



EB-2010-0300
EB-2010-0333

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

AND IN THE MATTER OF an Application by Union Gas
Limited for an order or orders pre-approving the cost
consequences associated with three long-term natural
gas transportation contracts;

AND IN THE MATTER OF an Application by Enbridge
Gas Distribution Inc. for an order or orders pre-approving
the cost consequences associated with a long-term
natural gas transportation contract.

BEFORE: Paul Sommerville
Presiding Member

Marika Hare
Member

Karen Taylor
Member

DECISION and ORDER

January 27, 2011

INTRODUCTION

The Applications

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 make provision 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. By letter dated January 17, 2011 Union amended its application, withdrawing its request for pre-approval of costs consequences of the Parkway contracts.

The Niagara contract is for firm transportation of 21,101 GJ/d on the TCPL system. The term of the contract is ten years commencing November 1, 2012. The receipt point of the contract is Niagara and the delivery point is Kirkwall. The annual demand commitment of the contract at current National Energy Board (NEB)-approved rates is \$697,000 CDN per year.

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 application was assigned Board File No. EB-2010-0333.

Enbridge’s contract is also for a term of ten years commencing November 1, 2012. For the first year of the contract the delivery point of the contract is Kirkwall and the costs associated with the contract at currently NEB-approved rates is \$991,000 CDN. The Enbridge CDA is the delivery point for the remaining nine years of the contract with an annual cost of \$1,325,000 CDN, again at current rates.

Both Enbridge and Union indicated that they would require a Board decision on their respective contracts no later than January 28, 2011. After this date each would be responsible for penalties associated with termination of the respective contracts.

The Proceeding

On November 1, 2010, the Board issued a Notice of Application and Procedural Order No. 1 with respect to Union's EB-2010-0300 application setting November 17, 2010 and November 30, 2010 as the dates for filing interrogatories and filing interrogatory responses, respectively.

All parties to the EB-2008-0280 proceeding were adopted as intervenors in the EB-2010-0300 and EB-2010-0333 proceedings. Parties who intended to seek costs were required to advise the Board by dates set out in the Procedural Order of each respective application.

On December 1, 2010, the Board issued a Notice of Application and Procedural Order No. 1 with respect to Enbridge's EB-2010-0333 application setting December 10, 2010 and December 29, 2010 as the dates for filing interrogatories and filing interrogatory responses, respectively.

By letter dated December 21, 2010, the Board requested additional information from Union regarding the EB-2010-0300 application. Union responded to the Board's request by letter dated January 6, 2011.

In its Notice of Hearing and Procedural Order dated January 7, 2011, the Board stated that it would consider these applications together (the "Applications") through a consolidated oral hearing to be held at its offices on January 20 and 21, 2011.

Oral arguments, in support of their respective Applications, were made by Union and Enbridge on January 21st, 2011. The following parties also made oral submissions on January 21, 2011; TCPL, Canadian Manufacturers & Exporters (CME) and Consumers' Council of Canada (CCC).

Written submissions were filed by Board staff and the following parties on January 24, 2011; Association of Power Producers of Ontario (APPrO), Industrial Gas Users Association (IGUA), Federation of Rental-housing Providers of Ontario (FRPO) and Energy Probe Research Foundation (Energy Probe).

Written reply arguments were filed by Enbridge and Union on January 25, 2011.

Background

In the fall of 2003, the Board undertook a comprehensive sector review called the Natural Gas Forum (“NGF”) in order to further improve the efficiency and effectiveness of natural gas regulation in Ontario.

The result of this review was a report, Natural Gas Regulation in Ontario: A Renewed Policy Framework (the “Report”) which was released on March 30, 2005. The conclusions of this Report were implemented over the following years through public processes that included stakeholder participation.

As part of the NGF, the Board reviewed the role of natural gas utilities with regard to the long-term contracting of gas supply and upstream transportation. In the Report, the Board stated that it would “offer utilities the opportunity to apply for pre-approval of long-term supply and/or transportation contracts” and that it “will consult on the development of guidelines that will inform all stakeholders of the principles and issues the Board will consider when evaluating an application for contract pre-approval.”

By letter dated August 22, 2008, the Board outlined the process and the issues to be addressed when developing a pre-approval process for long-term natural gas supply and/or upstream transportation contracts (EB-2008-0280). The Board indicated that it would hold a consultation to discuss the needs, benefits and risks of entering into long-term contracts, the impact of pre-approval of the cost consequences on competition, and the content of the filing guidelines. The Board stated that it planned to conduct the consultation in two phases: in the first phase, stakeholder meetings would be held by Board staff which would lead to the development of a Board staff discussion paper; and in the second phase, the Board would consider whether it was appropriate to develop filing guidelines for the pre-approval of long-term contracts.

