Timmins Presentation to the Natural Gas Market Review EB-2010-0199

Immediate Problem with TCPL Rate Design

The ICF Report makes it clear that TCPL's rate and supply situation constitutes a current problem for gas supply for all of Ontario. At various parts of the report ICF refer to this problem as "critical" and "crucial".

1. The immediate problem is one of TCPL rate design: how to deal with the TCPL's potential death spiral of rising rates due to declining throughput arising from lower cost gas availability. The result is twofold: TCPL has lost export volumes and there is displacement within Ontario by lower priced gas and transportation.
2. ICF sees this problem as possibly accelerating due to
   (a) a decline in the conventional reserves available to be moved on TCPL[1]; and
   (b) the very large demands for available supply and TCPL pipeline capacity from tar sands development and coal to gas switching for electricity generation in Alberta and the U.S. [2]

The ICF Report also makes it clear that Union's Northern Ontario customers are more vulnerable to both the above two risks than Union's Southern customers because they depend entirely on TCPL's Mainline for their supply.

Union's Northern/Southern Region Rate Design Split Compounds Problems for Union's Northern Region Customers

Union's rate design approach--with its separation of the North from the South--creates a great deal of increased exposure for the Northern customers to TCPL rate increases.

In order to understand that it is necessary to review Union's actual rate making procedure, at least in simplified terms, to understand the reason for that exposure.

[1] Although the ICF Report states that there are more than adequate gas reserves to meet future needs, the basis of that statement is that there will be full development of shale gas reserves. See their Table Ex.32 U.S. and Canada Natural Gas Resource Base. There are only 60 tcf of Proven Reserves shown for the WCSB and ICF replied to questioning in the Sept. 29 meeting that most of the 664 tcf of Unproved Plus Discovered and Undeveloped reserves are shale gas. There are, as they concede, some general uncertainties to regarding shale gas development. For that portion the shale gas in the WCSB available to the TCPL mainline there are some even greater uncertainties: 1) the shale development in this area is in its infancy 2)much of it may flow south

[2] "Coal fuels just over half of the installed electricity generating capacity of Alberta's power plants." (Alberta Government Energy webpage). Something close to 50 % of U.S. electricity generation is from coal and much of that takes place in the U.S. Midwest where much of the WCSB gas flows.

For rate making purposes Union divides its system as though the former Centra Gas (purchased in 1988) continued to exist as a separate company with its own gas purchasing regime and related delivery and storage access. It refers to this portion of its company as its Northern Region and separates out gas costs, transportation and storage for the Northern Region for rate making purposes.

One way of appreciating this rate making approach and its current and potential future impact on Northern customers is to look at Union's procedures in two of its most recent QRAM applications.

In those applications, as a direct result of Union's North/South split, we have them isolating the lower cost of gas and transportation achieved through their Dawn connections and dedicating it all to the Southern region. In EB-2010-0201 it is $35.138 million and in EB-2010-0265 it is $29.639 million[3]. (See Tab 1 Schedule 3 page 4 of 6 from each of those QRAMs attached ***Appendices A and B*** to this presentation). As we understanding the exercise, this lower cost, that flows from lower U.S. gas and transportation costs, gets credited to the Southern transportation costs as a "balancing" exercise. (See Testimony-Tab1 p. 3 of EB-2010-0201 and Tab 1 Sch. 2 from that same proceeding attached as ***Appendices C and D*** to this presentation.) While we don't understand just why the credit for lower gas and transportation should be credited to transportation or exactly how it flows through in Union's rate making process, it is clear that it is isolated for the sole benefit of the Southern customers. It is also evident that the accounting action plays some part in the ultimate 22% higher January bill for Northern residential customer's bill versus a Southern one's as shown in the bill projections attached as ***Appendix E*** to this presentation.

This discrimination flows directly from Union's notional division of its system into the Northern and Southern operating systems.

In another area—storage—we see that, in Union's residential customer notices for their July 1, 2010 QRAM (***Appendices F and G*** to this presentation) the unit rate for storage on a Northern customer's bill is 2.5971 cents/m3 whereas it is only .9919 cents per m3 for a Southern customer. Again it is very difficult to track through Union's rate design procedure or its justification but the result of the Northern system/Southern system split is clear. Much higher costs for the Northern customers for, we understand, much less access to Union's storage facilities.

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[3]We do note that it varies. In the respective supporting tables for each application (Tab 1 Sch. 3 p.4 of 5) that amounts in column (g) for the cumulative 12 month prior periods have been respectively $50.168 million (Sept. 2009) and $84.781(Sept2010) and $42.849 and $$77.047 million. This indicates to us that the potential discrimination could be much greater.

The Board's Rate Making Jurisdiction

While many of the factors that affect gas markets in Ontario are beyond the Board's jurisdiction, the Board's rate making jurisdiction <u>can</u> address this situation that we raise here.

To encourage the Board to look into the area, and in anticipatation of some resistance from Union Gas, we make that following ratemaking comments that we think are relevant.

