VINCENT J. DEROSE
T 613.787.3589

vderose@blg.com

Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen St, Suite 1100
Ottawa, ON, Canada K1P 1J9
T (613) 237-5160
F (613) 230-8842
blg.com

Borden Ladner Gervais

BY ELECTRONIC FILING

November 2, 2010

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

Dear Ms Walli,

2010 Natural Gas Market Review
Board File No.: EB-2010-0199
Our File No.: 339583-000080

On July 13, 2010, the Ontario Energy Board ("Board") announced that it would consult with stakeholders to assess the impact of changing dynamics in the North American natural gas supply markets. More specifically, the Board undertook to consider the impact that increased shale gas production from the Marcellus Shale would have on the Ontario natural gas market. The following are the submissions filed on behalf of Canadian Manufacturers & Exporters ("CME") in respect of this stakeholder consultation process.

I. <u>BACKGROUND AND OVERVIEW</u>

As the report prepared by ICF International confirmed, the development of shale gas resources has the potential to be a "game changer" for the North American market. Natural gas found in shale formations makes up over 50% of the total resource base, and, despite still being in the early stages of production, it already represents 13% of the total North American gas supply. ICF estimates that by the year 2020, shale gas is expected to grow to over 30 Bcfd (10.8 Tcf per year) thereby accounting for over 30% of North America's total natural gas supply.

Yet, as noted energy analyst John Rosenkranz observed, whenever there are significant changes to gas supplies there will always be associated risks and costs. The questions for the Board, therefore, is who will assume those risks and who will pay those costs? For its part, CME respectfully submits that the Board must protect Ontario consumers from subsidizing facility expansions and shouldering the risk of unutilized transmission capacity. Moreover, the Board must also eliminate barriers to allow consumers to diversify their sources of supply.

II. UNECONOMIC EXPANSIONS AND UNUTILIZED CAPACITY

CME was among a coalition of ratepayers who retained Mr. Rosenkranz to prepare an expert report for these proceedings. In his report, he cautioned that the "magnitude and variability" of the anticipated changes in natural gas supplies resulting from increased shale gas production, both out of the Marcellus shale in the United States and the Utica shale in Quebec, could cause "uneconomic expansions" of utility gas transmission facilities. CME shares these concerns and endorses Mr. Rosenkranz's recommendations for how these risks could be avoided.

To that end, CME submits that it is crucial for the Board to recognize that the increased production of natural gas out of the Marcellus shale is only one of a number of factors that could significantly impact North American natural gas supplies over the course of the next decade. As several participants observed, the increase in shale gas production is occurring at the same time as a corresponding, albeit unrelated, decline in available gas supplies from the Western Canadian Sedimentary Basin ("WCSB").

The cumulative impact of these factors could be that Ontario moves from the current east-west supply dynamic to a north-south supply dynamic. In addition, an increase in domestic natural gas production in the United States could result in a sharp reduction in the volume of natural gas exports out of Ontario. (This does not even include the potential for gas supplies from the Utica shale in Quebec or liquefied natural gas ("LNG") originating from Atlantic Canada.) The issue therefore becomes whether existing infrastructure can accommodate these emerging trends.

The inherent difficulty in determining whether the current infrastructure and facilities are sufficient is further complicated by the fact that there continues to be some uncertainty with respect to the volume of gas that could come to Ontario from the Marcellus shale. While there is general consensus among the experts that the Marcellus shale will yield a tremendous amount of natural gas, the fact remains that these are projections. Other factors, including environmental concerns, may impact those estimates in the years to come.

Where there continues to be some lingering uncertainty, CME submits that the Board must ensure that any expansion of facilities or infrastructure is approved in a responsible manner that takes into account the risks involved. The worst case scenario from the perspective of a ratepayer would be that they are first required to subsidize the construction of new facilities, and then left on the hook in the event that the newly constructed transmission capacity is underutilized. The Board can help avert these problems.

First, the Board must ensure that it has appropriate economic feasibility tests in place. Mr. Rosenkranz noted that when applying for leave to construct new facilities, Ontario gas utilities use the economic feasibility tests based on the Board's E.B.O. 134 report. He cautioned that these tests were developed to evaluate local distribution system expansions to serve new communities in Ontario. They may not, in his view, be appropriate for large capital projects to provide additional gas transportation services to markets outside of Ontario.

Second, utilities could be required to use incremental rates for ex-franchise transmission services. The Rosenkranz report explained that while the Board has traditionally accepted the use of rolled-in rates for gas utility services, the use of incremental rates for ex-franchise transportation services could better help ensure that in-franchise gas customers are not forced to subsidize ex-franchise customers. Mr. Rosenkranz also believes that incremental rates could help create appropriate price signals to discourage uneconomic investments in new facilities.

Third and finally, Mr. Rosenkranz argued that the Board should designate facilities to serve ex-franchise markets as being "at risk" investments. He contends that the incremental capital and operating costs for those facilities should then be tracked separately, as is currently done for new competitive storage facilities, and that those costs should be allocated entirely to the ex-franchise service when calculating rate. These steps would, in part, ensure that utilities do not recover the costs of underutilized gas transmission facilities from in-franchise customers.

III. DIVERSIFYING NATURAL GAS SUPPLIES

The ICF report noted that natural gas prices rose throughout the past decade because conventional production declined at the same time that demand was increasing. (This increase in demand was attributed to an increase in the use of natural gas for electricity generation.) As ICF confirmed, "[t]his tightening supply-demand balance cause natural gas prices to rise sharply." If natural gas production from the Marcellus shale offsets the decline in production from the WCSB, even if demand continues to rise, prices should level off and, eventually, fall.

In order for that to happen, however, Ontario consumers must have reasonably full access to new sources of supply like the Marcellus shale. The Board has consistently noted, as it did in EB-2005-0551, that choice is the bedrock of competition. It is only when consumers are able to choose among potential sources of supply that the natural market forces will help stabilize and, ultimately, lower prices. CME respectfully submits that the Board's mandate requires that it work to eliminate any barriers to diversifying natural gas supplies.

Mr. Rosenkranz outlines ways in which this can be done, and CME endorses all of his recommendations. First, the terms of service governing access to gas supplies under utility services should avoid any bias between system supply and direct purchase options. Second, the Board should require utilities to offer all direct purchase customers firm access to alternate delivery points. Third, if there are physical or contractual restrictions that limit access at certain delivery points, any available capacity should be allocated on a non-discriminatory basis.

Yours very truly,

Vincent J. DeRose

c. Paul Clipsham (CME)

OTT01\4247149\1