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APPrO
ASSOCIATION OF POWER PRODUCERS OF ONTARIO

January 24, 2011

APPrO Argument
Request for Approval of Long Term Contracts by Union Gas and Enbridge
EB-2010-0300/0333
January 24, 2011

Background

Union has applied to the Board for approval of a long term contract of 21,101 GJ/d on TransCanada to transport Marcellus based gas from Niagara Falls to Kirkwall. The gas purchased would replace gas currently purchased at Dawn and in the longer term would replace gas purchased via Alliance. Union indicated that this gas would form part of its overall system supply for its Southern franchise area.

Similarly Enbridge had also applied to the Board for approval of a long term contract for 30,000 GJ/d transportation contract on TransCanada to transport gas from Niagara, initially to Kirkwall and after the second year to the Enbridge CDA area. This change in delivery point would also require TransCanada to contract on Union from Kirkwall to Parkway and TransCanada would also expand its Parkway to Maple system to facilitate the delivery of gas to the Enbridge CDA.

Generator Interest

As outlined in the presentation that APPRO made at this Natural Gas Market Review Conference, APPrO members primarily use gas in one of the following ways:

- NUG generators have been primarily baseload generators. They generally purchase gas in Western Canada and have long haul long term transportation contracts on TransCanada. These customers are very sensitive to the TransCanada toll levels and have seen financial hardship from the recent TransCanada tolls increases over the last several years. These generators are very interested in having the TransCanada tolls reduced to more historical levels. One way of achieving this toll reduction is to increase the throughput on TransCanada. Long haul tolls have been as much as 60% higher than in the recent past.
- Newer CES generators are dispatchable generators and because of the way that their contracts with the OPA are structured, they are essentially required to buy gas at Dawn. These generators are often captive to TransCanada as well, since the plants are often situated at the confluence of high pressure gas transmission

lines and high voltage power lines. In order for them to fuel their plants, they require adequate and competitive priced gas. These customers have in most cases signed up for long term, short haul contracts on TransCanada and the proposal for interim 2011 tolls filed by TransCanada would have seen short haul tolls increase by up to 80%. This increase would represent a significant financial burden to these parties. The potential of continued high or even higher tolls in the future is of significant concern to these generators.

- The OPA has been directed to revisit the role of these NUGs as their contract terms are beginning to expire over the medium term. It is possible that some of these NUGs will transition over time to be more dispatchable similar to the CES generators. In order to be competitive they will likely need to acquire gas on a similar manner as the other CES generators.

As outlined by the Board's consultant in the recent Natural Gas Market Review, gas fired power generation in Ontario could represent about 1/3 of the total Ontario gas consumption by 2020. Given the structure of the generator contracts, much of this gas is currently sourced at Dawn and this could increase as the NUG contracts expire and transition to a CES like arrangement. It is therefore important that Dawn remains a liquid and competitive hub not only for the gas consumers in Ontario but also for power users as at certain times of the day, gas will set the marginal cost of power in the province. This means new supplies like Marcellus ought to be available at Dawn in order to increase gas on gas competition and keep gas prices low. It follows that helping to develop the infrastructure path from Niagara to Dawn is consistent with this goal of keeping Dawn competitive.

APPrO members generally are unbundled or semi-unbundled customers of the utilities and arrange for their own transportation and supply. These transportation contracts and the related supplies presumably will be used by system customers and therefore the direct cost consequences of one supply versus another is not normally an issue in which APPrO participates as it is not affected by such decisions made by the utilities. However APPrO members are captive customers of TransCanada and as noted earlier do purchase significant transportation services from TransCanada. Most gas fired generators are directly and materially affected by these higher tolls. Continued reduction in throughput or a lack of re-contracting on the TransCanada Mainline could very well have further negative impact on generators and other ratepayers in Ontario.

There was much discussion in this proceeding that the TransCanada rate design is in a state of flux and that TransCanada is working with stakeholders, including Union and Enbridge, to develop a new rate model.

The Issues at Stake in This Proceeding

APPrO believes that there are several issues at stake in this proceeding:

A. Do the long term contracts that have been applied by Union and Enbridge fall under the Board's February 11, 2009 Filing Guidelines?
B. Is this the right time for Union and Enbridge to enter into new contracts for Marcellus related transportation?

C. In this case, are there other criteria that are relevant to the Board that should take into account over and above the February 11, 2009 Guidelines in considering the applicants request for contract approval?

A. Do the long term contracts that have been applied by Union and Enbridge fall under the Board's February 11, 2009 Filing Guidelines?

