ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

Union Gas Limited
Enbridge Gas Distribution Inc.

Pre-Approval of the Cost Consequences of Long-Term Transportation Contracts with NEXUS Gas Transmission

EB-2015-0166 / EB-2015-0175

November 26, 2015

Background

Union Gas Limited (Union) and Enbridge Gas Distribution Inc. (Enbridge) filed applications for pre-approval of the cost consequences of the long-term transportation contracts they each intend to enter for transportation capacity on the NEXUS pipeline project (NEXUS), commencing November 1, 2017.

The proposed NEXUS pipeline consists of 400 kilometres of greenfield pipeline that runs from Kensington (Eastern Ohio) to Willow Run (Southeastern Michigan).

Based on their respective proposals, Union and Enbridge would both flow gas supplies on the greenfield portion of the NEXUS path from Kensington to Willow Run. From Willow Run, Union's supplies would flow on the existing DTE system to the St. Clair pipeline and on the St. Clair pipeline to the Dawn Hub. In the case of Enbridge, gas supplies would flow on the existing DTE system to the Vector pipeline (at the Milford Junction) and on the Vector pipeline to Dawn.

Union's precedent agreement is for 150,000 Dth/d of capacity on NEXUS for a 15-year period. Union's pre-approval request includes both the costs associated with the greenfield portion of the pipeline and the existing DTE pipeline that runs from Willow Run to the St. Clair pipeline. The annual cost of the contract is about $48 million US, which results in total cost over the term of the contract of about $715 million US (based on the upper end of the NEXUS toll). By contracting for 150,000 Dth/d, Union received anchor shipper status, which results in a discount on the toll.

Enbridge's precedent agreement is for 110,000 Dth/d of capacity on NEXUS for a 15-year period. Enbridge's pre-approval request includes both the costs associated with the greenfield portion of the pipeline and the existing DTE pipeline that runs from Willow Run to the Vector pipeline. The annual cost of the contract is about $28 million US, which results in a total cost over the term of the contract of about $420 million US. Enbridge does not have anchor shipper status.

The applications were filed under the OEB's filing guidelines for Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts (the Guidelines).[1]

OEB Staff Submission

OEB staff submits that pre-approval of the cost consequences associated with each of Union's and Enbridge's proposed contracts with NEXUS should be denied for the reasons set out below.

[1] EB-2008-0280, Filing Guidelines for Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts, April 23, 2009.

OEB staff agrees with Union, as set out in its argument-in-chief, that there are two aspects in reviewing an application for the pre-approval of cost consequences associated with a long-term transportation contract.[2]

First, the OEB must be satisfied that the project associated with the contract is eligible for pre-approval of the cost consequences in accordance with the EB-2008-0280 Report of the Board[3] and the Guidelines. Second, if the OEB determines that the project underlying the contract is eligible for pre-approval, then the contract must be reviewed in terms of its merits. The Guidelines include a number of filing requirements that speak to the evaluation of the merits of a contract including: the need, costs, benefits, and risks.

Eligibility of the NEXUS Contract for Pre-Approval

OEB staff submits that the NEXUS contracts proposed by Union and Enbridge do not meet the eligibility criteria necessary for pre-approval of the associated cost consequences.

The Guidelines stipulate that "this pre-approval process is limited to projects that would support the development of new natural gas infrastructure."[4] The cover letter that accompanied the Guidelines explained:

> …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 (e.g., new pipeline facilities to access new natural gas supply sources such as Liquefied Natural Gas plants and frontier production).[5]

The cover letter also referred to the OEB's report entitled, "Draft Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts" (the Draft Filing Guidelines) and stated, "[t]he Board reiterates its policy as set out in the Report".[6]

[2] EB-2015-0166/EB-2015-0175, Union Argument-in-Chief, November 18, 2015 at pp. 6-7.
[3] EB-2008-0280, Report of the Board, Draft Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts, February 11, 2009.
[4] EB-2008-0280, Filing Guidelines for Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts, April 23, 2009, Attachment A at p. 1.
[5] Ibid. cover letter at p. 2.
[6] Ibid. cover letter at p. 3.

The policy articulated in the Draft Filing Guidelines and reiterated in the final Guidelines was that pre-approval will only be available in "limited circumstances".[7] As the Draft Filing Guidelines explained:

> 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.[8]

Since the Guidelines were issued, there have been no successful applications for pre-approval. The OEB's most extensive analysis of the Guidelines is found in its Decision and Order dated January 27, 2011 (EB-2010-0300/EB-2010-0333), where the OEB rejected applications for pre-approval by Union and Enbridge. Although the cost consequences of the contracts at issue in that case were much smaller than the cost consequences associated with NEXUS, the OEB's interpretation of the Guidelines is instructive.

