692,016)** | (814,214) |
| Additions to deferred charges | **(213,254)** | - |
| Additions to deferred financing costs | **(47,793)** | - |
| | **(953,063)** | (814,214) |
| Cash flows from financing activities: | | |
| Repayments of long-term debt | **(2,723,409)** | (345,042) |
| Reduction of stated capital of Class A shares | **(2,038,581)** | - |
| Proceeds from term note payable | **6,500,000** | - |
| Repayments of term note payable | **(45,516)** | - |
| Repayments of demand debenture payable | **(118,000)** | (7) |
| | **1,574,494** | (345,049) |
| Increase in cash and cash equivalents during the year | **637,594** | 94,704 |
| Cash and cash equivalents, beginning of year | **45,526** | (49,178) |
| Cash and cash equivalents, end of year | $ **683,120** | $ 45,526 |

See accompanying notes to the financial statements.

**Summary of significant accounting policies:**

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, the more significant of which are summarized below.

*Regulation:*

The utility operations of the company is a rate regulated, natural gas distribution utility and operates within a limited area of Southwestern Ontario under franchise agreements that are approved by the Ontario Energy Board (OEB).

The utility operations are subject to regulations under The Ontario Energy Board Act and The Energy Act (Ontario). Revenue rate schedules are approved periodically by the OEB and are designed to permit a fair and reasonable return to the Company on the utility investment. Realization of the allowed rate of return is subject to actual operating conditions experienced during the year.

The Company follows Canadian generally accepted accounting principles. Such accounting principles may differ for regulated entities from those otherwise expected in non-regulated entities. These differences occur when the regulatory agencies render their decisions on the Company's rate applications and generally involve the timing of revenue and expense recognition to ensure that the Company has achieved a proper matching of revenues and expenses, and as a result the Company records assets and liabilities that would not have been recorded under GAAP for non-regulated entities.

In addition to defining certain accounting requirements, the regulatory agencies have jurisdiction over a number of other matters, which include the rates to be charged for the distribution of gas and approval and recovery of costs for major construction and operations.

*Inventory:*

Inventory is valued at the lower of cost and net realizable value, with cost being determined on a first-in, first-out basis. Net realizable value is defined as replacement cost.

*Deferred charges:*

Certain costs, required or permitted by the OEB, have been deferred for recovery from future revenues. The period of recovery for these deferrals have been or will be determined by decisions of the OEB, and will determine the classification of these charges in the financial statements.

*Property, plant, and equipment:*

Property, plant and equipment is recorded at cost, including associated labour and overhead costs. Expenditures which substantially increase the useful life of existing pipeline installations and additions to the pipeline are capitalized. Such expenditures include material, labour and overhead. Maintenance and repairs which do not extend the useful life of pipeline installations are charged to income.

Pursuant to the regulations of the OEB on the disposal of property, plant, and equipment, excluding major disposals, the company transfers the original cost of the retired assets, plus any related removal costs and net of any proceeds on disposition, to accumulated amortization. Proceeds from disposition are credited to accumulated amortization. This effectively credits gains, or charges losses on disposition to accumulated amortization. For major disposals, gains or losses are included in current earnings.

The company has reviewed its long-lived assets and determined there exists no asset retirement obligation as of September 30, 2006.

*Amortization:*

Pursuant to the periodic review and approval by the OEB of amortization rates, amortization is calculated using the straight-line method on the total gross cost of each asset category at the end of the year, rather than on an asset specific basis, at the following annual rates for the property, plant and equipment categories listed below:

| | |
|---|---|
| Automotive equipment | 17 % |
| Buildings | 2 % |
| Computer equipment | 33 % |
| Computer software | 20 % |
| Furniture and fixtures | 7 % |
| Machinery and equipment | 6 % to 9 % |
| Meters and regulators | 3 % to 4 % |
| Pipeline installations | 3 % to 13 % |

Amortization of deferred finance costs (related to the issue of debt) is calculated at the annual rate of 20% using the straight-line method over the life of the related debt issuance. In the current year, the company refinanced some of its existing debt. The deferred finance costs associated with the retired debt was amortized in full in the year of retirement.

Amortization of franchises and consents is calculated using the straight-line method over the term of the applicable franchise and consent.

Pursuant to the approval of the OEB, the company changes its amortization rates for the various categories of property, plant and equipment as well as for franchises and consents based upon OEB Rate Case filings. The last change was made at the start of the fiscal 2005 year and any such changes in estimate are applied on a prospective basis.

*Income taxes:*

The company's rate and revenues, established for regulatory purposes, allow for the recovery of income taxes on a formula basis which differs from the amount as determined under the tax allocation basis of accounting. Accordingly, the company accounts for income taxes using the taxes payable basis. This basis does not provide for future income taxes which may be payable in future years as a result of the difference between current financial reporting and reporting for income tax purposes. This method is followed for accounting purposes as there is a reasonable expectation that all such taxes will ultimately be recovered through rates when they become payable. Future income taxes not provided in these financial statements would amount to a provision of $4,000 for the year ended September 30, 2006 (2005 - $102,000 recovery) and an accumulated future liability of $428,000 at September 30, 2006 (2005 - $424,000).