On October 15-17, 2008, staff held a number of meetings with stakeholders. At these meetings, no substantive issues were raised and stakeholders generally agreed to a pre-approval process for long-term contracts that support the development of new natural gas infrastructure, such as new pipeline facilities to access new natural gas supply sources such as Liquefied Natural Gas (“LNG”) plants and frontier production).

On February 11, 2009 by way of a letter, the Board released The Report of the Board (2009 Report of the Board) and set out Draft Filing Guidelines for the Pre-Approval of

Long-Term Natural Gas Supply and/or Upstream Transportation Contracts for comment by participants in the proceeding. In the 2009 Report of the Board, the Board stated that a pre-approval process is appropriate for specific types of long-term contracts. The Board also stated:

The Board believes that these applications should be limited to those that support the development of new natural gas infrastructure (e.g., new transportation facilities to access new natural gas supply sources). The Board does not believe that the pre-approval process for long-term contracts should be used for the utility's normal day-to-day contracting, renewals of existing contracts and other long-term contracts. These contracts should continue to be addressed in the utility's rate application.

In its April 23, 2009 cover letter to all participants in the proceeding, the Board approved the LTC Filing Guidelines for the Pre-Approval of Cost Consequences for Long-Term Natural Gas Contracts (LTC Filing Guidelines). In that letter, the Board also reiterated its conclusions from the 2009 Report of the Board:

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.

Further, 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

The Applications filed by Union and Enbridge are the first that have been filed pursuant to the LTC Filing Guidelines.

THE ISSUES

In considering the Applications, the Board did not establish an Issues List as the 2009 Report of the Board and the LTC Filing Guidelines dated April 23, 2009 form an adequate point of reference. Prior to determining whether all aspects of the LTC Filing Guidelines have been fulfilled, the Board will determine whether the contracts for which pre-approval is sought qualify for pre-approval pursuant to the 2009 Report of the Board.

Do the contracts for which pre-approval is sought qualify for pre-approval pursuant to the 2009 Report of the Board and the LTC Filing Guidelines?

Union submitted that its contract is an appropriate contract for pre-approval under the Board's LTC Filing Guidelines. More specifically, Union pointed out that there are new facilities required as a result of these transportation arrangements and that compression, valving and metering would be needed to meet the contract requirements. In response to the arguments put forward by intervenors that there are no "new facilities" Union countered that the types of applicable facilities for the purpose of pre-approval under the LTC Filing Guidelines should not be limited to pipe in the ground.

Enbridge also argued that "infrastructure is going to be required and facility work is going to be needed to allow for bidirectional flow on the Niagara to Kirkwall line". Enbridge pointed to Exhibit K2.1 which estimated the total cost of that work at \$13 million over a ten year period.

Enbridge suggested that TCPL would also need to "add compression and looping to expand capacity between Parkway and Maple to allow delivery into Enbridge's CDA". TCPL confirmed that it is planning to spend about \$110 million to expand capacity from Niagara to Kirkwall and Parkway to Maple as set out in Exhibit K2.1. In addition Union would also have to install some infrastructure to allow bidirectional flows from Kirkwall to Dawn. These costs were estimated at \$5 million. Enbridge argued that given these facilities costs, "entering into this contract is not business as usual".

Board staff, APPrO, IGUA, CCC and CME argued that the Applications filed by the utilities did not qualify to be considered under the LTC Filing Guidelines for a number of reasons. The first argument put forward was that there was no security of supply issue. Second, the natural gas infrastructure underpinning the contracts was small and could not be characterized as significant. Third, the pre-approval process was not intended to eliminate normal prudence risk for normal day-to-day contracting.

Board staff submitted that the Applications filed by Union and Enbridge were 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.

The purpose of the pre-approval process, Board staff offered, 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. It was Board staff's submission there was no "new large infrastructure" associated with these contracts. Instead, only relatively modest modifications need to be made to existing infrastructure in order to enable bi-directional flow on existing pipelines. At the oral hearing, the utilities indicated that they did not know the exact infrastructure investments required but believed that TCPL needed to invest in metering and valving¹ to modify its existing pipeline system. Board staff concluded that the facilities required to move gas on TCPL's Niagara-Kirkwall system were minimal and could not be construed as a facilities expansion of a magnitude sufficient to support pre-approval of the cost consequences of the respective contracts.

