



uniongas

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January 25, 2011

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

Dear Ms. Walli:

**Re: EB-2010-0300 -- Union Gas Limited -- Pre-Approval for the Cost
Consequences of One Long-Term Transportation Contract**

Attached, please find Union Gas Limited's ("Union's") Reply Argument in the above-noted proceeding.

Yours truly,

[Original signed by]

Karen Hockin
Manager, Regulatory Initiatives

KH/la

Attach.

c.c.: M. Kitchen (Union)
C. Smith (Torys)
N. McKay (Board Staff)
Intervenors in EB-2010-0300

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15 (Schedule. B);

AND IN THE MATTER OF an Application by Union Gas Limited for an order or orders pre-approving of the costs associated with one long-term gas transportation contracts;

**REPLY ARGUMENT OF
UNION GAS LIMITED**

Overview

1. By application dated October 5, 2010 and later amended January 17, 2011, Union applied for approval of the cost consequences of a long-term transportation contract on the TCPL system between Niagara and Kirkwall (the “Niagara Contract”). Union’s application was filed in accordance with the Board’s Filing Guidelines for Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts (the “Guidelines”).
2. The Board issued Procedural Order No. 2 on January 7, 2011 providing for an oral hearing. The hearing commenced on January 20, 2011 followed by argument-in-chief by Union and Enbridge Gas Distribution. In response, argument was made or has been received from TCPL, Canadian Manufacturers & Exporters, the Consumers Council of Canada, the Federation of Rental Property Owners, IGUA, Energy Probe, the Association of Power Producers of Ontario and Board Staff.
3. This is Union’s reply to those arguments. It is Union’s position that, for the reasons set out in evidence, its argument-in-chief, and this reply, the Niagara Contract justifies pre-approval pursuant to the Guidelines without conditions.

The Guidelines Apply to the Niagara Contract

4. The main argument advanced by intervenors and Board Staff in opposition to Union’s application is the assertion that the Guidelines do not apply because the Niagara Contract

is not of the “type” contemplated by those Guidelines. With respect, this submission places too restrictive an interpretation on the Guidelines and misstates the evidence at the hearing.

5. On their face, the Guidelines plainly apply to long term contracts that support the development of new natural gas infrastructure. There is no requirement that the investment meet a certain threshold level, or be limited to pipeline facilities as suggested by Board Staff. Rather, it is submitted that the overarching concern of the Board in issuing the Guidelines was in promoting infrastructure intended to access new natural gas sources generally.
6. In the present case, the Niagara Contract unquestionably meets both criteria. The Niagara Contract affords access, at a reasonable cost, to the developing Marcellus shale gas, the most rapidly growing supply basin on the continent . Further, the investment in infrastructure is substantial, involving work estimated at \$15 million on TCPL’s Niagara to Kirkwall line and Union’s Kirkwall facilities.
7. Related to this issue is the suggestion by some intervenors that the underlying project will proceed absent the Niagara Contract. There is no evidentiary basis for this argument. On the contrary, Union’s evidence in response to two separate questions from the Board was that market participants consider utility participation when making their own choices and attach a certain “moral gravity” to utility involvement.

The Need, Costs and Benefits Favour Pre-Approval

8. It is submitted that the evidence supports the conclusion that the Niagara Contract warrants pre-approval.
9. When deciding to acquire this capacity, Union took the following into consideration:
 - Marcellus Shale is the most rapidly growing supply basin on the continent.
 - Production from the Marcellus is expected to compete in Midwestern and Eastern markets with the predominantly west-to-east flow of gas from basins in the west and south-to-north flow of gas from the Gulf of Mexico.

- Marcellus is in close proximity to Ontario and already well connected to the pipeline infrastructure linking Ontario to the region.
 - Attracting this supply to Ontario would improve the diversity and security of supply to the province.
 - Pipeline operators between the Marcellus and Dawn (National Fuel, Empire, Tennessee, TCPL and Union) held their open season efforts over the past year. A seamless path for this supply to flow into Ontario via TCPL and through to the Dawn Hub now exists.
 - Adding this source of supply to Union's gas supply portfolio helps to shield the portfolio from declining production in the Western Canadian Sedimentary Basin ("WCSB").
 - Holding firm transportation capacity between Niagara and Kirkwall provides Union with firm access to secure supply at a well-established hub.
 - Delivering supply at Kirkwall adds diversity to the points on Union's transmission system which are receiving supply.
10. While admitting that the Niagara Contract improves the security of supply, the diversity of supply sources and will "better utilize existing transportation routes to bring gas from a new supply basin into the province", Board Staff argues that diversity and security are not of concern. With respect, this is far too short sighted an approach to long-term contracting. The prudent management of Union's supply portfolio must have regard to possible long-term realities. Here, despite TCPL's protestations to the contrary, there can be no real dispute that the WCSB is in long run decline. This was the conclusion reached by ICF in its Report to the Board in connection with the Natural Gas Market Review. Union should not have to wait until a problem has developed in respect of its portfolio before looking for diversified sources of supply.