The OEB explained in that Decision and Order that applications for pre-approval must meet a high standard, and that the applicant must prove that pre-approval is needed to bring new supplies of gas to the Ontario market:

> Pre-approval of the cost consequences of a long-term transportation contract forecloses the opportunity for a future prudence review. <u>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.</u>[9]

Applying that framework, OEB staff submits that there is no basis to conclude that the NEXUS contracts for which Union and Enbridge seek pre-approval provide access to new gas supplies that would not be accessible to the Ontario market if pre-approval is not granted. OEB staff submits that pipeline paths that bring Appalachian region gas to Ontario already exist. In addition, there likely will be new greenfield pipeline paths developed that bring Appalachian region gas to Ontario in the future even in the absence of pre-approval of the cost consequences associated with the NEXUS contracts.

[7] EB-2008-0280, Report of the Board, Draft Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts, February 11, 2009 at p. 2.
[8] Ibid at p. 4.
[9] EB-2010-0300 / EB-2010-0333, Decision and Order, January 27, 2011 at p. 10. Emphasis added.

OEB staff notes that Union and Enbridge already receive natural gas supplies sourced in the Appalachian region (Marcellus and Utica shale) through Niagara. The volumes flowing from the Appalachian region through Niagara will be approximately 221 TJ/d in 2016.[10] It is also possible that some of the delivered supplies that Union and Enbridge purchase at Dawn and/or Chicago would include natural gas supplies that originate in the Appalachian region. In cross-examination, Enbridge noted that it is possible for Appalachian region gas to be delivered to Chicago via other pipeline paths (such as REX East) and then be transported on Vector to Dawn.[11] Therefore, paths that bring Appalachian region supplies to Ontario already exist and will continue to be available in the future.

Union and Enbridge have drawn a distinction between Marcellus and Utica natural gas supplies. They argue that the gas that currently flows into Ontario through the Niagara path is largely Marcellus shale gas and the gas that will flow on the NEXUS pipeline will largely be Utica shale gas. They also say that, at the time that they were entering into discussions with NEXUS, Utica shale development was in its infancy.[12]

OEB staff does not disagree with the assertion that Utica was in the early stages of development when the utilities began discussions with NEXUS. However, to be eligible for pre-approval, the applicants must not only prove that the natural gas supplies are new. The applicants must also convincingly demonstrate that, without pre-approval of the cost consequences of the NEXUS contracts, “new natural gas transportation infrastructure would not be constructed and new natural gas supplies would remain beyond the reach of the market.”[13] OEB staff submits that the applicants have not done so. There is no substantive evidence to support a position that new infrastructure will not be constructed to bring Appalachian region supplies (including Utica shale gas) to Ontario.

There is significant interest in the development of new direct greenfield paths from the Appalachian region to Dawn that could move forward even if Union and Enbridge do not receive pre-approval for the cost consequences of their respective NEXUS contracts.

The Rover pipeline, which follows a very similar route to NEXUS, has been fully subscribed with approximately 900,000 Dth/d contracted to Dawn. The parties that have contracted for capacity on Rover are largely producers who are looking to sell gas to

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[10] EB-2015-0166/EB-2015-0175, Union Argument-in-Chief, November 18, 2015 at p. 24; and EB-2015-0166, Oral Hearing Transcripts Vol. 1, November 13, 2015 at pp. 24-25. This amount represents 21,000 GJ/d for Union and 200,000 GJ/d for Enbridge.
[11] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 3, November 17, 2015 at pp. 29-30.
[12] EB-2015-0166/EB-2015-0175, Enbridge Argument-in-Chief, November 18, 2015 at p. 5; and EB-2015-0166/EB-2015-0175, Union Argument-in-Chief, November 18, 2015 at p. 9.
[13] EB-2010-0300 / EB-2010-0333, Decision and Order, January 27, 2011 at p. 10.

customers. An application to approve the Rover pipeline project is before the Federal Energy Regulatory Commission (FERC).[14] If approved by FERC, this project would provide a direct pipeline path for Appalachian region natural gas supplies (including Utica shale gas) to flow to Dawn.

