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EEP - Q3 2014 Enbridge Energy Partners LP Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the third-quarter 2014 Enbridge Energy Partners LP earnings conference call. My name is Lacey and I'll be your coordinator for today.

(Operator Instructions)

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the presentation over to your host for today, Sanjay Lad, Director of Investor Relations. Please proceed.

Sanjay Lad - Enbridge Energy Partners LP - IR

Thank you, Lacey. Good morning and welcome to the 2014 third quarter earnings conference call for Enbridge Energy Partners. This call is being webcast and a copy of the presentation slides, supplemental slides, condensed unaudited financial statements and news release associated with it can be downloaded from the Investor section of our website, at Enbridgepartners.com. A replay will be available later today and a transcript will be posted to our website shortly thereafter.

As a reminder, the partnership's results are also relevant to Enbridge Energy Management, or EEQ. I will be available after the call for any follow-up questions you may have.

Our speakers today are Mark Maki, President, and Steve Neyland, Vice President, Finance. Available for the Q&A session we also have Guy Jarvis, Executive Vice President, Liquids Pipelines; Greg Harper, Executive Vice President, Gas Pipelines and Processing; Jonathan Rose, Treasurer; and Noor Kaissi, Controller.

Let's move forward to slide 2, our legal notice. This presentation will include forward-looking statements. Any statements made or discussed today that do not constitute or are not historical facts, particularly comments regarding the Company's future plans and expected performance, are forward-looking statements. Actual results or outcomes may differ materially from those that may be expressed or implied. The risks associated with forward-looking statements have been outlined in the news release and the partnership's annual report on Form 10-K and other SEC filings, and we incorporate those by reference for this call.



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This presentation also contains certain non-GAAP financial measures. The reconciliation schedules for these non-GAAP measures to comparable GAAP measures can be found in the Investor section of our website.

Please turn to slide 3. I will now turn the call over to Mr. Mark Maki, President.

Mark Maki - Enbridge Energy Partners LP - President

Thank you, Sanjay. Good morning and welcome. On the call today, we'll provide an update on recent developments, discuss the partnership's strategic outlook, and Steve Neyland will address the third quarter financial highlights.

Before we get into the presentation, though, I want to touch on an 8-K that we filed announcing some changes in our directors at Enbridge Management and at our general partner. First, we'd like to thank Terry McGill for his leadership of the partnership during his impactful tenure as director on the boards of our general partner and Enbridge Management. With the new organizational structure, Terry will leave his position on these boards and will focus his efforts as President and Chief Commercial Officer for Midcoast Energy Partners, in addition to serving as director on the board of Midcoast Energy Partners' general partner.

We also welcome John Whelen, Executive Vice President and CFO at Enbridge, Inc. to the boards of our general partner at Enbridge Management. Finally, Richard Bird, who recently announced his upcoming retirement from Enbridge, Inc. will remain a director of EECI and EEM. We will continue to benefit from Richard's great depth and long history with EEP, which dates back to before its founding in 1991.

Moving on to the noteworthy highlights for the third quarter, first, deliveries on the Lakehead system reached a record high, averaging close to 2.2 million barrels per day. Deliveries in our North Dakota system also reached record levels during the third quarter. We expect deliveries in both Lakehead and North Dakota to remain strong and continue to increase as our market access projects enter service.

We continue to progress very well on our major projects. Collectively, the partnership has placed in service over \$2 billion of capital in the year. We expect our organic projects and our recently announced Alberta Clipper drop down transaction will deliver highly certain earnings and cash flows, which will increase our DCF and strengthen distribution coverage.

In July, we closed on the previously announced equity restructure transaction whereby our general partner agreed to reduce the partnership's incentive distribution tier in exchange for a new class of limited partnership units. Finally, we recently received a \$900 million drop down proposal from our parent, under which our general partner will drop its remaining two-thirds interest in the US segment of the Alberta Clipper pipeline to the partnership.

We'll discuss the details of this exciting development shortly. Collectively, these highlights provide the partnership with strong momentum as we head into the fourth quarter and into 2015, and they position us to deliver on our plan.

Please turn to slide number 4. In late September, we received a proposal initiated by our parent under which our general partner will drop down its remaining two-thirds interest in the US segment of the Alberta Clipper pipeline to the partnership for an aggregate consideration of approximately \$900 million. The proposed transaction, or consideration, includes cash of approximately \$300 million, plus approximately \$600 million of a new class of limited partner equity units to be issued to our general partner. The transaction will not require EEP to issue any equity in the public markets, and we do not expect current market conditions to affect the closing of this transaction.

The Board of Directors of Enbridge Management has appointed a special committee comprised of independent directors to review the proposal. The drop down transaction is targeted to close by the end of 2014.

The proposed drop down value corresponds to an approximate 11 times multiple of expected 2015 EBITDA. The Alberta Clipper pipeline earns a stable cost of service return which is not subject to variations in throughput. We expect the proposed drop down to be immediately accretive to DCF by approximately 3%.

This transaction is the latest in a series of actions Enbridge has taken to strengthen and enhance the composition of EEP's distributable cash flow and reestablish EEP as a strong master limited partnership. Enbridge has reinforced its objectives to utilize drop downs as a source of funding for its own \$44 billion growth program, and this initial drop down paves the way for future drop downs.