*Revenue recognition:*

The Company recognizes revenues when gas has been delivered or services have been performed. Gas distribution revenues are recorded on the basis of regular meter readings and estimates of customer usage since the last meter reading to the end of the reporting period.

A significant portion of the Company's operations are subject to regulation and accordingly there are circumstances where the revenues recognized do not match the amounts billed. Revenue is recognized in a manner consistent with the underlying rate setting mechanism as mandated by the OEB. This may give rise to regulatory deferral accounts on the balance sheet pending disposition by a decision of the OEB.

*Gas commodity costs:*

Gas commodity costs are recorded using prices approved by the OEB in the determination of customers sales rates. Differences between the OEB approved reference prices and those costs actually incurred are deferred in accounts receivable or accounts payable for future disposition subject to the approval of the OEB, usually within a maximum timeframe of the next fiscal year. In a non-regulated environment periodic variances between gas commodity sales rates and costs would be reported through the income statement annually without the use of deferral accounts.

*Use of estimates:*

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reported period. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

**1. Property, plant, and equipment:**

| | | 2006 | | 2005 |
|---|---|---|---|---|
| | Cost | Accumulated Amortization | Net Book Value | Net Book Value |
| Land | $ 71,700 | $ - | $ 71,700 | $ 71,700 |
| Buildings | 682,331 | 91,842 | 590,489 | 605,637 |
| Furniture and fixtures | 54,020 | 28,116 | 25,904 | 28,720 |
| Machinery and equipment | 2,344,902 | 1,037,231 | 1,307,671 | 1,256,667 |
| Computer equipment | 157,870 | 116,697 | 41,173 | 9,845 |
| Computer software | 106,519 | 90,629 | 15,890 | 15,890 |
| Automotive equipment | 446,015 | 124,669 | 321,346 | 376,192 |
| Meters and regulators | 3,023,610 | 1,354,506 | 1,669,104 | 1,557,008 |
| Pipeline installations | 8,976,619 | 3,589,618 | 5,387,001 | 5,506,687 |
| | $ 15,863,586 | $ 6,433,308 | $ 9,430,278 | $ 9,428,346 |

**2. Franchises and consents:**

| | 2006 | 2005 |
|---|---|---|
| Franchises and consents | $ 151,094 | $ 151,094 |
| Less: accumulated amortization | 79,277 | 72,007 |
| | $ 71,817 | $ 79,087 |

### 3. Deferred finance costs:

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Deferred finance costs | $ | **47,793** | $ | 92,945 |
| Less: accumulated amortization | | **4,779** | | 75,711 |
| | $ | **43,014** | $ | 17,234 |

During the year, the company refinanced its debt. The result was that the remaining deferred finance costs of $17,234 associated with the old debt were fully amortized in the year. The costs associated with the new term note payable of $47,793 were deferred and are amortized over the expected term of the debt.

### 4. Deferred charges - other assets:

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Total deferred charges - other assets | $ | **213,253** | $ | - |
| Less: accumulated amortization | | **21,325** | | - |
| | $ | **191,928** | $ | - |

The company has been given approval by the OEB to recover the above costs already incurred from rate payers over future periods. The recovery will occur over the next five years as noted below.

| | | |
|---|---|---|
| 2007 | $ | 42,651 |
| 2008 | | 42,651 |
| 2009 | | 42,651 |
| 2010 | | 42,651 |
| 2011 | | 21,324 |
| | $ | 191,928 |

## 5. Related party transactions:

During the year, rent of $9,600 (2005 - $9,600) and management fees of $117,000 (2005 - $87,000) were paid to a related company.

During the year, the company purchased gas in the amount of $4,006,684 (2005 - $2,028,997) from a related company.

During the year, maintenance charges of $58,200 (2005 - $41,280) were charged to a related company.

During the year, the company provided installation services and product to a related company in the amount of $nil (2005 - $15,015).

Included in accounts payable and accrued liabilities are amounts payable to related companies of $665,948 as at September 30, 2006 (2005 - $462,345).

Included in accounts receivable are amounts receivable from related companies of $8,726 as at September 30, 2006 (2005 - $16,642).

Related companies are companies controlled, directly or indirectly, by trusts, where the beneficiaries of the trusts are common to both trusts, but the trustee or group of trustees which exercise control over any of the related parties are different than the group of trustees of the trust which controls Natural Resource Gas Limited.

These transactions are in the normal course of business, and are measured at the exchange amount.