Energy Probe supported the Enbridge application on the grounds that, in its view, the criteria set out in the LTC Filing Guidelines had been met. Energy Probe did not support Union's application as its contract had "little or no prudence risk exposure should the Board require review of the contract at its next rates application."

FRPO contended that Enbridge's contract warrants consideration due to the nature of facilities, financial commitments required and benefits to the marketplace. However, according to FRPO, Union's contract failed to meet the requirements as there was limited investment in infrastructure and limited exposure for the company.

¹ Transcript Volume 1, page 52

IGUA argued that “the types of contracts at issue do not involve material infrastructure development associated with “frontier” supply or otherwise, are not of the type envisioned by the Board’s policy on pre-approval of the cost consequences of long-term gas transportation contracts. These gas supply and transportation contracts, according to IGUA, should be subject to review in the normal course of regulatory review of such arrangements.

APPrO suggested that the nature of infrastructure required to access Marcellus shale gas may not be material enough to invoke the application of the Board’s Guidelines.

Board Findings

The Board finds that for the reasons provided below, the applied-for contracts do not qualify for pre-approval of their costs consequences.

It is the Board’s view that its process for the pre-approval of the costs consequences of long-term transportation or supply contracts was intended to serve a very specific role in the development of natural gas infrastructure in the interests of Ontario consumers. Adoption of the process was recognition by the Board that as a matter of commercial reality the developers of natural gas infrastructure must in some circumstances require long-term commitments to support large infrastructure investments. With such assurances in hand the developer can proceed with the project with confidence and can secure financing on the strength of such commitments.

The Board recognized that the enrolment of regulated utilities for such long term arrangements would be a necessary and desirable element in new infrastructure development. It considered that in order to facilitate such developments it was reasonable to make provision for an extraordinary process wherein the costs consequences of such long term arrangements could be pre-approved. This was so because regulated utilities whose sourcing decisions are typically and conventionally subject to ex post facto prudence review would be reluctant or unwilling to accept very significant long-term commitments without assurances of costs recovery. The result would be a frustration of demonstrably needed new natural gas infrastructure.

As the 2009 Report of the Board and the LTC Filing Guidelines make clear, pre-approval is an unusual regulatory instrument reserved for cases where it is genuinely needed in order to enable infrastructure development.

Do the long-term contracts support the development of new natural gas infrastructure?

Surprisingly, neither Union nor Enbridge were able to state with any degree of particularity what new natural gas infrastructure would be required to meet the relatively modest transportation volumes of 21,101 GJ/d and 30,000 GJ/d respectively as per the Precedent Agreements with TCPL. They could only provide assurances that some facilities would be required and some examples of the types of facilities that may be needed were provided. The Board notes that the Precedent Agreements signed by Enbridge and Union do not contain any description whatsoever of the facilities to be constructed. In fact, the only reference to infrastructure in the contracts allows TCPL to make efficient use of existing infrastructure to minimize the need for new facilities. Importantly, all of the facilities that may or may not be constructed would be part of a mature and well developed existing natural gas transportation infrastructure.

In short, the Applicants were not able to confirm that estimated facilities costs would result in the construction of new natural gas infrastructure as opposed to creating new capacity and/or services on existing natural gas infrastructure. It is apparent to the Board that a portion of the facilities underpinning the applied-for contracts would result in the creation of a natural gas hub at the Niagara delivery point on existing natural gas pipeline infrastructure and the remainder would support actions to expand and potentially reverse the flow on existing natural gas pipeline infrastructure. The Board believes that these types of modifications to existing natural gas pipeline transportation infrastructure are not of a nature to require the extraordinary measure of providing the utilities with the comfort of pre-approval. Conversely such development is not sufficient justification to forego the normal process of a prudence review at the next cost of service reviews for these utilities. These arrangements are consistent with a utility's day-to-day activities and should not be afforded the unusual treatment contemplated by the LTC Filing Guidelines.

Finally, a significant portion of the cost set out in the application by Enbridge relates solely to demand charges incurred by a third party pipeline on Enbridge's behalf. This third party is, in turn, contracted for long-term, firm service on an existing natural gas pipeline facility. The Board is of the view that this arrangement clearly does not constitute new natural gas infrastructure. Again, it is representative of a utility's normal, day-to-day contracting and transportation portfolio management activities.

