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BY E-MAIL

January 24, 2011

Board Secretary
Ontario Energy Board
2300 Yonge Street, Ste. 2701
Toronto ON M4P 1E4

Attention: Ms. Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: Application for Pre-Approval of Long-Term Contracts of Union Gas Limited and Enbridge Gas Distribution Inc.
Board Staff Submission
Board File No. EB-2010-0300 and EB 2010-0333

Please find attached Board staff's submission in the above proceeding. Please forward the attached to Union Gas Limited, Enbridge Gas Distribution Inc. and to all other registered parties to this proceeding.

Sincerely,

Original Signed By

Hima Desai
Case Manager

Encl.

APPLICATION BY UNION GAS LIMITED FOR PRE-APPROVAL OF THE COST CONSEQUENCES ASSOCIATED WITH A LONG-TERM NATURAL GAS TRANSPORTATION CONTRACT

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APPLICATION BY ENBRIDGE GAS DISTRIBUTION INC. FOR PRE-APPROVAL OF THE COST CONSEQUENCES ASSOCIATIONTED WITH A LONG-TERM NATURAL GAS TRANSPORTATION CONTRACT

EB–2010-0300

EB-2010-0333

STAFF SUBMISSION

January 24, 2011

INTRODUCTION

Union Gas Limited (“Union”) filed an application on October 5, 2010 with the Ontario Energy Board (the “Board”) seeking approval of the cost consequences associated with three long-term natural gas transportation contracts. The three contracts are for transportation services on the TransCanada PipeLines Limited (“TCPL”) system between Niagara and Kirkwall (the “Niagara Contract”), between Parkway and Union’s Eastern Delivery Area and between Parkway and Union’s Northern Delivery Area. The application was assigned Board File No. EB-2010-0300. On January 17, 2011 Union filed a letter with the Board and an amended application. In its letter, Union advised that it will only be seeking pre-approval of the cost consequences associated with the Niagara Contract and that it was withdrawing its request for pre-approval of the other two contracts.

Enbridge Gas Distribution Inc. (“Enbridge”) filed an application dated November 9, 2010 with the Board seeking approval of the cost consequences associated with a long-term natural gas transportation contract. The contract is for transportation service on the TCPL system between Niagara and Enbridge’s Central Delivery Area (the “Niagara-CDA Contract”). The application was assigned Board File No. EB-2010-0333.

Pursuant to section 21 (5) of the *Ontario Energy Board Act, 1998*, the Board determined that it would hear these applications (the “Applications”) together through a consolidated hearing and an oral hearing was scheduled for January 20 and 21, 2011. The Board noted that both Union and Enbridge (the “Applicants”) filed evidence and interrogatory responses in support of their respective applications. As part of its review, the Board indicated that it expected that Union and Enbridge will fully and completely address the criteria set out in the Filing Guidelines for Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts (the “LTC filing guidelines), in particular Part V, Other Considerations item 5.2.

This submission reflects observations and concerns which arise from Board staff’s review of the case record including the oral hearing which was held on January 20 and 21, 2011 and is intended to assist the Board in evaluating the Applications.

BACKGROUND

In its letter of April 23, 2009, the Board notified all participants in EB 2008-0280, "Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and/or Transportation Upstream Transportation Contracts", of the release of the final LTC filing guidelines.

In this letter the Board noted the following:

1. The Board believes that applications for pre-approval of the cost consequences of long-term contracts should be limited to those that support the development of new natural gas infrastructure. The Board does not believe that the pre-approval process should be used for the natural gas utility's ("utility") normal day-to-day contracting, renewals of existing contracts and other long-term contracts that are not related to new natural gas infrastructure. These contracts should continue to be addressed in the utility's rate proceedings.

2. The Board is of the view that this pre-approval process should be an option available to the utility and not a requirement (even if the long-term contract involves an affiliate). As a consequence, the Board offers utilities the opportunity to apply on a case-by-case basis for pre-approval of these long-term contracts that support new natural gas infrastructure.

Board staff provides a brief of summary of the Applications below and then addresses the issues which Board staff believes are relevant to the Board when considering the request being made by the Applicants for pre-approval of the cost consequences of long-term contracts.