## 6. Term note payable:

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Bank of Nova Scotia term note payable, 7.52%, repayable in blended monthly installments of $48,201, due March 2011 | $ | **6,454,484** | $ | - |

Although the above loan is due on demand, the company expects to make installments as per the amortization schedule which forms part of the loan agreement. The aggregate amount of principal payments required in each of the next 5 years to meet minimum retirement provisions is as follows:

| | | |
|---|---|---|
| 2007 | $ | 94,946 |
| 2008 | | 102,346 |
| 2009 | | 110,348 |
| 2010 | | 118,963 |
| 2011 | | 6,027,881 |
| | $ | 6,454,484 |

The company has pledged the following as security against the term note payable, the operating line of credit, and the revolving line of credit:

a) General assignment of book debts

b) General Security Agreement over all of the present and future personal property and undertaking of the company

c) Security under Section 427 of the Bank Act with appropriate insurance coverage assigned to the Bank

d) Demand Debenture for $15,000,000 secured by a first fixed and floating charge over all assets including, but not limited to, the Certificate of Public Convenience and Necessity and all Municipal Franchise Agreements, with replacement cost fire insurance coverage, loss, if any, payable to the Bank as mortgagee.

The company also has unused credit facilities in the amount of $2,000,000 which it obtained in conjunction with the term note, consisting of:

a) Operating line of credit in the amount of $1,000,000 with interest at the Bank's Prime Rate on any advances, and

b) Revolving line of credit in the amount of $1,000,000 to be used for financing capital expenditures with interest at the Bank's Prime Rate plus 0.25% on any advances.

The company has not used either of the above credit facilities during the year, and their continuation is subject to annual review by the Bank..

7. **Income tax expense:**

Income tax expense differs from the amount that would be computed by applying the federal and provincial statutory income tax rates to income before income taxes. The reasons for the difference and the related tax effects are as follows:

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Income before provision for income taxes | $ | **451,958** | $ | 672,953 |
| Statutory tax rate | | **36.12 %** | | 36.12 % |
| Tax on net income at statutory rates | | **163,247** | | 243,071 |
| Amortization on financial statements in excess of Capital Cost Allowance for tax purposes | | **49,883** | | 46,931 |
| Ontario Small Business Deduction utilized | | **(34,000)** | | (34,000) |
| Non-deductible expenses | | **870** | | 6,206 |
| Deferred charges on financial statements deductible on a cash basis for tax purposes | | **-** | | 11,792 |
| Provision for income taxes | $ | **180,000** | $ | 274,000 |

**8. Long-term debt:**

| | 2006 | 2005 |
|---|---|---|
| Debenture payable, 11.8%, repayable in blended monthly installments of $44,525 principal and interest, repaid in the year | $ - | $ 1,615,977 |
| Debenture payable, 11.03%, repayable in blended monthly installments of $3,384, principal and interest, repaid in the year | - | 156,432 |
| Debenture payable, 9.57% (interest rate adjusted annually based upon the allowed rate of return as set by the Ontario Energy Board. Minimum rate of 9.25%), repayable in monthly interest only installments, repaid in the year | - | 951,000 |
| | - | 2,723,409 |
| Less: current portion | - | 387,780 |
| | $ - | $ 2,335,629 |

## 9. Share capital:

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Authorized: | | | | |
| Unlimited Class A shares, non-voting, redeemable and retractable at the paid up amount, with non-cumulative dividends | | | | |
| Unlimited Class B shares, participating, non-voting, with non-cumulative dividends ranking pari passu with common shares on dissolution | | | | |
| Unlimited Class C shares non-voting, with preferential 7% non-cumulative dividends redeemable and retractable at $100 per share | | | | |
| Unlimited Class Z shares voting, redeemable and retractable at $1 per share, with no dividend entitlement | | | | |
| Unlimited number of common shares | | | | |
| Issued and outstanding: | | | | |
| Retractable shares: | | | | |
| 50,000 Class A shares | **$** | **1** | $ | 2,038,582 |
| 10 Class B shares | | **10** | | 10 |
| 134,614.18 Class C shares | | **13,461,418** | | 13,461,418 |
| 10 Class Z shares | | **10** | | 10 |
| | **$** | **13,461,439** | $ | 15,500,020 |

During the year, the company paid to the Class A shareholder $2,038,581 as a reduction in the stated capital of the Class A shares.

## 10. Gas imbalances:

The Company, in the normal course of its operations experiences imbalances in the quantity of gas purchased and the quantities of gas sold and provides the gas balancing services to customers. The company records the net liability (or net asset) associated with gas imbalance volumes.

Accounts payable and accrued liabilities include $43,441 (2005 - $84,351) related to gas imbalances. Natural gas volumes owed from the Company are valued at the natural gas reference price as approved by the OEB as of the balance sheet dates.

## 11. Regulatory matters:

The Company has rates that are approved by the OEB. The fiscal year 2005 was a one year Cost of Service Rate filing. The company received the OEB decision dated December 20, 2004 and the rate order was dated December 31, 2004. The company did not make a submission for the fiscal year 2006 which left rates unchanged from 2005. The company's fiscal 2007 rate submission to the OEB was approved, and the company is currently working on the fiscal 2008 submission.

Rates for the sale of gas commodity are adjusted quarterly to reflect updated commodity price forecasts. The difference between the approved and the actual cost of gas incurred in the current period is deferred for future recovery subject to approval by the OEB. These differences are directly flowed through to customers and, therefore, no rate of return is earned on the deferred balances. The OEB's approval for recovery of these gas purchase costs primarily considers the prudence of costs incurred.