As such, the Board finds that the contracts for which the Applicants seek pre-approval do not support the development of new natural gas infrastructure.

In so doing, the Board is in no way suggesting that the proposed contracts are not prudent, or that costs recovery should in any degree be limited or precluded. That is an issue that a subsequent panel may have to decide upon if the utilities proceed with these or analogous long term contracts for access to Marcellus or any other gas supplies. The Applicants should take some comfort in the Board's decision in EB-RP-2001-0032 which established that in making a finding of prudence the Board should not apply hindsight, but rather should be guided by what utility management knew, or can reasonably be considered to have known at the time of contracting. Much of Union's reply argument is directed to advancing the reasons why it considers the proposed contract desirable. These reasons may well be relevant in a subsequent prudence review.

Do the long-term contracts provide access to new natural gas supply sources?

Both Applicants argued that given the size of their respective contractual commitments, at Niagara a total of 51,101 GJ/d of a possible maximum contracted capacity of 800,000 GJ/d to 1,200,000 GJ/d, it was not appropriate to characterize them as "anchor" shippers on the applied-for contract path. The Applicants also indicated that even if their applied-for contracts were not approved by the Board, given the small portion of the contracted capacity, there is a reasonable chance that whatever infrastructure changes or expansion may be needed would be built anyway. This view was further reinforced by TCPL who indicated that there are other developments, as yet undisclosed, happening at this time, involving other shippers, that are directly relevant to whether the facilities will ultimately be constructed. TCPL acknowledged that these activities had not been discussed in the context of the Applications filed with the Board.

While it is true that Marcellus natural gas is a new source of supply – technological innovation having created access to otherwise non-recoverable natural gas supplies – it is important to note that it is not so new that it is not already being produced and transported - it has been integrated into the market, and it is having an effect on the market. Moreover, Pennsylvania and New York State can hardly be described as "frontier" areas, being relatively well populated with significant and mature natural gas pipeline infrastructure. As noted earlier, the purpose of the pre-approval process is to

support the development of new transportation facilities to access new natural gas supply sources. This is clearly not the case.

There is no basis for the Board to conclude that the contracts for which pre-approval has been sought provide access to new natural gas supply that would not be accessible if pre-approval is not granted.

To be clear, the Board has stated as a matter of policy that there is a role for long-term transportation contracts within the utility transportation portfolio. The Board also identified the specific type of long-term contract where pre-approval of the cost consequences of the contract may be appropriate. In the normal course, the prudence of the cost associated with a long-term contract is appropriately addressed in the utility's rate application. Pre-approval of the cost consequences of a long-term transportation contract forecloses the opportunity for a future prudence review. It is a departure from the Board's conventional approach and therefore must meet a high standard. There must be a compelling case that without the reallocation of risk to the ratepayer from the shareholder arising from pre-approval, new natural gas transportation infrastructure would not be constructed and new natural gas supplies would remain beyond the reach of the market. The Applicants have not met this standard.

Finally, and as discussed in the following section, the Board is reluctant to consider pre-approval in the absence of more reliable and specific costs information.

Did the applicants fulfill the LTC Filing Guidelines?

Although the applied-for long-term contracts do not qualify for pre-approval, the Board notes that these are the first applications for pre-approval filed with the Board. Accordingly, the Board believes it may be helpful to the Applicants to understand whether the Board considers that the LTC Filing Guidelines have been met.

Part II – Needs, Costs and Benefits

Both Applicants argued that pre-approval of the cost consequences of the applied-for contracts was necessary to ensure the diversity and security of natural gas supply. The Applicants did not file evidence that diversity and security were at issue. Moreover, since the applied-for contract volumes comprise less than 5% of each respective utility's system supply and the facilities that underpin the contracts would not be in-service prior

to late 2012, it is not immediately apparent that these contracts will have a consequential impact on natural gas supply diversity and security.

As it relates to the costs for which pre-approval would be granted, without being able to definitively identify the nature, type and cost of the facilities that TCPL would need to construct to fulfill the terms of the Precedent Agreements and meaningfully quantify the potential effect of changes to TCPL's rate design and cost allocation, the Applicants were not able to identify with certainty the costs of the proposed contracts, as outlined in Part 2.1 of the LTC Filing Guidelines. As such, given this uncertainty, even if the Board had found that the applied-for contracts qualified for pre-approval, in this instance pre-approval may not extend to all costs associated with the respective contracts, and some portion might still be subject to a prudence review. Where an application for pre-approval has such fundamental uncertainty, pre-approval may be limited to only reasonably discernable categories of costs.