APPrO notes on page 2 of the February 11, 2009 Board letter that:

> *"applicants generally agreed to a pre-approval process for long term contracts that support the development of new natural gas infrastructure (e.g. new pipeline facilities to access supply sources such as Liquefied Natural Gas and frontier production)."*

APPrO believes that while the nature of the Marcellus shale gas is neither as high profile as Arctic supply or a new LNG facility, nor requiring as much infrastructure to bring such gas to market as these other sources, it is none the less a new and significant emerging major supply basin that will impact consumers in Ontario. Enbridge notes that as of November 2010 the Marcellus basin is producing 1.4 bcfd[1]. Union further adds that this supply is forecasted to grow to 2 bcfd by 2012[2]. ICF noted in its report that it prepared for the Board that the Marcellus production by 2020 is forecasted to be 6 bcfd[3]. Clearly this supply is in its infancy and has significant potential to grow and will over time become an important supply source for Ontario.

It is less clear in APPrO's view whether the nature of the infrastructure required to access Ontario markets is material enough to fall under the Board's guidelines. While neither applicant knew the specific facilities that were required to provide the service, they both confirmed that the pipeline between Niagara and Kirkwall was currently in place and that the new facilities that were necessary were those facilities to provide bidirectional flow[4]. Mr Isherwood noted it would involve valving and metering[5]. APPrO questions whether the valving and metering is what the Board had intended in developing its guidelines for approval of long term contracts to underpin new supply sources being accessible to Ontario. Moreover the infrastructure required to get the Marcellus gas to Niagara Falls for subsequent importation into Canada is being underpinned generally by Marcellus producers and marketer[6].

[1] Exhibit I Tab 1 Schedule 3
[2] Transcript V1 page 85
[3] ICF Report page 63 EB-2010-0199
[4] Transcript V1 pages 52 and 148
[5] Transcript V1 page 52
[6] Transcript V1 pages 122 and 123

B. Is this the right time for Union and Enbridge to enter into new contracts for Marcellus related transportation?

APPrO in principle supports the utilities in leading the way to examine and support contracts that help to develop transportation paths from new supply sources. Not only is their expertise to evaluate the various supply and transportation options valuable, their ability to enter into new long term transportation contracts helps to establish the initial critical mass required for the development of new infrastructure. Once the initial transportation path is established from a new supply basin it is much easier and potentially less expensive to then increment the capacity on that path for other parties wishing to use that path in the future. Ongoing access to new supply sources in the long run ought to ensure that the ratepayers in Ontario continue to have access to competitive natural gas supplies.

APPrO is however concerned that it may be premature for Union and Enbridge to enter into these contracts.

a. The evidence advanced by both Union and Enbridge that their primary motivation for entering into these contracts at this time was for additional security of supply and to diversify their existing supplies for their system supply customers[7]. However, neither applicant filed evidence to support their need for either additional security of supply or diversity at this time.
b. There was much discussion and evidence about the TransCanada tolling matters. The tolls have experienced significant volatility in the recent past. In particular there has been significant decline in throughput and all tolls are at a much higher level than just a few years ago. Under TransCanada's recently filed request for interim 2011 tolls, short haul tolls were proposed to have a larger increase than other tolls. The uncertainty related to the future toll model that will be used by TransCanada adds risk not only to this supply source but all other western Canadian supplies transported to Ontario. Until the longer term tolling model is more clearly understood it may be better for the utilities to refrain from entering into these contracts.
c. Union and Enbridge acknowledged that other shippers participated in TransCanada's open season for capacity from Niagara. Neither company believed that their volumes constituted a critical share of the capacity and that it was likely that the overall TransCanada infrastructure development would proceed without their participation[8]. As these other supplies enter Ontario some of the benefits of Marcellus gas will accrue to Ontario gas consumers.
d. While there is no guarantee that there would be uncontracted capacity available in the future from Niagara if the utilities did not sign up at this time for capacity, neither Union nor Enbridge had any reason to believe that they would not be able to request capacity from TransCanada and TransCanada would be unable to provide such capacity in the future[9].
e. Union indicated that while they value diversity of supply it seemed that it was the fact that there was an open season for capacity that may have triggered

[7] Union Exhibit A page 4 of 14 paragraph 4 and Enbridge Exhibit B Tab 1 Schedule 1 page 3 paragraph 10
[8] Transcript V1 page 111
[9] Transcript V1 page 119 -120

their interest in Marcellus supply at this time; as opposed to their fundamental need to diversify supply sources[10].

f. Union noted that if this contract were not approved, they had no concerns about continuing to purchase gas at Dawn to serve their system supply, although they indicated that this would not meet their diversity objective. Their analysis also noted that Dawn supply was cheaper than landed supply from Niagara and that they would save approximately 30¢/GJ in buying Dawn gas[11].