## 12. Financial instruments:

The carrying values of the company's financial current assets and liabilities, including cash, accounts receivable, deferred charges, and accounts payable and accrued liabilities approximate their values due to their short-term maturity.

The fair value of the term note payable is estimated using a discounted cash flow calculation that uses market interest rates currently charged for similar debt instruments at September 30, 2006 to expected maturity dates. Since there have not been significant changes to market interest rates since the term note payable was obtained in the year, the carrying value approximates its fair value.

*Natural gas prices:*

The Company has entered into several material contracts for the supply of natural gas. The Company employs established policies and procedures in order to manage the risk associated with the market fluctuations of natural gas prices. The Company, through the rate regulations imposed by the OEB, is effectively allowed to fully recover its costs, reasonably incurred, and as such the ratepayers, and not the Company, are ultimately exposed to the risk of these market fluctuations.

*Credit risk:*

Credit risk arises from the potential that a trade customer will fail to pay its account. The company is exposed to credit risk from its customers. However, the company has a large number of diverse customers, which minimizes concentration of credit risk.

## 13. Additional cash flow statement information:

| | **2006** | 2005 |
|---|---|---|
| Interest paid | **$ 385,085** | $ 325,099 |
| Income taxes paid | **$ 289,045** | $ 226,118 |

# ADDITIONAL COMMENTS OF AUDITORS

The accompanying schedule of expenses is presented as supplementary information only. In this respect, it does not form part of the financial statements of Natural Resource Gas Limited for the year ended September 30, 2006 and is hence excluded from the opinion expressed in our report dated December 20, 2006 to the board of directors on such financial statements. The information in this schedule has been subject to audit procedures only to the extent necessary to express an opinion on the financial statements of the company and, in our opinion, is fairly presented in all respects material to those financial statements.

London, Canada
December 20, 2006

Neal, Pallett & Townsend LLP
Chartered Accountants
Licensed Public Accountants

# NATURAL RESOURCE GAS LIMITED

Unaudited Schedule of Expenses

Year ended September 30

| | | 2006 | | 2005 |
|---|---|---|---|---|
| Advertising | $ | **28,472** | $ | 29,888 |
| Automotive and maintenance | | **187,793** | | 233,851 |
| Bad debts | | **13,500** | | 8,000 |
| Bank charges and other interest | | **281,434** | | 26,854 |
| Capital tax | | **10,818** | | 24,524 |
| Consulting fees | | **95,972** | | 35,800 |
| Dues and fees | | **19,596** | | 22,543 |
| Employee benefits | | **126,485** | | 129,604 |
| Insurance | | **235,774** | | 263,750 |
| Interest on long-term debt | | **141,393** | | 320,867 |
| Legal and audit | | **145,446** | | 105,327 |
| Management fees - affiliated company | | **117,000** | | 87,000 |
| Miscellaneous | | **15,593** | | 37,538 |
| Office | | **93,487** | | 82,181 |
| Ontario Energy Board hearings | | **164,540** | | 150,256 |
| Promotional rebates | | **11,511** | | - |
| Property taxes | | **261,404** | | 285,288 |
| Rent - affiliated company | | **9,600** | | 9,600 |
| Salaries and wages | | **832,251** | | 773,372 |
| Telephone | | **41,658** | | 39,366 |
| Travel and promotion | | **2,158** | | 6,787 |
| Utilities | | **16,565** | | 14,263 |
| Amortization - Automotive equipment | | **74,039** | | 75,649 |
| Buildings | | **15,148** | | 15,148 |
| Computer equipment | | **12,428** | | 7,716 |
| Computer software | | **8,051** | | 2,575 |
| Deferred finance costs | | **43,339** | | 6,196 |
| Franchises and consents | | **7,270** | | 7,270 |
| Furniture and Fixtures | | **3,646** | | 3,590 |
| Machinery and equipment | | **39,817** | | 37,006 |
| Meters and regulators | | **110,047** | | 101,970 |
| Pipeline installations | | **296,915** | | 290,692 |
| | | **3,463,150** | | 3,234,471 |
| Equipment expenses capitalized to pipeline installations | | **(17,102)** | | (31,690) |
| Interest expense (income) | | **(60,747)** | | 12,521 |
| Amortization capitalized to pipeline installations | | **(10,279)** | | (11,038) |
| | $ | **3,375,022** | $ | 3,204,264 |

unionGas
A Spectra Energy Company

P.O. Box 2001
50 Keil Drive North
Chatham, Ontario
Canada N7M 5M1

June 16, 2008

**BY FAX and**
**BY COURIER**

Natural Resource Gas Limited
39 Beech Street East
Aylmer, ON N5H 2S1
FAX: (519) 773-5335

Attn: Mr. Mark Bristol

Dear Mr. Bristol:

**Re: Financial Assurances from Natural Resource Gas Limited for Direct Purchase Contract (SA 918); M9 Distribution Contract (SA 1550) ("contracts")**

This letter is a follow up to my email dated February 20, 2008 and subsequent phone message left with you in which I requested a meeting to discuss the provision of financial security. As of today, I have not received a response to this request.