This lack of cost certainty also had the effect, as discussed by a number of parties, of exacerbating the difficulties that are inherent in the assessment of the landed costs of Marcellus gas delivered over the applied-for contract paths over the contract term versus the landed costs of the possible alternatives, as outlined in Part 2.2 of the LTC Filing Guidelines. As such, given this uncertainty, even if the Board had found that the applied-for contracts qualified for pre-approval, the reliance that the Board could have placed on this analysis to inform its decision process would likely have been limited.

Part IV – Risk Assessment

The issue of whether the Applicants adequately identified and analyzed the relevant risks associated with the applied-for contracts was discussed during the proceeding. Neither Application was complete from the point of view of risk identification and analysis. But for the interrogatories filed by various intervenors, including Board staff, little or no information relating to environmental risks or to the TCPL tolling risks, for example, would have been placed on the record. It is not adequate to simply produce a non-exhaustive, high level list of potential risks without adequate analysis. The discussion relating to risk in this proceeding did not support the appropriateness of shifting risk to the ratepayer from the shareholder in advance of the prudence review that would normally be conducted in the context of a rates case.

Part V – Other Considerations

As indicated by the Board's Letter to Union dated December 21, 2010, the adequacy of the record with respect to this section of the LTC Filing Guidelines has been a concern of the Board. The Board has had similar concerns with respect to the application filed by Enbridge. At a minimum, the financial impact exhibit filed by TCPL in support of the Applications by Union and Enbridge was helpful and it is this sort of analysis that the Board expects to see in applications of this type in the future. Applicants should consider the benefit of having the developer of the new infrastructure which is supported by the long term contracts, providing an authoritative and detailed presentation of the nature of the facilities contemplated to the Board and thereby forming an integral part of the evidentiary record.

Little or no information was provided that would inform the Board as to activities occurring in the Ontario market that appear to have a bearing on the facilities that would be supported by the applied-for contracts. Moreover, little context was provided to explain the relationship between the applied-for contracts and Union's recently approved C1 and M12X application. Absent meaningful information and analysis to support Part 5.2 of the Guidelines, it appears that the Board was asked to approve the applied-for contracts in isolation.

The Board is aware that the Applicants' transportation contracting activities have an impact not only on each respective utility's natural gas transportation portfolio for in-franchise customers, but also on retail competition and may have potential impacts on existing transportation pipeline facilities (in terms of Ontario customers). The current uncertainties arising from the potential changes to TCPL's rate design and cost allocation are illustrative of this point. The Applicants did not provide a reasonable assessment of these impacts upon which the Board could confidently rely to inform its decision process.

COST AWARDS

The Board may grant cost awards to eligible stakeholders pursuant to its power under section 30 of the *Ontario Energy Board Act, 1998*. The Board will determine eligibility for costs in accordance with its Practice Direction on Cost Awards. When determining the amount of the cost awards, the Board will apply the principles set out in section 5 of

the Board's Practice Direction on Cost Awards. The maximum hourly rates set out in the Board's Cost Awards Tariff will also be applied.

All filings to the Board must quote the file numbers, EB-2010-0300 and EB-2010-0333, be made through the Board's web portal at www.errr.oeb.gov.on.ca, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.oeb.gov.on.ca/OEB/Industry. If the web portal is not available, parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

THE BOARD ORDERS THAT:

1. The application filed by Union Gas Limited (EB 2010-0300) for pre-approval of the cost consequences of a long-term natural gas transportation contract is denied.
2. The application filed by Enbridge Distribution Inc. (EB 2010-0333) for pre-approval of the cost consequences of a long-term natural gas transportation contract is denied.
3. Intervenors shall file with the Board and forward to Union Gas Limited and Enbridge Gas Distribution Inc. their respective cost claims within 21 days from the date of this Decision and Order.
4. Union Gas Limited and Enbridge Gas Distribution Inc. shall file with the Board and forward to intervenors any objections to the claimed costs within 28 days from the date of this Decision and Order.

5. Intervenor shall file with the Board and forward to Union Gas Limited and Enbridge Gas Distribution Inc. any responses to any objections for cost claims within 35 days of the date of this Decision and Order.

DATED at Toronto, January 27, 2011

ONTARIO ENERGY BOARD

Original Signed by

Kirsten Walli
Board Secretary