Risk Assessment

11. A central feature of Board Staff and intervenor opposition to pre-approval of the Niagara Contract is based on their argument that pre-approval amounts to an attempt to transfer risk from Union to ratepayers. With respect, this submission is without merit.
12. As an initial matter, the argument is premised on a misunderstanding of the principles applicable to a prudency review. The OEB correctly defined the prudence standard at paragraph 3.12.2 of its decision in RP-2001-0032 as follows:
 - (a) Decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds.
 - (b) To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.
 - (c) Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.
 - (d) Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on facts about the elements that could or did enter into the decision at the time.
13. This approach has been explicitly affirmed by the Ontario Divisional Court and the Court of Appeal in *Enbridge Gas Distribution Inc. v. Ontario Energy Board*.
14. Some parties, principally CME, argue that the fact that Union has applied for pre-approval should be taken as evidence of the imprudence or riskiness of the Niagara Contract. If ever this argument had a place, it would have been in the context of submissions in relation to the Guidelines themselves and whether they should have been issued by the Board. It has no application now.

15. The fact that Union has applied for relief under a guideline established by the Board is entirely appropriate. As Enbridge points out, utilities should not be penalized or questioned for seeking approval under Guidelines that the Board has approved, and with which stakeholders generally agreed.
16. Moreover, this application does not simply concern the cost consequences of a single year - something that would be dealt with in a rates case. The Niagara Contract is a ten year commitment. Rate case review later this year of the 2011 cost consequences of the Niagara Contract would not address that fact, nor provide relief for cost consequences in future years.
17. In the result, the threshold question of whether to proceed with the Niagara Contract can and should be made now. That decision is to be made having regard to the evidence presently available, all of which was adduced in the hearing. The Board therefore is in the same position now as it will be in later to assess prudence.
18. In any event, Board Staff and intervenor arguments are not supported by the evidence. First, the concept of risk allocation as articulated by the parties is inapposite. In its role as system supplier and consistent with well-established Board practice, Union makes no profit or return on the provision of system supply (gas transport or commodity sale). The cost of these activities is passed on to ratepayers and, for this reason it is appropriate that they bear the cost of the Niagara Contract. Union applies, in respect of all of its supply decisions, the same guiding principle. These are set out in Exhibit B3.6 and include ensuring the secure and reliable supply of gas to Union's territory at a reasonable cost. There is no basis to allocate any costs (UDC or otherwise) to Union's shareholders; it is neither appropriate nor necessary.
19. Second, there is no real or substantial risk that Marcellus supply will not be available. Supply risk related to the availability of Marcellus Shale gas arriving for sale at Niagara is mitigated by the number of upstream projects. To date three projects in upstate New York, resulting in over 800,000 Mcf/d of firm transportation, will physically connect Marcellus supply with TCPL at their Niagara and Chippawa interconnects along the

Canadian/U.S. border. The Niagara Contract represents just 2 percent of the capacity contemplated by these projects.

20. Finally, while it is true that the level of TCPL's tolls for future years is unknown, the evidence establishes that under any of the scenarios discussed at the hearing, Union's landed cost analysis establishes that the Marcellus supply that will be transported using the Niagara Contract comes at a competitive cost. This is the case regardless of whether one applies: (i) current TCPL tolls; (ii) the new TCPL tolls that have been proposed which shift costs from long-haul to short-haul routes; or (iii) higher TCPL tolls that would use current methodology applied to lower throughput.
21. In short, under any future TCPL toll scenario examined in this proceeding the landed cost of gas supply for Union's system gas customers is competitive with other options even absent the diversity and security of supply benefits discussed above. In fact, as indicated in Union's January 6, 2011 letter, the landed cost of the Niagara Contract under either the high or low TCPL toll scenario is the same (\$US8.35 per mmBtu).
22. Union further agrees with Enbridge that the Board should not be influenced by concerns regarding the certainty of future TCPL tolls caused by ongoing reductions in throughput on the TCPL mainline. First, the uncontradicted evidence is that there will be no decontracting or migration away from TCPL mainline service as a result of the Niagara Contract. Second, whatever the long term solution may be to the issues relating to TCPL tolls, it will not materialize in the near future. However, given the evidence relating to the benefits of the Niagara Contract and the landed cost analysis referred to above there is no reason to delay approval of the contract.

Other Non-Issues

23. In its argument, TCPL focuses on a number of non-issues which do not bear on the application having regard to Union's decision not to proceed with the Parkway Contracts. These non-issues include:
 - The existence of a bottleneck between Parkway and Maple;

- The negotiation of the Parkway Contracts; and
 - The suggestion of a “gap” in the regulatory process.
24. Union disagrees with each of the assertions put forward by TCPL in respect of the foregoing. TCPL filed no evidence on the application, its assertions have no support and they are contradicted by the evidence adduced at the hearing. However, in light of the revised nature of the application, Union submits that none of the assertions warrants consideration by the Board in respect of the contract for which Union is seeking pre-approval.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



Crawford Smith

Lawyers for Union Gas Limited