To confirm Union Gas Limited's ("**Union's**") intentions, it has been identified that Union is forecasted to experience a maximum exposure to Natural Resource Gas Limited **("NRG")** of **$1,928,138 CDN** (the "Anticipated Maximum Exposure"). This exposure primarily consists of a forecasted Banked Gas Account ("BGA") draft position of $1,778,305, based upon Union's current weighted average cost of gas (WACOG). Please note that this exposure forecast does not take into account fluctuations in gas price or usage and assumes that NRG will continue to make timely payments on all accounts.

Union has assigned an unsecured credit limit of $600,000 CDN to NRG as this is the maximum that can be issued based upon analysis conducted using NRG's 2006 financial statements, an acceptable credit report (Dunn & Bradstreet) and satisfactory payment history with Union. When Union is exposed to an amount in excess of the unsecured credit limit assigned to a Customer, or anticipates that it will become so exposed, it seeks financial assurances under section 5.04 of the General Terms and Conditions of the contracts to mitigate that risk.

NRG may seek to satisfy Union's Anticipated Maximum Exposure in one of two ways.

- NRG can provide financial assurances in the amount of **$1,328,138CDN**. Such financial assurances may be provided in the form of a cash security deposit or a letter of credit.

- Alternatively, NRG can make arrangements to change the renewal date of their direct purchase contract to an annual anniversary date of April 1. To facilitate this option, Union would agree to an early renewal of the bundled transportation contract effective August 1 which, in turn, would require NRG to balance the BGA at July 31, 2008. A new 8 month contract dated August 1, 2008 would be issued whereby the daily contracted quantity would equal consumption. NRG would have to avoid a negative BGA balance. The contract would then renew for 12 month periods starting April 1, 2009. An April contract renewal date should eliminate any credit issues related to the BGA going forward.

We would appreciate receiving your positive response with regards to these options prior to **June 23, 2008**. If NRG does not provide the requisite financial assurances or make arrangements to transition the bundled transportation contract to an April 1 anniversary date prior to the close of business on **July 30, 2008**, then NRG shall be in default under the General Terms and Conditions.

Such default would entitle Union to certain contractual remedies including, but not limited to, suspension of service and/or termination of the said Contract(s) between Union and NRG. If required, Union shall seek leave of the Ontario Energy Board pursuant to section 42. (1) of the OEB Act in order to exercise these remedies.

If you have any questions with regards to this notice, I can be reached at (519) 436-4599.

Yours truly,

P Elliott

Pat Elliott, Controller
Union Gas Limited, a Spectra Energy Company

cc: Kirsten Walli, Board Secretary, OEB

unıongas
A Spectra Energy Company

P.O. Box 2001
50 Keil Drive North
Chatham, Ontario
Canada N7M 5M1

June 27, 2008

**BY FAX and**
**BY COURIER**

Natural Resource Gas Limited
39 Beech Street East
Aylmer, ON N5H 2S1
FAX: (519) 773-5335

Attn: Mr. Mark Bristol

Dear Mr. Bristol:

**Re: Financial Assurances from Natural Resource Gas Limited for Direct Purchase Contract (SA 918); M9 Distribution Contract (SA 1550) ("contracts")**

This letter is a follow up to my letter dated June 16, 2008 where I asked for a positive response with regards to the options provided in the said letter prior to **June 23, 2008**. As of today, I have not received a response to this request.

Union Gas Limited ("**Union**") reconfirms it's intentions to seek financial assurances from Natural Resource Gas Limited **("NRG")** under section 5.04 of the General Terms and Conditions of the contracts to mitigate the risk of Union's exposure to NRG. Alternatively, NRG can make arrangements to change the renewal date of their direct purchase contract to an annual anniversary date of April 1, which should eliminate any credit issues related to the Banked Gas Account beyond April 2009. Union has requested a resolution to this issue prior to the close of business on **July 30, 2008.**

Due to the lack of response from NRG, Union intends to begin the process of filing an application with the Ontario Energy Board to request permission to suspend service and/or terminate the said contracts pursuant to section 42. (1) of the OEB Act.

If the appropriate action is not taken by NRG prior to July 30, 2008, Union will continue to seek the Ontario Energy Board's permission to proceed with the application.

If you have any questions with regards to this notice, I can be reached at (519) 436-4599.

Yours truly,

Pat Elliott, Controller
Union Gas Limited, a Spectra Energy Company

cc: Kirsten Walli, Board Secretary, OEB

OGILVY
RENAULT
LLP / S.E.N.C.R.L., s.r.l.