THE APPLICATIONS

Union's Application

In its pre-filed evidence and answers to interrogatories, Union has confirmed that the contract for which it is seeking pre-approval is a short-haul contract for in-franchise customers. The ten-year Niagara Contract is estimated to make up 4% of the transportation portfolio (of 480,500 GJ/d). Furthermore, the Niagara capacity will result in annual imports of 7.7 PJ's from the developing Marcellus Gas play for a 10-year term. This represents 5.7% of Union's annual sales service purchases (supply portfolio) of 135.7 PJ/year.[1] At this time, Union has not made any gas supply commitments but Union has indicated that it will issue an RFP to contract for supply sourced at Niagara in October 2012 for delivery commencing in November 1, 2012. [2]

Other key aspects of the Niagara Contract are summarized below:

Transportation Contract on TCPL	**Niagara to Kirkwall**	**Decontracting (Exhibit B1.10 – staff's IRR)**
Service	FT	Replace the Dawn purchased supply from November 1, 2011 to November 2015. In December 2015 it will replace a portion of Alliance based supply.
Cost (per year)	$697, 000	
Term (in years)	10	
Total Cost	$7, 000, 000	
Volume (GJ/d)	21, 101	
Effective Date	November 1, 2012	
Receipt Point	Niagara (receive Marcellus gas via Niagara)	
Delivery Point	Kirkwall	

Enbridge's Application

In its pre-filed evidence and answers to interrogatories, Enbridge has confirmed that the contract for which it is seeking pre-approval is a short-haul contract for in-franchise customers. The ten-year Niagara-CDA contract is estimated to represent 4.79% of supply portfolio [3] and 1% of total firm transportation services (transportation portfolio). [4]

[1] Exhibit A, page 6 of 14
[2] CME's IRR Exhibit B2.11
[3] Exhibit B, Tab 1 Schedule 1, page 6 of 11
[4] Exhibit I, Tab 1, Schedule 4

Enbridge in its evidence has stated that there will be no decontracting of long-haul on TCPL as a result of this proposed contract because this contract will replace Dawn spot and peaking services.[5] At this time, Enbridge has not made any gas supply commitments but has indicated that it is planning to contract for gas supply equal to the contracted transportation. [6]

The following table summarizes Enbridge's Application:

Transportation Contract on TCPL	**Niagara to Kirkwall**	**Niagara to CDA**	**Total**
Service	FT	FT	
Cost (per year)	$991,000	$1, 325, 000	
Term (in years)	1	9	
Total Cost	$991,000	$11, 925, 000	$12, 916, 000
Effective Date	November 1, 2012	November 1, 2013	
Receipt Point	Niagara	Niagara	
Delivery Point	Kirkwall	CDA	

Board Staff Submission

Board staff has reviewed the evidence and the record for the Applications and addresses the following two issues in this submission:

1. Are these contracts appropriate for consideration by the Board for pre-approval under its LTC filing guidelines?

2. Have the Applicants met the criteria set out in the LTC filing guidelines as outlined in the EB-2008-0280 proceeding?

1. Are these Contracts Appropriate for Pre-Approval?

As noted above, the Board in its letter dated April 23, 2009 in the EB-2008-0280 Proceeding indicated that applications for pre-approval of the cost consequences of

[5] Exhibit I, Tab 1, Schedule 1, page 1 of 2
[6] Exhibit I, Tab 3, Schedule 5

long-term contracts should be limited to those that support the development of new natural gas infrastructure and that the pre-approval process should not be used for the utility's normal day-to-day contracting, renewals of existing contracts and other long-term contracts that are not related to new natural gas infrastructure. Rather, these contracts should continue to be addressed in the utility's rate proceedings.

Board staff submits that the Applications filed by Union and Enbridge are not within the spirit of the Board's policy as outlined in its April 23, 2009 letter with respect to the types of contracts which are appropriate for pre-approval. The contracts should, more appropriately, be considered in the utility's normal rate proceedings. More specifically, Board staff submits that the purpose of the pre-approval process was to address specific types of contracts such as long-term contracts that support new large infrastructure investments (i.e., new pipeline facilities) to access new natural gas supply sources such as Liquefied Natural Gas plants and frontier production. In the "Report of the Board", EB-2008-0280, the Board stated, at page 3:

> With regards to long-term transportation contracts, the Board notes that the natural gas utilities ("utilities") currently have a portfolio of contract lengths. This reflects an upstream transmitter's market requirement to have long-term contracts to support new large infrastructure investments while contracts for existing capacity are generally shorter. Also, the Board is of the view that long-term transportation contracts may help to ensure an adequate natural gas supply in the Ontario market from a diverse portfolio of sources. This may increase supply reliability and reduce price volatility, which would benefit all market participants. Consequently, long-term transportation contracts may be justified.

Board staff submits that there is no "new large infrastructure", rather existing infrastructure is to be modified in order to become bi-directional (i.e., reverse the flow on existing pipelines). From the oral hearing, the utilities argued that they did not know the exact infrastructure investments but believed TransCanada needed to invest in metering and valving[7] to modify its existing pipeline system. As such, Board staff is not aware of any new large infrastructure investment which these contracts underpin.

Board staff concludes that the facilities required to move gas on TCPL's Niagara-Kirkwall system are minimal and cannot be classified as a major build. Station work and

[7] Transcript Volume 1, page 52

metering appear to be the only facilities required to move the gas through Niagara-Kirkwall into Ontario.