Enbridge, Inc., as you all know, has a very attractive portfolio of liquids pipelines assets in the US, representing over \$10 billion in book value that can be dropped down to the partnership over the longer term. And as a reminder, the partnership has drop down call options in the Eastern Access and Mainline Expansion series of

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projects, whereby EEP may increase its ownership participation in these attractive projects by an incremental 15 percentage points at cost. The value of this is about \$800 million. EEP intends to position for these drop down transactions in opportunities in the 2016 and 2017 time frame.

The Clipper drop down transaction, together with future drop down call options in the EA and NE projects, provides further momentum for the partnership's distribution growth potential. And this ought to be clear from our comments in the press release, but management intends to request that the Board of Directors consider approval of an initial 2015 distribution increase following the close of the drop down transaction, which we expect to occur before the end of the year.

Let's move ahead to slide number 5. The equity restructure that we recently closed is a very important transaction for EEP. Our general partner agreed to reduce its incentive distribution tier in exchange for a new class of limited partner units and a single tier IDR structure. Limited partner unit holders will receive a 75% share of distributions in excess of \$0.5435 per unit per quarter.

There some overarching prospective benefits to the partnership from this. The equity restructure will improve EEP's cost of capital, as the general partner's share of future distributions will be lowered. The equity restructuring also enhances the economics of the partnership's investment projects and will result in a greater proportion of cash flows being available for distribution to the public unit holders from existing capital projects, as well as future growth projects.

In addition, the improved cost of capital enhances the partnership's acquisition and drop down positioning. The positive momentum established by the equity restructure was a key catalyst that paved the way for Enbridge to accelerate its drop down objectives and initiate the Alberta Clipper drop down.

Cost of funding arbitrage between Enbridge and the partnership has compressed enough that it's now possible to structure transaction that's mutually beneficial to both parties. This is, again, a key step in establishing EEP as a strong master limited partnership.

Please turn to slide number 6. Turning to project execution, we continue to make solid strides in project construction and delivering on our growth projects. During the quarter, we completed the remaining 50 miles of 30-inch diameter pipeline between Stockbridge, Michigan and Sarnia, Ontario. We've now expanded this line's capacity from 240,000 to 500,000 barrels per day. This project is a critical component of our Eastern Access program.

Next, we placed into service phase one of our Line 61 Mainline Expansion, whereby we increased our Southern Access pipeline capacity by 160,000 barrels a day between Superior, Wisconsin and Flanagan, Illinois. The partnership has placed into service over \$2 billion of liquid pipelines expansions in 2014. Collectively, the long-term, low risk commercial frameworks underpinning our organic growth projects, such as cost of service and take-or-pay, provide us a high level of confidence in progressive DCF growth and strengthening distribution coverage.

Let's move ahead to slide number 7. The market access programs that we have underway collectively with Enbridge, Inc. are part of the overall strategic initiative to match growing North American crude oil supply to domestic demand centers. This slide summarizes all those projects and illustrates on a year-by-year basis the expanded market access that our systems will provide. Through a combination of new pipeline construction and expansion of existing pipelines, we are also strengthening our strategic position in all of our markets.

As you can see from the projects listed on the right of the map, Enbridge and the partnership have successfully executed on our program in 2013 and 2014. And looking ahead to 2015, we are on target to deliver the remaining components of our US Mainline Expansion projects, specifically phase 2 of the Line 61 and Line 67 expansions and the Line 62 twin, also known as the Chicago Connectivity project. These expansion projects are expected to progressively increase the utilization of the partnership's Lakehead system and are facilitated by the downstream pull from the parent's US Gulf Coast and Eastern Access market extensions.

As it relates to the Sandpiper pipeline project out of the Bakken, we originally estimated a target in-service date for the project would be early 2016. We now estimate that an in-service date will occur during 2017. The delay is a result of a longer than expected permitting process in the state of Minnesota.

Let's turn to slide 8 and I'll turn the call over to Steve to discuss the financial results.

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

Thank you, Mark. For the third quarter, the partnership reported adjusted EBITDA of \$406.7 million. This represents a 48% increase over the third quarter of FY13. Record Lakehead and North Dakota system deliveries, in addition to our organic growth projects entering service in FY13 and through FY14, contributed to solid EBITDA growth.



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Third quarter adjusted net income of \$117.8 million was \$56.8 million higher than the same period of 2013. Increased earnings were attributable to higher transportation rates, increased deliveries, and associated revenues from our Liquids segment, which were partially offset by lower gross margin in our Natural Gas segment.

During the third quarter, the partnership attributed approximately \$22.5 million of earnings to its Series One preferred unit holders. The main items eliminated from these adjusted results include unrealized non-cash mark-to-market net gains and losses and other items noted in our supplemental slides.

Interest expense increased approximately \$62.3 million, due to the recognition of non-cash unrealized-mark to-market losses associated with the amendment of the maturity date for our interest rate hedges that were originally set to mature in 2014 and 2016, resulting in hedge ineffectiveness.

Adjusted earnings per unit for the third quarter increased \$0.25 compared to \$0.09 for the same period of 2013, due to higher adjusted earnings attributable to limited partner interests. Our year-to-date as declared distribution coverage ratio on a cash basis was 1.08 times and was 0.9 times assuming the inclusion of the paid in-kind distribution.