Direct Dial: (416) 216-2311
Direct Fax: (416) 216-3930
rking@ogilvyrenault.com

SENT BY FACSIMILE

Toronto, July 2, 2008

Union Gas Limited ("Union")
P.O. Box 2001
50 Keil Drive North
Chatham, Ontario
N7M 5M1

Attention: Ms. Pat Elliott, Controller

Dear Ms. Elliott:

**RE: Financial Assurance Request from Natural Resource Gas Limited ("NRG")**

We are counsel to NRG, and are in receipt of your letters of June 16, 2008 and June 27, 2008. This letter is to advise you of NRG's intention to vigorously respond to any application brought by Union to suspend service and/or terminate its existing contracts with NRG.

Section 5.04 of Union's General Terms and Conditions allows Union to request financial assurance from a Customer only upon Union having reasonable grounds to believe that the Customer's creditworthiness has become unsatisfactory. We are of the view that Union has absolutely no reasonable grounds to believe that NRG's creditworthiness has suddenly become unsatisfactory. NRG's creditworthiness has consistently improved over the past several years, as was recently evidenced by NRG's ability to recently obtain third party financing on favourable terms. To current management's knowledge, NRG has never missed or made a late payment to Union.

Your letter of June 16, 2008 seems to suggest that because NRG's forecasted Banked Gas Account draft position has increased, Union is entitled to demand financial assurance. With respect, this is an incorrect reading of the provisions of Union General Terms and Conditions. The portion of section 5.04 dealing with a Customer's forecasted negative Banked Gas Account balance deals with the maximum financial assurance that Union may request in the event that a Customer's creditworthiness has become unsatisfactory. It does not play a role in the determination of a Customer's creditworthiness.

OGILVY RENAULT
LLP / S.E.N.C.R.L., s.r.l.



Section 5.04 operates in a straightforward two-step manner. First, Union must have reasonable grounds to believe that NRG's creditworthiness has become unsatisfactory. If such reasonable grounds exist, then the second step is for Union to determine how much financial assurance to request (which is capped by a formula that recognizes the Banked Gas Account balance). Your letter of June 16, 2008 makes it clear that Union has merged the two steps, by using NRG's forecasted Banked Gas Account balance to determine NRG's creditworthiness.

In addition, we believe four further facts are relevant. First, it is important for the Board to understand that Union has never before requested financial assurance of NRG, so Union will need to explain what about NRG's financial circumstances has changed in the recent past to warrant a financial assurance order. Second, although you have not provided NRG with any data supporting Union's calculation of its Anticipated Maximum Exposure, we are sceptical that your figures represent a reasonable forecast. NRG's Banked Gas Account balance is typically in its greatest "negative" position in early April, before steadily moving towards a zero position in September. As a result, we expect that the current, actual Banked Gas Account balance is smaller than reflected in your letter, and decreasing on a daily basis. Third, Union's existing M9 rates (like the rates of all utilities) explicitly incorporate a risk premium. Utilities are not entitled to risk-free arrangements with its customers, which is effectively what your letter is requesting. Finally, the two "options" proposed by Union (as put to NRG) are not without cost consequences that will ultimately be borne by NRG's ratepayers. As a result, it would be imprudent for NRG to simply accede to your request for financial assurance (and incur rate increases to NRG's customers) on the basis of a one-page demand letter.

In sum, NRG will oppose any application made by Union on the basis that it is unreasonable and unfounded.

Yours very truly,

Richard King

c.c. Kirsten Walli (OEB)
Adrian Pye (OEB)
Brian Hewson (OEB)

uniongas
A Spectra Energy Company

August 27, 2008

Mr. Mark Bristoll
Natural Resource Gas Limited
39 Beech Street E.
Aylmer ON N5H 2S1

Dear Mr. Bristoll:

By letter dated June 16, 2008, Union indicated that it was forecasting a maximum exposure to Natural Resource Gas Limited ("NRG") well in excess of the unsecured credit limit assigned by Union to NRG. Union also outlined two ways that NRG could seek to satisfy Union's anticipated maximum exposure: NRG could provide financial assurances in the form of a cash security deposit or letter of credit, or it could make arrangements to change the renewal date of its direct purchase contract.

Also, by letter dated August 1, 2008, Union applied to the Ontario Energy Board for an order to suspend service or terminate service to NRG.

The NRG direct purchase contract is scheduled to expire on September 30, 2008. Union is not prepared to renew that contract for a further 12 month term effective October 1, 2008. Union has prepared an amendment to renew the contract for a 6 month term (October 1, 2008 to March 31, 2009). In addition, Union has increased the Daily Contract Quantity ("DCQ") to match NRG's consumption during that 6 month term. As a result, NRG will need to arrange for additional supply. Subsequent renewals will be for 12 month terms (April 1 to March 31) with the DCQ lowered to match consumption.

Renewing the contract as outlined above will reduce Union's maximum exposure to a level within the unsecured credit limit currently assigned by Union to NRG and resolve Union's concern regarding NRG's creditworthiness. In the event NRG is prepared to accept the above changes to its direct purchase contract, Union will withdraw its above noted application to the OEB.

Enclosed please find two copies of the amendment to the Bundled T Gas Contract between Natural Resource Gas Limited and Union Gas Limited ("Union").

Please sign and return these amendments to me. After we receive your signed amendments, we expect to execute them within two weeks. Once all signatures are in place, we will return your copy of the executed amendment.

