ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION ON PROPOSED SETTLEMENT AGREEMENT

March 3, 2015

Union Gas Limited
2016 Dawn Parkway Expansion Project
EB-2014-0261

OEB staff has reviewed the proposed settlement agreement filed by Union Gas Limited (Union) on February 27, 2015. OEB staff submits that the OEB's approval of the proposed settlement agreement as filed would adequately reflect the public interest and would result in reasonable rates impacts for customers. OEB staff is of the view that the explanation and rationale accompanying the proposed settlement agreement is sufficient to support the OEB's approval of the agreement when considered in the context of the filed evidence.

Union filed an application on September 30, 2014 seeking approval for the 2016 Dawn-Parkway expansion project. The project involves the installation of a compressor station at Lobo and approximately 20 km of NPS 48 pipeline expected to be in service in the Fall of 2016. The estimated capital cost of the Lobo compressor and associated facilities is $169.9 million and the estimated capital cost of the NPS 48 pipeline is $245.8 million. The total estimated cost of the project is therefore $415.7 million.

Union's Dawn-Parkway system is an integrated network of natural gas transmission pipelines and compressors, transporting natural gas between the Dawn Compressor Station near Sarnia and the Parkway Compressor Station located in Mississauga, Ontario. The Dawn-Parkway transmission system serves the natural gas transportation needs of a majority of Ontario's population as well as Quebec and US Northeast natural gas utilities.

In its application, Union noted that the gas supply dynamics have significantly changed in North America with increasing supplies of natural gas coming from shale production and a decrease in conventional gas from the Western Canadian Sedimentary Basin. Consequently, shippers are demanding short haul transportation services as compared to long haul. Union conducted a binding open season and received significant interest for incremental transportation capacity on the Dawn-Parkway transmission system. Consequently, Union initiated a further expansion of the Dawn-Parkway system and filed the application before the OEB.

As per Procedural Order No. 2, a settlement conference was held on February 9, 2015 between Union and stakeholders. The parties reached a settlement on all ratepayer issues. Issues related to landowner matters, form of easement agreement and conditions of approval will be heard in an oral hearing on March 5, 2015 are:

6. Are there any outstanding landowner matters for the proposed facilities with respect to routing and construction matters? For greater clarity, landowners include parties from whom permits, crossing agreements and other approvals are required.

7. Is the form of easement agreement offered by Union or that will be offered by Union to each owner of land affected by the approved route or location appropriate?

11. If the Board approves the proposed facilities, what conditions, if any, are appropriate?

OEB staff supports the proposed settlement agreement as filed and submits that the agreement is in the public interest. OEB staff agrees with the benefits of the project as outlined by Union. The project benefits include enhanced liquidity at the Dawn hub in Ontario, greater diversity of supply, and enhanced supply choices.

Union also identified significant gas cost savings as a result of transportation portfolio changes (from long haul to short haul routes). The revised net present value (NPV) of the project of ($238.5) million and profitability index (PI) of 0.39 does not include the estimated gas cost savings associated with the proposed changes to Union's gas supply portfolio. Union estimated annual gas cost savings of $28.1 million for Union North sales service and bundled direct purchase customers and savings of $19.0 million for Union South sales service customers. Based on the original evidence, the PI and NPV of the project inclusive of the gas cost savings would be 1.19 and $80.0 million respectively based on a term of 15 years for the gas cost savings.[1] Using the annual in-franchise revenue requirement associated with the project in 2018 with and without the estimated gas cost savings shows that the project results in net savings to Union North and Union South residential customers.[2] Union also indicated that it uses a three-stage analysis to assess the economic feasibility of projects in accordance with the Filing Guidelines on the Economic Tests for Transmission Pipeline Applications, dated February 21, 2013. Stage one consists of a discounted cash flow analysis. Stage two may be undertaken when the stage one NPV is less than zero. The stage two analysis considered the estimated energy cost savings that accrue directly to Union's in-franchise general service customers as a result of using natural gas instead of other fuels. The third stage included other public considerations such as economic and environmental benefits. Based on the original evidence, the three-stage economic analysis of the project, excluding the gas cost savings, showed a positive net present value of $119 million.[3]

Canadian Manufacturers and Exporters (CME), Federation of Rental-Housing Providers of Ontario (FRPO) and Ontario Greenhouse Vegetable Growers (OGVG) submitted evidence relating to concerns regarding potential capacity turnback and resulting rate