For the third quarter, the as declared coverage ratio on a cash basis was 1.14 times and was 0.95 times assuming the inclusion of the paid in-kind distribution. We are pleased by the strengthening of our coverage ratio and expect it will continue to strengthen as we place additional assets from our multi-billion dollar organic growth program into service.

Please turn ahead to slide 9. The Liquids Pipelines segment had another strong quarter. Adjusted operating income of \$269.7 million for the third quarter was \$119.5 million, or 80% higher than the same period from 2013, and \$38.9 million, or 17% higher than the second quarter of 2014. Third quarter operating revenues over the prior year increased due to an increase in transportation rates and higher deliveries on our Lakehead and North Dakota systems.

The partnership completed a large component of its Eastern Access program, specifically the Line 6B Replacement project from Griffith, Indiana to Sarnia, Ontario, in two phases during 2014. The 160-mile segment of the Line 6B Replacement project from Griffith, Indiana to Stockbridge, Michigan entered service May 1, 2014 and contributed to the increase in revenues during the third quarter.

The remaining 50-mile segment of the line 6B Replacement to Sarnia, Ontario entered service September 30, 2014. These phases have collectively brought the full Line 6B Replacement project into service. Additionally, the first phase of the Line 61 Mainline Expansion began service on August 1, 2014.

Third quarter 2014 operating revenues decreased \$17.7 million, as a result of regulatory accounting true-ups related to Lakehead toll revenues. Our updated Lakehead tariff filing, which was effective August 1, 2014, placed the updated index rate adjustment into effect, eliminated the SEP II surcharge for Line 14, and added new components to the facility surcharge mechanism in order to recover the remaining Line 14 rate base. Operating income benefited from lower operating and administrative expenses of \$23.2 million over the prior year, primarily due to the higher pipeline integrity costs related to the Line 14 hydrostatic test which we completed last year.

As you view the chart on the right, you can see the increasing deliveries trend on our Lakehead and North Dakota pipeline systems during the quarter. Deliveries on our Lakehead system reached a record 2.17 million barrels per day during the third quarter. Strong deliveries, driven by continued supply growth out of Western Canada, as Enbridge and the partnership's pipeline expansion projects were entering service.

Deliveries on our North Dakota system also reached record levels, at approximately 350,000 barrels per day, as volumes transitioned back to our pipeline system, due to favorable market pricing differentials between the East Coast and Gulf Coast markets. Collectively, total Liquids System deliveries increased approximately 21% over the same period from the prior year.

During the quarter, we increased our total cost estimate related to the Line 6B incident by \$51.9 million, to a total cost of \$1.21 billion. The cost increase during the third quarter is primarily related to the finalization of the Michigan Department of Environmental Quality approved schedule of work, as we completed the dredge activities near Ceresco and Morrow Lake, and updated estimated civil penalties under the Clean Water Act of the United States. We are currently working with the Michigan Department of Environmental Quality to transition activities from the EPA.

The cumulative amount collected from insurance recoveries is \$547 million. The remaining uncollected liability insurance coverage is \$103 million. We believe we will collect these amounts in future periods. Through the end of the third quarter, cumulatively, we have spent approximately \$989 million on Line 6B remediation and have a remaining estimated liability of approximately \$219 million.

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Let's move forward to slide 10. The Natural Gas segment had an adjusted operating loss of \$3.2 million for the third quarter, which was \$20 million lower than the same period for 2013 and \$9.8 million lower than the second quarter of FY14. The decrease in our third quarter Natural Gas adjusted operating income over the prior year was primarily due to lower natural gas and NGL volumes on our systems.

Moving to the right hand side of the slide, you can see wellhead volumes increased approximately 1% in the third quarter versus the second quarter of 2014. We are encouraged by the sequential increase in total system natural gas volumes from the first through the third quarter and expect volumes to continue to progressively ramp up.

New production in the Anadarko region is coming on to replace volume losses from the previously announced lost customer. Also, reduced dry gas drilling in the East Texas region is being partially offset by rich gas drilling. Likewise, North Texas is showing steady gains underpinned by richer gas streams.

Moving down to the system-wide NGL production chart, we have represented the portion of NGL production related to the previously disclosed customer loss on our Anadarko System. As you can see, our system-wide NGL production continues to increase when excluding the production associated with the lost customer. This positive trend in the NGL production indicates that we are benefiting from richer gas developments across our systems.

Please turn to slide 11. In February, we provided full-year 2014 adjusted EBITDA guidance of \$1.5 billion to \$1.6 billion. We remain confident in delivering our full-year financial guidance for 2014.

Year-to-date, adjusted EBITDA through the third quarter was \$1.108 billion. Looking forward to the fourth quarter of 2014, we continue to expect a ramp in adjusted EBITDA, predominantly due to successful project completion.

As Mark discussed earlier, in 2014 we completed a large component of our Eastern Access program, notably the Line 6B Replacement project and the first phase of our Line 61 Mainline Expansion. Collectively, full quarter contributions from these recently completed growth projects are expected to fuel sequential growth in EBITDA and cash flows for the partnership in the fourth quarter. Additionally, our updated Lakehead tariff filing, which became effective August 1, 2014, is expected to provide full quarter benefits in the fourth quarter.