If you require any further information, feel free to contact me (519) 436-5386.

Yours truly,

Tom Byng

Tom Byng
Manager, Contracting & Customer Support
Enclosure

CC:
Patrick Boyer, Manager, Retail Energy Markets
Lori Couture, Customer Support Representative
Mark Kitchen, Director, Regulatory Affairs
Pat Elliott, Controller
Kirsten Walli, Board Secretary, OEB
Richard King, Ogilvy Renault

P.O. Box 2001, 50 Keil Drive North, Chatham, ON, N7M 5M1 www.uniongas.com
Union Gas Limited

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Contract ID: | SA918 |
| | Contract Name: | NRG |
| | DUNS#: | DUNS04387 |

# Contract Parameters Report

| Month | | Historical Consumption (m3) | Forecast Consumption (GJ) | Forecast Receipts (GJ) | BGA (GJ) | Checkpoint (GJ) | Balancing Points Ceiling (GJ) | Balancing Points Floor (GJ) |
|---|---|---|---|---|---|---|---|---|
| October | 2008 | 627,539 | 23,608 | 78,709 | 55,101 | | | |
| November | 2008 | 1,678,469 | 63,144 | 76,170 | 68,127 | | | |
| December | 2008 | 2,301,223 | 86,572 | 78,709 | 60,264 | | | |
| January | 2009 | 2,598,804 | 97,767 | 78,709 | 41,206 | | | |
| February | 2009 | 2,725,173 | 102,521 | 71,092 | 9,777 | 9,777 | | |
| March | 2009 | 2,351,914 | 88,479 | 78,709 | 0 | | 29,464 | (29,464) |
| | **Total** | **12,283,122** | **462,091** | **462,098** | | | | |
| Load Factor | | 1.000 | | | | | | |
| Heat Value | | 37.62 | | | | | | |
| DCQ (GJ) | | 2,539 | | | | | | |



unIongas
A Spectra Energy Company

| | Western | | | Parkway | | | Dawn | Dawn-Vector | | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| | South | Exchange | VS | Regular | Trunkline | PEPL | Regular | Vector | Alliance/ Vector | |
| Current DCQ (Auth. Notice) | 761 | 0 | 0 | 739 | 0 | 0 | 0 | 0 | 0 | **1,500** |
| Current DCQ (Schedule 1) | 761 | 0 | 0 | 739 | 0 | 0 | 0 | 0 | 0 | **1,500** |
| Consumption Increase (+ve) | 0 | 0 | 0 | 1,039 | 0 | 0 | 0 | 0 | 0 | **1,039** |
| Consumption Decrease (-ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| Account Transfer (+ve/-ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| Delivery Point Change (+ve/-ve | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| Turnback (+ve/-ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| Move (+ve/-ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| DCQ Adjustments (+/-) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| Drop (-ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| New DP Enrol (+ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| Vendor Switches (+/-) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| **Revised DCQ (Schedule 1)** | **761** | **0** | **0** | **1,778** | **0** | **0** | **0** | **0** | **0** | **2,539** |
| Assignment (+ve/-ve) | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **0** |
| **Revised DCQ (Auth. Notice)** | **761** | **0** | **0** | **1,778** | **0** | **0** | **0** | **0** | **0** | **2,539** |

Contract Id: SA918

**SCHEDULE "1"**
Contract Parameters And Notice Lists
Southern Bundled T

Contract ID: SA918
Contract Name: NRG
DUNS#: DUNS04387

**1. Dates**

"Day of First Receipt" means the 1st day of October, 2007.
The Contract Year shall expire at the end of March, 2009.
This Schedule 1 is effective October 01, 2008.

**2. Daily Contract Quantity (DCQ)**

**Upstream Point(s) Of Receipt**

| LOCATION | Obligated DCQ GJ per Day |
| --- | --- |
| Western | 761 |

**Ontario Point(s) Of Receipt**

| LOCATION | Obligated DCQ GJ per Day |
| --- | --- |
| Parkway | 1778 |

Obligated DCQ does not include fuel.

On Days when requested by Customer and Authorization Notice is given by Union, the above quantity parameters, Upstream Point(s) of Receipt, and Ontario Point(s) of Receipt shall be deemed to be amended in accordance with such Authorization Notice.

**3. Maximum BGA Balances**

All units referenced in the table below are Gigajoules (GJ).

| BGA Balancing Period Date | Maximum Positive Variance | Maximum Negative Variance |
| --- | --- | --- |
| September 30, 2008 | 21,900 | -21,900 |
| March 31, 2009 | 29,464 | -29,464 |

In this Schedule 1, if a BGA Balancing Period Date (other than Contract Anniversary) coincides with the Winter Checkpoint Date, the greater of the Maximum Negative Variance on the BGA Balancing Period Date or the checkpoint value will prevail. If a BGA Balancing Period Date (other than Contract Anniversary) coincides with the Fall Checkpoint Date, the lesser of the Maximum Positive Variance on the BGA Balancing Period Date or the checkpoint value will prevail.