g. If the Board did not approve their contract, Enbridge indicated that while they could continue to purchase Dawn supplies, they were concerned that they had insufficient transportation to get gas from Dawn to their franchise area. They also noted that they could purchase firm supplies from the WCSB albeit at a 7 ¢/GJ[12] premium over Niagara supplies using existing TransCanada capacity. Enbridge also acknowledged that they would incur greater unit demand charges than if they purchased from Niagara which would result in a higher risk if there was a downturn in demand. APPrO notes that much more contract term flexibility would be available for supplies from western Canada (from a few days to a year) than the proposed Niagara transportation to manage this potential risk. Moreover TransCanada long haul capacity has a crediting mechanism or risk alleviation measures within the long haul contracts (1 year or greater) for any unused capacity which further reduces their exposure. Enbridge did indicate that expanding their purchases from the WCSB, despite the fact that new British Columbia shale supplies are coming on line was not in line with their desire to diversify their supply sources. Enbridge also noted that the $17 million in demand charges that would be payable by them to underpin a 1 year FT contract from Alberta on TransCanada would also benefit other shippers on TransCanada, as it was a 'zero sum game'. They noted in response to APPrO interrogatory number 4[13] that the long haul toll on TransCanada would decline by an estimated 1.8 ¢/GJ for all long haul volumes if they shifted this supply to TransCanada long haul. The reduction in tolls would apply to their existing 260,000 GJ/d of capacity as well as the 30,000 GJ/d if contracted from western Canada. The analysis below shows that the 7¢/GJ[14] landed premium over Niagara supplies for the 30,000 GJ of supply would be more than offset by the transportation savings for Enbridge long haul volumes:

   i. Premium on 30,000 GJ WSCB supply 30,000 X 365 X $0.07 = $766,500
   ii. Transportation Savings:

Existing Long Haul Capacity	260,000 GJ/d
New Long Haul Capacity	30,000
Total	290,000 GJ/d
Unit savings	$0.018/GJ
Annual Transport Savings	$1,905,300

[10] Transcript V1 page 110-111
[11] Transcript V1 page 110
[12] Enbridge Exhibit I Tab 1 Schedule 23 Corrected page 2 of 2 top box second last column, difference between TransCanada and Niagara rows
[13] Exhibit I, Tab 2, Schedule 4
[14] Exhibit I Tab 1 Schedule 23 Corrected page 2 of 2 top box second last column, difference between TransCanada and Niagara rows

Net Benefit to Enbridge Customers $1,138,800

Since there is a net financial benefit to Enbridge alone for transporting long haul on TransCanada, the implied net premium for Niagara gas is $1,138,800 ÷ 30,000 GJ/d ÷ 365 days = $0.10/GJ.

Moreover all long haul (and to a lesser extent short haul shippers) on TransCanada would also receive the benefit of this transportation toll reduction.

C. In this case are there other criteria that are relevant to the Board that should take into account over and above the February 11, 2009 Guidelines in considering the applicants request for contract approval?

The Board's February 11, 2009 filing guidelines are just that - guidelines. The Board did not preclude other factors being taken into consideration when evaluating new long term supply and transportation sources.

One factor that APPrO views as relevant at this time in considering whether to approve these contracts is the considerable uncertainty about TransCanada tolling matters and the impact to all Ontario ratepayers.

If the Board approves these contracts, the utilities have made it clear that they view they will have no cost responsibility through the term of these contracts and this portion of their supply portfolio will be essentially committed to Niagara for the term of the contract. This creates a question for the Board - is this the best use of ratepayers dollars during the term of these contracts?

The Math

Union: 21,101 GJ/d X 365 days/yr X 10 years X $8.29/GJ[15] = $638.48 million
Enbridge: 30,000/GJ/d X 365days/yr X 10 years X 6.69/GJ[16]=$<u>732.55</u>
Total $1,371.03 million
$137.1 million annually

As has been discussed based on the TransCanada interim toll application to the NEB, the range of long haul (Eastern Zone) tolls is $1.35/GJ and in the Alternative Filing, it was $2.91/GJ. The long hauls in the past have hovered around $1/GJ. The range of 2011 interim toll applied for was from 135% to 291% of the previous $1/GJ toll. The 2011 interim long haul toll approved by the NEB is $1.64/GJ. These tolls and the range represent unprecedented toll levels. Even at the current level the tolls are causing financial hardship to at least some ratepayers in Ontario. Continued decontracting may further exacerbate this situation and increase the financial burden.

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[15] Exhibit K1.3
[16] Ibid

It is unclear what TransCanada will do in their final 2011 toll application, clearly the resulting tolls will have a material financial consequence on those remaining long haul shippers and indeed any remaining shipper on the TransCanada system.