Let's move forward to slide 12. This slide provides our 2014 capital expenditure forecast, which is estimated to be \$1.6 billion and is inclusive of approximately \$100 million maintenance capital expenditures. These expenditures are presented net of joint funding.

At the end of the third quarter, we had approximately \$1.4 billion of available liquidity. On July 3, 2014, we amended our 364-day credit facility to extend the termination date to July 3, 2015 and to decrease the aggregate commitments under the facility by \$550 million. This adjustment is, in effect, a right sizing of EEP's liquidity requirements.

On October 6, 2014, we amended the five-year credit facility to extend the maturity date from September 26, 2018 to September 26, 2019, with \$175 million of commitments expiring on the original maturity date of September 26, 2018.

Please turn to slide 13. I will now turn the call back over to Mark for his closing comments.

Mark Maki - Enbridge Energy Partners LP - President

Thank you, Steve. Just a couple of points and emphasis, in closing. First, we are pleased with the strong performance at our liquids pipeline system so far in 2014. We expect deliveries in both our Lakehead and North Dakota systems to remain strong as we leave the year and enter 2015.

Our 2015 organic growth is on target. We expect our organic growth projects and our recently announced Alberta Clipper drop down transaction will deliver highly certain earnings and cash flows, which will increase our DCF and strengthen our distribution coverage.

Our expected equity funding needs are very modest through 2017, as the net drop downs largely defray our near-term equity requirements. EEP will optimize the size and timing of any future drop downs to meet the mutual objectives of EEP and Midcoast Partners.

The positive momentum established following our equity restructuring transaction was a key catalyst that paved the way for Enbridge to accelerate the drop down objectives and initiate the \$900 million Alberta Clipper drop down. Our parent has reinforced its objectives to utilize drop downs as a source of funding for Enbridge's own project growth program.

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So with that, Lacey, I'd like to turn the call over for questions, please.

QUESTION AND ANSWER

Operator

Thank you.

(Operator Instructions)

Mark Reichman, Simmons & Company.

Mark Reichman - Simmons & Company International - Analyst

Just a few questions. The Liquids segment performed very well. The Natural Gas segment was a little weak. And during your Analyst Day presentation, you had outlined an MEP drop down schedule through 2017. I was just curious, would your preference be to accelerate the sale of your interest in MEP, or would you be more apt to extend it to allow MEP to use its financial capacity to fund organic expansions or even third-party acquisitions that could diversify its business?

Mark Maki - Enbridge Energy Partners LP - President

I think, Mark, one of the things that we've -- all of those are certainly options we want to look at for Midcoast. One of the key things I want to emphasize, without question, is Midcoast is an important part of EEP's future. And we want to take actions that are going to help MEP be successful.

So if it's throttling up or throttling down on the drop down schedule in order to accomplish that, that's one thing we could do. Especially as Greg looks at opportunities to step outside the footprint and diversify the Midcoast business, EEP would certainly intend to invest alongside Midcoast, anything that happens on the footprint. But also, where there's opportunities off the footprint and you look at the types of projects that Greg is targeting with his leadership team, those are projects that would fit well in EEP and EEP would then drop it down at a later point. So there's lot of things that we can do. All those options that you outlined are all things that we would consider.

Mark Reichman - Simmons & Company International - Analyst

On the FY14 capital expenditure budget, was just wondering how much of the \$95 million reduction is attributed to lower costs, deferred spending or changes to the project portfolio? And any comments on expectations for FY15 -- or I guess that's generally outlined at your Analyst Day.

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

Hello, Mark. Steve Neyland.

As it relates to the \$95 million change -- I'm sure you've probably already done the math -- but about \$40 million of that is around Eastern Access and really it just has to do with really just timing of Phase I. It's just the clean-up costs associated with the in-service of the asset, as well as some of the decommissioning costs we have around the old Line 6B. So it's really just a function of some timing.

And the other big component that's there is on the Liquids, other expansion capital for about \$65 million, which is quite honestly a number of different projects and again, timing. So it's really just refinement, if you will, this late in the game process in the year. And as it relates to future periods, FY2015, FY2016, really not any additional guidance to provide, other than what we've already communicated.

Mark Reichman - Simmons & Company International - Analyst



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Okay. And then just lastly, last question. Could you just provide an update on efforts to optimize the permitted cross-border capacity on 67 and Line 3, and also what your expectations are in terms of the timing on ramping up capacity and expectations to receiving a permit amendment?

Mark Maki - Enbridge Energy Partners LP - President

Guy, do you want to handle that? Guy Jarvis?

Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

Sure, Mark. Thanks.

So in terms of the cross-border Line 3 maintenance and our flexibility program that we had talked about implementing at the border, that is now in service. It's been in service since the second half of September. And as we've previously indicated, that allows us -- that and some other things that we've been doing have allowed us to realize the incremental capacity of up to 570,000 barrels a day that we're expecting versus the prior limitation of 450,000. So that's in service. We've got the capability to add the additional 120,000 barrels a day.

In terms of then the next stage of the Clipper expansion to 800 barrels, we have got all of the state and Army Corps permits that are required to build those stations, and we're going to be commencing that construction shortly. It is expected they will be in service by the middle part of next year. And we're still confident, based on the insight that we have through our major projects group, that we can get the Presidential permit amendment in place by that time.

Mark Reichman - Simmons & Company International - Analyst

Okay. Thank you very much.