## 4. Checkpoint Balancing Parameters

| Checkpoint | Fall/Winter Checkpoint Date | Checkpoint Quantity (GJ) |
|---|---|---|
| Winter | Feb 29, 2008 | -179,823 |
| Winter | Feb 28, 2009 | 9,777 |

This Contract operates on the basis of:

☐ Customer Determined Balancing Option

Or ☑ Union Determined Balancing Option

## 5. Contact List for Notices

**Notices for Nomination Matters**

Natural Resource Gas Limited
Controller
Mail: 39 Beech Street E., P.O. Box 307, Aylmer ON, N5H 2S1
Courier: 39 Beech Street E., Aylmer ON, N5H 2S1
Phone: 519-773-5321
Fax: 519-773-5335

Union Gas Limited
Manager, Gas Management Services
Mail: 50 Keil Dr N, Chatham ON, N7M 5M1
Phone: 519-436-4545
Fax: 519-436-4635

**Notices for Invoices and Payments**

Natural Resource Gas Limited
Controller

| | |
|---|---|
| Mail: | 39 Beech Street E., P.O. Box 307, Aylmer ON, N5H 2S1 |
| Courier: | 39 Beech Street E., Aylmer ON, N5H 2S1 |
| Phone: | 519-773-5321 |
| Fax: | 519-773-5335 |

Union Gas Limited
Manager, Billing & Operational Support

| | |
|---|---|
| Mail: | 50 Keil Dr N, Chatham ON, N7M 5M1 |
| Phone: | 519-352-3100 |
| Fax: | 519-436-5320 |

**Notices for All other Matters**

Natural Resource Gas Limited
Controller

| | |
|---|---|
| Mail: | 39 Beech Street E., P.O. Box 307, Aylmer ON, N5H 2S1 |
| Courier: | 39 Beech Street E., Aylmer ON, N5H 2S1 |
| Phone: | 519-773-5321 |
| Fax: | 519-773-5335 |

Union Gas Limited
Manager, Contracting & Customer Support

| | |
|---|---|
| Mail: | 50 Keil Dr N, Chatham ON, N7M 5M1 |
| Phone: | 519-352-3100 |
| Fax: | 519-358-4064 |

The undersigned execute this Contract as of the above date.

UNION GAS LIMITED

I have the Authority to bind the Corporation, or Adhere C/S, if applicable

Wayne Andrews - Manager, Contract Billing & Operational Support

CUSTOMER

I have the Authority to bind the Corporation, or Adhere C/S, if applicable

please print name

| | |
|---|---|
| Contract ID: | SA918 |
| Contract Name: | NRG |
| DUNS#: | DUNS04387 |

# "SCHEDULE 3"

End Use List

The location(s) stated hereunder shall collectively be defined as Point(s) of Consumption. The parties acknowledge that the Union account number(s) is for ease of administration and should any number be changed to a new number, this Contract is deemed to be automatically amended to include such new number.

For all Bundled T Contracts submitted and administered electronically by the Customer or its Agent using Unionline, the End Use List is provided in the Unionline Price Point Cross Reference Report ("Price Report").

If this Contract is executed by an Agent, then Customer shall mean the End Users referenced in this Schedule 3.

| Union Account # | Consumer Name | Location |
|---|---|---|
| SA1550 | NRG LIMITED | 30040 WESTCHESTER BR DORCHESTER N TP, ON |

OGILVY
RENAULT
LLP / S.E.N.C.R.L., s.r.l.

Direct Dial: (416) 216-2311
Direct Fax: (416) 216-3930
rking@ogilvyrenault.com

SENT BY E-MAIL

Toronto, September 5, 2008

Mr. Tom Byng
Manager, Contracting & Customer Support
Union Gas Limited ("Union")
P.O. Box 2001
Chatham, ON, N7M 5M1

Dear Mr. Byng:

**RE: Union Application to Discontinue Service**
**EB-2008-0273**

As you know, we are counsel to Natural Resource Gas Limited ("NRG"). We are in receipt of your letter to Mark Bristoll dated August 27, 2008.

Your letter states that Union is not prepared to renew my client's existing Bundled-T Gas Contract with Union. As you know from my correspondence to Union of July 2, 2008, NRG's position is that Union has no reasonable grounds to demand that natural gas be supplied to NRG only if: (a) NRG agrees to post financial assurance; or (b) NRG agrees to change its contract commencement date.

Union has already decided, by virtue of filing is application to discontinue service to NRG, to have the Board determine the contractual arrangement between the parties post-September 30, 2008. My client's position is that the most appropriate course of action (assuming that the matter cannot be resolved by the two parties or the Board by September 30, 2008) is to continue the existing contractual arrangement on a "status quo" basis pending an ultimate Board determination.

Please contact me directly if you have further questions.

Yours very truly,

Richard J. King

RJK/mej

c.c. Ms. Kirsten Walli, Board Secretary (Ontario Energy Board)
Mr. Mark Bristoll, Chairman (Natural Resource Gas Limited)