APPrO understands that this TransCanada tolling issue is not a problem for either Union or Enbridge to solve. Clearly this rests with TransCanada and its stakeholders to develop a long term sustainable solution.

APPrO suggests that given the highly unusual circumstances that exist with TransCanada tolling, this should be a special consideration in this case. If the Board approves these contracts for 10 years then this supply will be committed to US supplies during this period. APPrO suggests to the Board that it is premature to approve these contracts and requests that the utilities take a more comprehensive look at what is best in the overall interests of all Ontario ratepayers, not only the ratepayers that will benefit from this 21,101GJ/d and 30,000 GJ/d of supply. APPrO agrees that diversity can be an important consideration in any gas supply portfolio; as Union aptly noted in a response to Mr Thompson about supplies to Union's northern area

> "We do want diversity in the north, but not at all costs[17]."

Is the diversity being requested at this time both needed by the applicants for its customer and is the real price being paid for the diversity worth the cost? Should a portion of the $137 million annual cost of this related supply be used to increase TransCanada long haul throughput to lower the tolls for all Ontario ratepayers, at least until there is greater clarity around the longer term TransCanada tolling matters? A lower TransCanada toll would benefit all ratepayers whether they be in Enbridge's or Union's Northern, Eastern or Southern franchise area.

Neither Union nor Enbridge pre-filed any information suggesting security of supply or diversity was of any current concern. Moreover these are relatively small volumes within their portfolios, in the range of 5%. It is hard to imagine that changing 5% of their portfolio will make an overall material difference to security of supply or diversity.

Mr Isherwood indicated that there is currently 800,000 GJ/d of Marcellus related capacity committed to come to Niagara and a further 200,000 GJ/d of additional capacity committed to through an Empire open season for a total of at least 1 bcfd[18]. Clearly it does not sound like US Marcellus producers or other parties that are committing to US pipeline capacity are concerned about the lack of capacity into Ontario on TransCanada. Marcellus supplies are also in its infancy, as the basin continues to grow from the current 1.2 bcfd[19] to the levels of 6 bcfd[20] by 2020 that experts have forecasted. It is very hard to imagine, given this growth profile, that additional Marcellus supplies will not be available after 2012 for Union and Enbridge to pursue their security and diversity goals, if it was appropriate to do so at that

[17] Transcript V 1 page 40
[18] Transcript V1 page 52-53
[19] Transcript V1 page 132
[20] ICF Report to the Board EB-2010-0199 page 63

time. A short pause in contracting for Marcellus supplies should not limit their longer term options to access this supply source.

Response to the Applicants' Argument in Chief

In its argument Union notes that not acting will result in higher costs if they wait

> *"In a good case scenario, it might be that the capacity exists later on, but that it comes at a much higher cost, and in a bad case scenario, Union customers could be shut out entirely"*[21]

Union has not provided any information to indicate that access to Marcellus gas is a onetime opportunity; rather just the opposite has been suggested. They have noted that Marcellus is a growing supply basin and is only getting established. They have indicated that Empire just had an additional open season to provide 200,000 GJ/d[22] of transportation to Niagara. The notion that Union could be shut out is not consistent with their description of the evolution of the basin. Their concern about capacity being a higher cost if they wait is completely contrary to TransCanada's rolled in rate making policies and NEB rules. If their reference to cost being much higher relates to the purchase of the gas at Niagara, then this begins to bring into question the fundamental appropriateness Niagara as a point of purchase. This would imply that this point has poor liquidity and transparency or sellers potentially having market power. If sellers of gas can charge significantly different prices for a similar product at a similar time then it is not a logical supply source for gas.

Furthermore it is clear from Union's evidence that they forecast that the landed cost of Niagara gas is currently a 30 ¢/GJ[23] premium over Dawn supplies, so it appears at this time that the premium is not in waiting but rather the premium is if they act now to commit to these supplies.

As far as being shut out completely, TransCanada has demonstrated its willingness to incrementally expand its facilities since their origin over 50 years ago. Incremental expansion through looping and compression is the traditional method to expand pipeline systems. This exactly how Union expands its transmission systems as well. APPrO sees no basis for Union's position that if they were to wait to acquire Marcellus supplies at a later point in time it would be at a higher cost or not available at all.

Summary

While APPrO supports in principle developments that increase access to competitive supplies at Dawn it believes that:

- In light of the uncertainty around TransCanada tolling matters,
- The lack of a full and complete analysis of the impact of entering into these contracts on all Ontario customers,
- The likelihood of ongoing access to Marcellus supplies in the future, and
- The limited impact to competition in Ontario at this time if these contracts were entered into,

it is premature for the Board to approve these long term contracts.

[21] Transcript V2 page 20
[22] Transcript V1 page 53
[23] Exhibit K1.3