<u>Why there should be no North/South division in Union's rate design:</u>

- Union is a single corporation with an integrated operating system. The usual practice, in such circumstances, is to treat all customers equally baring some extraordinary physical circumstance. Examples of this are:
    1. TCPL's Eastern rate zone was extended by the National Energy Board to include Union (which then was only in southwestern Ontario and wanted <u>that</u> as a separate zone) *and* Gaz Metropolitain despite its being a great distance downstream and in a separate province.
    2. Electricity rates for default supply by distributors are the same across the province, regardless of distributor.
    3. Electricity distributors that have merged with or acquired others have moved to "harmonize" distribution rates. For example, Hydro One's most recent cost of service application proposed the phase-in of a universal rate for all of its acquired systems, and the Board has approved the plan.[4]
    4. Enbridge has single rate for all its customers including those in Ottawa and Niagara who are physically separate from Enbridge's principal distribution area of Toronto.

- Union's announced intention, when it received Board approval for the acquisition of the Centra Gas system, was to effect some $14 million dollars of savings annually through the integration of the two operations (and these savings were to be spread among <u>all</u> customers) and to effect company wide sharing the of flexibility of customer and load diversity, storage availability, integrated load dispatch and gas supply under the combined operations of a single company.

- If the downstream location of storage and alternate supply are the excuses for Union's separation of the North then their Eastern Zone constitutes a total anomaly. The Eastern Zone is downstream of storage and U.S. deliveries and physically has full access to them but is lumped in with the Northern Region for rate making purposes. The truth of the matter is that Union acquired a separate operating system when it acquired Centra and, for some reason—inertia, fear of local resistance to rate change, has chosen to stick with the old Centra rate zones and has continued to do its rate

[4] EB-2007-0681.

design on the basis of those zones as though they were not part of its integrated operations.

- Union operations are integrated. As far as we know it has only one gas supply/dispatch operation.

- The creation of different rate regions within a single operating company ought only to be done if there are overwhelming operational or corporate reasons to do so. In Union's case they don't exist to a sufficient degree. Even if there are physical limitations an artificial separation merely magnifies them.

- With a single operating company there are many avenues to see that storage and alternate gas supplies are shared even upstream by all customers: back hauls, exchanges, deemed deliveries, storage trading etc. This would be easier and more logical if there was a single rate zone for Union.

Possible Infrastructure Improvement to Northern Ontario Supply

There may not be any complete infrastructure solution to the dilemma of Northern Ontario customers because of their isolation but one possibility may exist for at least partial amelioration.

There is a Great Lakes interconnection at Sault Ste. Marie that feeds a transmission line that runs east to Blind River and Elliot Lake. Union Gas operates a transmission line that runs west of the TCPL mainline at North Bay over to beyond Espanola. That leaves a gap of less than 40 miles. The linking of these two systems, with some attendant looping of the in-place systems, could provide some access for the Northern customers to alternative supplies.

Assessment of General Exposure to Future Gas Market Developments

Failure of Conventional WCSB Supply and Increased Competing Supply Demands

Timmins has already mentioned in footnote 1 above its skepticism with regard to the adequacy of future WCSB reserves available to TCPL. In footnote 2 above it raises its strong fear that the demands for coal to gas conversion for electricity and tar sands development will be much larger than ICF anticipates and that they will have first call on remaining reserves.

Marcellus Displacement

We anticipate that Marcellus development will displace more TCPL exports than ICF projects and that Marcellus supply to the Ontario market will be larger than ICF foresees. Our reasons for this are:

- the projected costs of Marcellus development in the 5 to 6 dollar range mean that they are going to very competitive (and with the recent price spikes of 14 to 16 dollars we are not confident that ICF's projections on future gas costs are high enough)
- the size of the resource and its contiguity to major markets indicates it's exploitation will be rapid and very large
- there are difficulties in building pipelines into the major U.S. northeastern markets
- the continuing development of other U.S. shale deposits that are already serving those northeastern markets will form a barrier to Marcellus entry
- there are existing pipelines close to the Marcellus area currently used for export that have unused capacity that may increase and their flow could easily be reversed.

Possible Ontario Energy Board Actions

The gas supply issue involves matters that, with the exception of the Union rate action that Timmins urges, are largely beyond the jurisdiction of the Board or are matters over which the Board can have only an indirect or secondary effect e.g.

- TCPL rate making
- the determination of available reserves particularly conventional reserves available to TCPL's mainline
- size and location of demand
- exports and imports between provinces and internationally and
- the development of gas reserves.

Timmins notes the Rosencrantz recommendation of the adoption of a Gas Supply Plan. We would note that there would be some limits to that:

- Our understanding is that the Board's attempts to date to look at the reasonableness of individual gas utilities' gas supply plans have not been successful
- We understand that gas supply as a specific item in a rate case has not been addressed recently
- With the deregulation of gas supply and transportation access it may be very difficult for the Board to determine just exactly what the gas supply is for any utility. Direct purchase over which the Board has no direct control accounts for much if not the majority of the supply.

We anticipate that the Board may have limited regulatory tools to intervene with the utilities under its jurisdiction to shape the gas available to them. Query: can the Board issue mandatory orders for a utility to bring a Leave to Construct or cause it to acquire storage or enter into long term firm supply contracts etc?

Given the above observations the Board should attempt to craft its report to urge the cooperation of all parties involved.

To the extent possible the Board should point out what directives and supporting required legislation it would recommend the provincial government give it to protect the gas supply interests of Ontario consumers.

Again, to the extent possible, the Board should attempt to outline what federal regulatory action it sees as being required together with any desired legislative changes.

All of which is respectfully submitted on behalf of the City of Timmins by its consultant,

Peter F. Scully