[1] Union's Evidence (EB-2014-0261) Exhibit A, Tab 9, page 4.
[2] Residential bill impacts presented at Appendix 3, Schedule 3 and 5 of the proposed settlement agreement.
[3] Union's Evidence (EB-2014-0261) Exhibit A, Tab 9, Page 10, Table 9-1.

impacts (Intervenors Evidence on Turnback Issues). Intervenors expressed a concern that increasing shale gas production in the US Northeast has caused deliveries through the Niagara and Chippewa export points to plummet, leading to a steep decline in demand for Union transportation service to Kirkwall. The same market changes that caused flow reversal at Niagara are also affecting gas exports at Iroquois, putting Dawn-Parkway transportation contracts held by Northeast US local distribution companies at risk of capacity turnback. The capacity turnback risk includes the possibility of reducing demand on the Dawn-Parkway system. Consequently, building additional capacity could put ratepayers at risk. It could also lead to increasing costs being transferred to in-franchise ratepayers as volumes from ex-franchise customers decrease. The Intervenors Evidence on Turnback Issues proposed that the OEB condition its approval to protect the interest of existing Union's customers.[4]

OEB staff submits that the proposed settlement agreement does address this concern. The parties have not reached an agreement regarding the risk of Dawn-Parkway capacity turnback post-2018. This time period refers to the end of the Incentive Regulation Mechanism plan term for Union. Parties have agreed to raise this issue in Union's next cost of service proceeding in 2019. At that time, all parties, including OEB staff, will be have the opportunity to present their position on any cost allocation measures to protect ratepayers from the effect of unutilized or under-utilized capacity on the Dawn-Parkway system due to potential turnback risk.

OEB staff agrees with the position of parties outlined in the proposed settlement agreement. Although there is a risk of capacity turnback on the Dawn-Parkway system, OEB staff notes that this is not a certainty and there is no evidence that Union will not be able to fill the capacity that may be vacated by turnbacks. Although, there is some level of risk to in-franchise customers, OEB staff agrees that the project will benefit Union ratepayers and there is sufficient demand on the Dawn-Parkway system to mitigate this risk. In its application, Union has noted that even with the forecasted capacity turnbacks, Union faces a system shortfall without the proposed facilities[5].

The other issue that has been addressed in the proposed settlement agreement refers to contingency costs. Union originally estimated contingency costs of $90.14 million which translates to approximately 22% of the total costs. This is higher than the standard 15% used for other projects. In the proposed settlement agreement, Union agreed to reduce the contingency costs to $65.14 million which brings it in line with the standard contingency rate of 15%. OEB staff supports this change. Parties also agreed

[4] Intervenors Evidence (EB-2014-0261) Union Gas 2016 Dawn-Parkway Expansion: Capacity Turnback Issues,prepared by John A. Rozenkranz, January 9, 2015, pages 1-2, "A. Summary and Recommendations".
[5] Union's Evidence (EB-2014-0261) Exhibit A, Tab 8, Page 9.

that any party could challenge the prudence of the actual capital costs in a subsequent proceeding should the actual capital costs exceed the revised forecast capital cost.

OEB staff further notes that the proposed facilities are dependent on a number of other projects that have either been approved by the OEB or require approval of the National Energy Board. Of these, Enbridge Albion Line Project, TransCanada PipeLines Limited's (TransCanada) Kings North Pipeline Project and Union's Brantford to Kirkwall Pipeline and Parkway D Compressor Project are expected to be in service in 2015. However, TransCanada will require new facilities to be built for November 2016 in-service to provide the necessary incremental capacity within the Eastern Ontario Triangle, specifically the Parkway to Maple corridor (the Vaughan Loop). The risk to ratepayers in this case is that if Union's facility would be in service in the Fall of 2016 and TransCanada is unable to complete the Vaughan Loop in time, ratepayers would start paying for capacity that is not being utilized. The proposed settlement agreement addresses this concern in Section 10 which states that parties are free to take any position as to whether or not an adjustment is required to the deferral account balance that records the net delivery revenue requirement as a result of the timing difference between the in-service date of the Vaughan Loop and 2016 Dawn-Parkway expansion project. In other words, parties would be free to seek an adjustment to the revenue requirement in the event that the Vaughan Loop is not completed or in service at the same time as Union's proposed facilities. OEB staff submits that the language in the proposed settlement agreement adequately addresses any timing concerns as a result of a delay in the Vaughan Loop project.

\- All of which is respectfully submitted -