Operator

Brian Zarahn, Barclays.

Brian Zarahn - Barclays Capital - Analyst

On the planned distribution increase from the Alberta Clipper drop down, is that going to be part of your regularly quarterly distribution?

Mark Maki - Enbridge Energy Partners LP - President

Brian, that would be the intent.

Brian Zarahn - Barclays Capital - Analyst

And then how should we think about your distribution growth guidance range, given that you have tailwinds obviously from the drop downs and your organic projects entering service, but headwinds from lower NGL prices. So how should we think about those cross currents?

Mark Maki - Enbridge Energy Partners LP - President

You've hit on a couple of them, the headwinds and tailwinds. Certainly, we're sticking, for the time being, anyway, to the 2% to 5% over time. But certainly, we could look at the distribution outlook, based on what we've already talked about for FY15, is better than, say, what it was this year, given the drop down from the parent, plus we come back to our normal distribution cycle at the middle of the year and see how things are looking.



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But certainly, the 2% to 5%, Brian, we're going to stick with that for the time being and monitor the headwinds and tailwinds and see if there's any adjustment required from 2% to 5%. But that's a pretty broad range. It covers lots of different conditions in the market. And we consider that when we're establishing what our outlook is for distribution growth.

Brian Zarahn - Barclays Capital - Analyst

Okay. And then Mark, in your comments, you mentioned expected growing liquids volumes. I'm just curious in your North Dakota system, since the price, crude price, decline really accelerated in October, any impact on the North Dakota system that you're seeing, on volumes?

Mark Maki - Enbridge Energy Partners LP - President

Not yet, Brian. And I think certainly, the decisions that producers are making in North Dakota are like a lot of us, are based on long-term fundamentals. And you'll get short-term blips and aberrations in the market, and you're seeing some of that in pricing now. But we've seen volume come back to our system away from rails as differentials have come in. And I think the fundamentals really line up for that for the longer-term. So right now, we feel very, very good about the outlook for North Dakota. And long-term, we feel great about the outlook for North Dakota.

Brian Zarahn - Barclays Capital - Analyst

The last one for me, related to that. On Sandpiper, any change on your cost estimates due to the permitting delay, and any additional color on the when in 2017 do you think the project will enter service?

Mark Maki - Enbridge Energy Partners LP - President

I'll take the top level of that, and then look to Guy to add any additional color. But basically, the timing in 2017 is going to be somewhat dependent on when we receive all the different decisions we need from the state of Minnesota. You've got, first off, a certificate of need, and then you've got the route decision. Depending on the route that eventually is chosen -- and certainly, we think the one that we put forward is the right one -- but if there's some alterations or deviations, that would likely add cost to the project.

So until we know that, it's very hard for us to say the number is X or Y. Certainly, a delay will likely add some marginal dollars to the cost. Again, it's hard to say what that is until we have a chance to look more definitively at what the schedule is. When do we received the go-ahead? When do we have the route set? And then we can look at what we can do to manage the construction to get it done still in an accelerated time frame, looking at winter construction and other alternatives. So there's a lot of variables that we don't know the answer to that make it hard to answer the cost question.

Brian Zarahn - Barclays Capital - Analyst

Okay. Well, thanks, Mark.

Mark Maki - Enbridge Energy Partners LP - President

Guy, anything else you want to add to that?

Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

No, nothing to add to that, Mark. I think you highlighted on it briefly, but one of the real issues that we face is that winter construction period, and areas that do need work in winter. Depending on when we get our permits, you can't just say, well, it's two months or three months behind what we expected, so the in-service date is delayed two or three months. If we get into a construction window problem, a two- or three-month delay on the permitting side could have the potential to result in larger delays. But as Mark said, at this point in time, we don't have enough information to have anything more definitive.



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Operator

TJ Schultz, RBC.

TJ Schultz - RBC Capital Markets - Analyst

If you previously thought there was \$2.6 billion, I think was the number, of value to drop to MEP, how has that view or dollar value changed, given the year-to-date results in the gas business generally?

Mark Maki - Enbridge Energy Partners LP - President

The \$2.6 billion was before the first drop; so again, factor that down. But then thereafter, TJ, the value that we expect to the drop down strategy for Midcoast is going to be dependent upon when it takes place, what the commodity cycle looks like at the time the drops takes place, and other activities that happen on the system and off the system, and how EEP invests alongside Midcoast along the way. So again, lots of variables in that.

I would say in the \$2.6 billion, using that old number, there was certainly a cushion as to how much we expected to get from the drop down strategy. We have certainly the ability to pick a lesser number and still be fine, as far as our equity funding requirements are at EEP. We had -- JR and the Treasury folks have made sure we've got room. The number may be less. No one is particularly concerned with that on this end, at this particular point in time.

TJ Schultz - RBC Capital Markets - Analyst

Okay. So I understand it's kind of variable as you look to grow the Midcoast operating business to grow the size of that pie to allow for drop downs. But maybe that means acquiring something outside the footprint there, but maybe if you could just expand on in that gas business what you see for the investable opportunity set, what dollar values of Midcoast's growth organic CapEx is maybe achievable next year, and then the types and returns on the projects there?