2. LTC Filing Guidelines

The Board outlined several areas of information that Applicants needed to provide and address when applying to the Board under the LTC filing guidelines. The areas of information include: general information relating to the Applicant, the needs, cost and benefits of the contract; contract diversity; risk assessment; and, other considerations. For the purpose of this submission Board staff is restricting its comments to the following key areas of interest:

1. Needs, Costs and Benefits; and,
2. Risk Assessment.

2.1 Needs, Costs and Benefits

Board staff submits that in reviewing the need, costs and benefits of a proposed contract the Applicant needs to demonstrate that the project improves the security of supply and the diversity of supply sources[8].

Board staff agrees with Union and Enbridge that the proposed contracts to bring Marcellus gas into Ontario will increase diversity of supply and will better utilize existing transportation routes to bring gas from a new supply basin into the province. However, staff disagrees with the utilities that this diversity, although minimal, is necessary for the overall security of supply for Union and Enbridge customers.

Board staff submits that no evidence was presented that would point to diversity and security as issues now or in the future given the utilities current supply portfolios.

The utilities do have multiple supply points and source gas from a number of supply basins. Both Union and Enbridge indicated that they could not put a price

[8] Report of the Board, EB-2008-0280, at page 5

on diversity and security as they are subjective elements. Also, staff notes that open seasons in the United States have resulted in 800,00 to 1.2 million GJ/d of pipeline capacity to transport Marcellus gas to the Ontario border to serve Ontario customers.

It is Board staff's view that, by their very nature, long-term contracts will have elements of uncertainty. No party can be expected to identify and detail all potential risks associated with such contracts. If this were the test to be applied by the Board however all long-term contracts would fail. Board staff agrees with this position however, in the case of the contracts currently before the Board there are unprecedented economic uncertainties which must be considered to ensure that the province's ratepayers are not burdened with unnecessary costs associated with these uncertainties.

Furthermore, as outlined in section 15(a) of the Precedent Agreement, the risks for Union is an estimated maximum liability in the amount of $232, 241 (plus applicable taxes)and for Enbridge it is $17,428, 476. However, it should be noted that a large portion of Enbridge's risk is due to a 10-year contract for Union's M12X services.

In addition, Board staff notes that both Applications are for relatively small contracts in terms of volumes (50, 000 GJ/d) and the level of risk (liability as outlined in precedent agreement, sheet 12, #15). Both Union and Enbridge have indicated that the contracts for which they are requesting pre-approval represent minimum volumes (4-5% of their transportation portfolio). Both utilities also indicated that they were not anchors for the TCPL expansion and that open seasons in the United States have resulted in 800,000 to 1,200,000 GJ/d of pipeline capacity to transport Marcellus gas to the Ontario border.

2.2 Risk

Board staff submits that the issue before the Board is whether or not the Applicants should be protected from risk and if the evidence warrants that the risk be borne by the ratepayer. Board staff submits that the nature of those risks and their impact on ratepayers must be considered.

The Marcellus production, while growing and by all accounts abundant, is a relatively recent development. It does not have a long history and natural gas has just begun to flow from this area. There are regulatory risks which may impact the long-term development. In particular, costs associated with environmental regulations may impact the rate of production and the cost of shale gas development in the area. Union and Enbridge have stated that their transportation portfolio is flexible and that a decline in Marcellus production can be mitigated through the Applicants' contract term flexibility in their transportation portfolios. Board staff submits that the long-haul TCPL contracts provide the utilities with this transportation portfolio flexibility. This potential decontracting may impact Ontario customers[9].

TCPL tolls and rate design are under review. Current tolls are interim and negotiations ongoing with respect to finding a solution to TCPL loss of long-haul load on its mainline system. There may be increasing pressure on short-haul shippers such as those using the Niagara lines to make up the revenue deficiency on the mainline.

Both Union and Enbridge have indicated that they would not proceed with the contracts in the absence of Board pre-approval. Neither Union nor Enbridge appear to want to bear the risks associated with costs of the contracts over the 10-year period. Instead the ratepayers are being asked to underwrite the cost consequences of the contracts. Board staff is of the view that these risks should not be borne by the ratepayer for the same reasons that the Applicants do not want to enter the contracts without Board pre-approval, namely that the cost consequences are uncertain. Union and Enbridge can, without Board pre-approval, enter into these contracts and have the cost consequences reviewed within the utility's rate proceedings.

Board staff submits that the proposed contracts are not any more risky than the utility's normal day-to-day contracting and other long-term contracts and as a result, the Applications filed by Union and Enbridge for pre-approval of the cost consequences of certain long-term transportation contracts are not consistent with the LTC filing guidelines.

- All of which is respectfully submitted -

[9] Transcript Volume 1, pp 129-131 and 184-185