Mark Maki - Enbridge Energy Partners LP - President

Well, Greg touched on this in the call for Midcoast, and you could certainly add additional color here. But a couple hundred million dollars range organic, \$200 million to \$300 million of organic in and around the footprint. And Greg touched on -- and we'll let Greg speak to here in just a moment -- but Eagle buying opportunities. There are certainly other opportunities in the North Texas footprint organic on system activity.

In addition, one of the things Greg highlighted as a key strategy, once he came in and looked at our business, is we need to get assets that enhance the value chain, change some of the contract mix that's in that existing business, look at other basins so that we've got more exposure to other shales and activity areas in the US. And so all those are places we could see Midcoast invest. And EEP, I think we'd be very happy to invest alongside Midcoast.

Greg Harper - Enbridge Energy Partners LP - EVP of Gas Pipelines and Processing

Thanks, Mark. This is Greg. You did quite well answering that. I'd say you've got in footprint strategy in East Texas that's going to be getting Beckville online a fully operational and getting the gas stream richened to the optimum level is going to be key for East Texas. North Texas is, as Mark says, continuing on what we're doing. We're actually having a pretty good year in North Texas and adding new business and new richer volumes in that stream.

Anadarko has been a disappointment, for sure. But that's a key focus here. And I think fourth quarter will illustrate the renewed focus on Anadarko for us and some things we're doing better to bring more gas into that system and get it processed and then moved down to Texas Express. So that's the end footprint.

Dave Weathers and his team, Mark addressed this earlier in his comments, is looking for an new opportunities outside the footprint within the gathering processing world and to be more proactive in those approaches, as opposed to reactive to RFPs. And we're hopeful to be successful. Again, you can't make people dance with you, but we're wanting to at least -- we'll be kissing a lot of frogs out there, on that end.



TJ Schultz - RBC Capital Markets - Analyst

Okay. Understood.

Just lastly, going back to the distribution growth guidance or range. In the past, you've highlighted that organic projects provide some of the momentum maybe to accelerate to the high end of that 2% to 5% range by 2017. So if you could just frame the ability to accelerate distribution growth in the context of Sandpiper getting delayed. Do you consider that project the crux to accelerate growth, or now do you think the call options on EA and Mainline provide some flexibility? Just how you're thinking about the need or ability to accelerate that growth to the higher end of your range?

Mark Maki - Enbridge Energy Partners LP - President

I would say it really was the confluence. If you look at the old guidance, if you will, on that particular subject matter, the acceleration to the higher end of the range was a confluence of the call options, together with Sandpiper getting done in 2016 and then the Line 3 project in 2017. So what you have now is you've got Sandpiper and Line 3 still lined up in the 2017 time frame, but you still have the call options in 2016.

So as you think about the ability to accelerate, we're going to be carrying some capital, no question, with respect to Sandpiper, through 2016. So we probably don't quite have the same crossover, if you will, to that particular point in time. But we get there, with the projects that we've got lined up.

And I think one of the nice things, if you think about what has been done of late with respect to EEP, the IDR restructuring was a critical component. You see that with the Alberta Clipper transaction. So the ability of EEP now to be in a position to take drop downs from the parent is substantially better than it was when that prior guidance was given.

So I think we've done a lot of work to strengthen EEP's positioning to be in a position to take drop downs from the parent. And that, I think, would be probably one of the things I'd look at as being a catalyst to drive us to the higher end sooner, or to maintain the old kind of look that we have before.

TJ Schultz - RBC Capital Markets - Analyst

Okay. Thanks, Mark.

Operator

Sunil Sibal, Seaport Global Securities.

Sunil Sibal - Seaport Global Securities - Analyst

Congratulations on a solid quarter. And many of my questions have been already asked, but one quick question, if I may, regarding your operating and administrative expenses, especially the way they are broken down between the Liquids and the Gas business.

So looking at the total operating and administrative expense pie, seems like Gas business is taking a much bigger share of that expense, especially as a percentage of gross margins across the two businesses. I think Greg alluded a little bit to that on the MEP call. I was wondering if you could talk about how you're thinking about that going forward?

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

I think one thing just when you're comparing the two businesses and their cost structures, the comparability is a little bit tough, from the standpoint that Lakehead is -- or the Liquids segment, I should say -- is predominantly, not exclusively, but predominantly mainline pipe, whereas the gathering and processing system, there's more people and equipment to operate the processing plants and treating plants that we have to accommodate the margins. So just by its nature, the gathering and processing



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business is going to carry a higher cost structure than would mainline or interstate type pipelines. That said, we did talk about on the call with MEP that we believe there's opportunities to optimize that cost structure and make it more effective.

Sunil Sibal - Seaport Global Securities - Analyst

Okay. Very helpful. Thanks.

Operator

Faisel Khan, Citigroup.

Faisel Khan - Citigroup - Analyst

Thanks for the time. I just wanted to go back to a question you answered earlier. So the Line 67, Line 3 optimization plan, you said that now you're capable of running 570 versus 450. You said you're capable of it. But are you running at full capacity across the border?

Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

Mark, I can jump into that. Yes, we have. We've been heavily apportioned on our system throughout most of the year, particularly on the heavy side of things. So while we remain apportioned, that capacity has been utilized quite -- well, I think just about every day.

Faisel Khan - Citigroup - Analyst

Okay. Understood. As you look at the -- provide the slide on your Lakehead growth, the volumes on the Lakehead system, can you just clarify exactly moving from the 1.83 a day to the 2.17 a day, is that a combination of light and sweet, or mostly heavy crude? You said Western Canadian, so I assume that's all heavy crude, if terms of the incremental barrel, from last year to this year.

Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

Mark, you want me to --

Mark Maki - Enbridge Energy Partners LP - President

Go ahead, Guy.

Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

I think the first answer is it's both. I think if we looked at what we've seen manifest this year versus our projection coming into the year, while the heavy has grown, it maybe hasn't grown as strong as we had anticipated. And part of that is based on earlier in the year having less heavy market attached to our system, which has improved throughout the year. But on the light side of things, particularly light originating in Western Canada, we've seen those volumes coming in stronger than we had anticipated.

Faisel Khan - Citigroup - Analyst

Okay. But you attribute the lower heavy volumes that you anticipated to more connection issues farther upstream, is that a fair statement?



Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

Actually, I don't think it was so much upstream as it was throughout this year, for example, BP Whiting's been ramping up their major program to consume more heavies. So earlier in the year, they weren't fully up and our ability to deliver to heavy markets was decreased, whereas now, particularly throughout the summer, BP and all of the other refineries on our system had quite a stable quarter. So our access to more market is better.

Faisal Khan - Citigroup - Analyst

Okay. Makes perfect sense. Thanks. And then Line 61 Superior to Flanagan, you said that's up and running and running at full capacity. Is that what's going on right now?

Guy Jarvis - Enbridge Energy Partners LP - EVP of Liquids Pipelines

You know, I don't have the answer to that. I'd have to -- we'd have to get back to you on that. (Interposing voices) Sorry, Mark. I was just going to say, I know it's in service, capable of that. How that's operating on any particular day, I don't have that information.

Faisal Khan - Citigroup - Analyst

Okay. Understood. And just on the drop down of the rest of Alberta Clipper and the accretion dilution, just curious, in terms of the decision to issue Class C units versus common units, what was the logic behind that or strategy behind that? Is there a tax issue or a timing issue, or was it an issue of you didn't want to come to market with that much equity?

Mark Maki - Enbridge Energy Partners LP - President

Maybe I'll field that. There's quite a few reasons. Tax isn't one of them, though. I would say that. It's a relatively -- basically almost a brand new asset, so we don't have something that had its basis ground down a ton. So if you think about -- we've done a lot of work to try and mitigate the amount of equity needs that EEP has. The parent is, again, another example of how supportive Enbridge has been to EEP -- and this is an example of it -- is they're prepared to step in and take equity in EEP's activity.

So I think it really is again just a sign, the parent wants EEP to be successful. It's a very loud and clear demonstration of that. Besides a reasonable drop, it's got a nice accretion. They're taking equity and equity disproportionate to what the investment would normally require. Think about a pipeline investment with a cost of service structure, to fund it with two-thirds equity is certainly strong. So I think, again, it's a strong statement that Enbridge Inc. is supportive of EEP.

Faisal Khan - Citigroup - Analyst

Okay. Fair enough. And just in terms of from here on out, assuming that a Presidential permit is issued in mid-2015, so would all the incremental volumes on the US side of the border be associated with upside to EEP, and how much of that is in your planning assumptions for distribution growth?

Mark Maki - Enbridge Energy Partners LP - President

We've already have basically contemplated -- keep in mind, the projects that this relates to largely are cost of service projects. So you're going to get a specified rate or return, regardless of whether the volume actually moves or not. So we've already effectively dialed that into our distribution outlook. And there may be some modest upside that come from index volume that move in the system. But by and large, it's already been factored in.

Faisal Khan - Citigroup - Analyst

Right. But the customer commitments are there. The revenues are there only if the project is up and running, right?



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Mark Maki - *Enbridge Energy Partners LP - President*

The project has to be up and running and in service. And as Guy pointed out, it's pump stations in the US and those will be up ready and available for service.

Faisal Khan - *Citigroup - Analyst*

Okay. I hear you. And then on the interest rate hedges, the ineffectiveness. I guess that was all non-cash, but can you just talk about, was that a result of the hedges actually didn't work at all. So there's a loss somewhere on the accounting and financial side, or is it something else? Is it just an accounting issue and it doesn't matter?

Steve Neyland - *Enbridge Energy Partners LP - VP of Finance*

Yes. So what we've done is as the timing of our projects has moved out, our need to issue debt and the timing of those debt issuances has moved to later periods. And so we've rolled those hedges into future periods. And when we did that roll, as the underlying or the initial amount has moved and then is deemed ineffective from an accounting US GAAP perspective, and we're required to recognize that loss or that change at that time. So again, it is non-cash and it really ties to the fact that we've rolled those hedges to future periods to accommodate and line up with the change in the capital spend profile.

Faisal Khan - *Citigroup - Analyst*

Okay. Got it. Thanks a lot, guys. Appreciate the time.

Operator

John Edwards, Credit Suisse.

John Edwards - *Credit Suisse - Analyst*

One of the things I was thinking about, earlier in the year, you indicated you've identified \$10 billion of projects for drop down from ENB to EEP. And in light of the distribution growth outlook, the 2% to 5%, why not accelerate some of those drop downs so that you're at the top end of your range pretty consistently? Maybe you can enlighten us on the potential thought process there.

Mark Maki - *Enbridge Energy Partners LP - President*

I think, John, you've certainly seen the Alberta Clipper drop. And you think about the various actions that have been taken by the parent to help EEP, whether it's the IDR restructuring or now the Alberta Clipper transaction. We've got the call options embedded in the existing projects. And clearly, the need at the parental level is there's \$44 billion in growth projects, either secured or projects that are going to be coming in the near future. There's definitely a need for that.

I think we're positioning EEP to be capable of taking the drop downs from the parent. We have not laid out a schedule, specified time so forth. EEP still has to finance, though, its organic projects. And we think we've got that well in hand. We want to make sure that continues to be the case. And as we continue to perform as we have as of late, we ought to be able to be in a position to take more drop downs from the parent, where it works for both parties, as the Clipper transaction does.

So this is an important one to watch. We'll see how it goes, and expect it's going to go very, very well. And we've got our call options; and then to add something on top of the call options, I'm sure the parent will be thinking about that, when the time comes.

John Edwards - *Credit Suisse - Analyst*

Okay. Fair enough. And the other thing I was going to ask you is, have you taken on more insurance coverage in light of this rising liability, if you will, from the Michigan incident a few years back? And if so -- I think you had about \$600 million or so before -- have you taken that up to over \$1 billion in the wake of that incident, or maybe you can talk about the thought process there?

Mark Maki - Enbridge Energy Partners LP - President

We've had very modest increases in the amount of liability coverage that we have, John. Off the top of my head, it's just not top of mind, I think it's right around \$700 million in liability. It gets very, very expensive beyond that particular point.

If you go back over our history, the Marshall incident was, without question, really a confluence of a number of very, very difficult and bad events, in terms of what it cost, ultimately here. So we just don't see a lot of value in insuring for another Marshall, especially if you consider what the Company has done in terms of the response, the capabilities the Company has, the additional investment we've made in terms of new pipelines, replaced Line 6B, going to replace Line 3, the integrity program we've announced here on Line 10.

We've done a tremendous amount, and we've got, again, more work to do, as Al often highlights at the Enbridge, Inc. level. So I think this is an example, John, I think we're adequately insured of the risks. And it is insurance. It's not meant to cover off every conceivable potential incident. It covers off what we think to be the likely incidents, and then some.

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

And just to confirm that number, it is \$700 million in the aggregate insurance liability for environmental for Enbridge Inc. and its affiliates.

John Edwards - Credit Suisse - Analyst

Okay. So basically, what you're saying is it's just, to cover more than that, from a rate perspective, it's really not cost effective to take that on.

Mark Maki - Enbridge Energy Partners LP - President

For a company the size of EEP and its ability to handle, I don't see any good to come from insuring at \$1 billion or \$1.2 billion, or whatever you want to look at.

John Edwards - Credit Suisse - Analyst

Okay. Obviously, I'm just not familiar with the rates and what it would be to take that up. But that's really helpful. Okay. Thank you very much. My other questions have been asked and answered, so thank you.

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

Thanks, John.

Operator

Ross Payne, Wells Fargo.

Ross Payne - Wells Fargo Securities, LLC - Analyst

My first question is what kind of cash flow impact do you think this additional Griffith to Sarnia segment might give you in the future quarters? And getting back to some of these drop downs with ENB, any other near-term targets you would have in terms of projects that could be dropped? Thanks.

Mark Maki - Enbridge Energy Partners LP - President



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Ross, I'll take the last part, and Steve will get the metrics for the EA project. With respect to other drops from the parent that we would target, certainly other interests in Eastern Access and Mainline Expansion beyond what we have as a call option would be of interest to EEP. That would be probably number one.

Anything on the existing Mainline would be certainly ideal initial candidates. After that, you start talking about projects like Flanagan South or Enbridge's interest in the Seaway system. There's also Toledo pipeline, Chicap, Mustang would be a couple others that are ancillary to the Mainline system, also could be looked at. And certainly the Line 3 project is going to be jointly funded, again, which would be another key project. So all those are laid out in some detail in EEP's Analyst Day from last year.

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

Ross. And on the first part of that question, and it speaks a little bit to what's on slide 11, is as we have full quarter participation of Eastern Access and Mainline Expansion. Line 61, helps us get a higher run rate for the fourth quarter. And we'd expect the Eastern Access contribution of that is somewhere in the \$20 million to \$25 million range, incrementally Q3 to Q4, probably at the higher end of that range.

Mark Maki - Enbridge Energy Partners LP - President

And Steve's talking increment, Q3 to Q4.

Steve Neyland - Enbridge Energy Partners LP - VP of Finance

Incremental. So you get a piece of it in each of the quarters. So all-in different.

Ross Payne - Wells Fargo Securities, LLC - Analyst

Okay. Great. Thanks.

Operator

Ladies and gentlemen, this concludes the question-and-answer portion of today's call. I will now turn the call back over to Sanjay Lad for closing comments.

Sanjay Lad - Enbridge Energy Partners LP - IR

Great. Thank you, Lacey. We have nothing further to add at this time; however, I would like to remind you that I will be available for any follow-up questions you may have. Thank you and have a great day.

Operator

Thank you for your participation in today's conference. This concludes your presentation. You may all disconnect. Good day, everyone.



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