OEB staff notes that the proposed capacity contracted on NEXUS by Union and Enbridge represents less than 20% of the total capacity of the pipeline.[15] Of the capacity on NEXUS contracted to Dawn, the capacity Union and Enbridge propose to contract represents approximately 35%.[16] The remaining 65% of the NEXUS capacity that has been contracted to Dawn is held by producers.[17] On this basis, it is clear that NEXUS has significant support from producers and the pipeline could very well be developed in the absence of the utility contracts. In any event, there is no evidence from Union or Enbridge that indicates that the NEXUS pipeline would not proceed if one or both companies did not execute their precedent agreements.

Overall, there is likely to be significant pipeline capacity developed that will bring Appalachian region gas supplies (including Utica shale) to Dawn, even in the absence of the utility contracts for NEXUS capacity.

In summary, OEB staff submits that the OEB should deny the requests for pre-approval of the cost consequences associated with the NEXUS contracts on the basis that the contracts do not meet the necessary eligibility criteria. The applicants have not shown that without pre-approval, Appalachian gas will be beyond the reach of the Ontario market.

OEB staff also notes that the NEXUS pipeline path to Dawn includes the utilization of existing infrastructure. The cost consequences for which Union and Enbridge seek pre-approval include costs associated with transportation tolls for the portion of the pipeline path that utilizes existing infrastructure.[18] OEB staff submits that the pre-approval of costs associated with existing infrastructure was not contemplated in the Guidelines.

The Merits of the NEXUS Contracts

If the OEB finds that the NEXUS contracts do meet the eligibility criteria necessary for pre-approval of the associated cost consequences, OEB staff submits that pre-approval

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[14] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at pp. 26, 35-36.
[15] The total capacity on NEXUS is 1,500,000 Dth/d. Union and Enbridge have contracted for 260,000 Dth/d total.
[16] The capacity on NEXUS that has been contracted to flow to Dawn is approximately 760,000 Dth/d. Union have contracted for 260,000 Dth/d total.
[17] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at pp. 33-34.
[18] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at pp. 27-28; and EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 2, November 16, 2015 at pp. 105-106.

of the cost consequences should be denied on the basis of the merits of the NEXUS contracts.

Union estimated that the gas cost savings arising from the NEXUS contract would be in the range of $700 million to $900 million.[19] OEB staff submits that Union's estimate of gas cost savings is overstated.

OEB staff notes that the estimate of gas cost savings is based on the difference between the landed costs of Western Canadian supplies that flow on the TCPL Mainline and Alliance / Vector (which Union is decontracting) and the landed costs associated with the NEXUS contract (which Union will use to replace its Western Canadian supplies). OEB staff submits that the non-renewal of Western Canadian supplies (on the TCPL Mainline and Alliance / Vector) has, and will, occur irrespective of Union signing a long-term transportation contract with NEXUS. In addition, the Western Canadian supplies are the most expensive part of Union's supply portfolio. As such, whether the Western Canadian supplies are replaced by supplies flowing on NEXUS or virtually any other supply option, a significant saving in gas costs will be achieved.[20]

Enbridge did not estimate any direct gas cost savings to arise from the NEXUS contract as the NEXUS supply is competitive with the supply that it will replace (Chicago supplies).[21]

Union and Enbridge cited increased supply security and supply diversity as benefits of the NEXUS contracts. OEB staff agrees that a new pipeline path that brings Appalachian region gas directly to Dawn would benefit Ontario in terms of increased diversity and security of supply. OEB staff believes that supply security and diversity are the most prominent benefits of the NEXUS contracts. However, OEB staff submits that security of supply, and supply diversity, could equally be achieved by purchasing delivered supplies at Dawn (and other liquid market hubs – e.g. Chicago) at a lower overall risk to ratepayers. This risk includes forecasting, construction and regulatory risk.

OEB staff notes that there is likely to be significant new supply flowing to Dawn on Rover (900,000 Dth/d). NEXUS could also be built in the absence of pre-approval which, even without the 260,000 Dth/d contracted by the applicants, would bring in almost 500,000 Dth/d to Dawn from the Appalachian region. As mentioned previously, the capacity on Rover and NEXUS cited above has been entirely contracted by

[19] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at p. 47. The gas cost savings estimate varies depending on whether there are capital cost overruns.
[20] Ibid at pp.47-49.
[21] EB-2015-0166/EB-2015-0175, Exhibit I.T1.EGDI.Staff.6; and EB-2015-0166/EB-2015-0175, Oral Hearing Transcript Vol. 2, November 16, 2015 at p.120.

producers and suppliers.[22] Therefore, a significant amount of gas could be landed at Dawn that does not have a firm market. As such, OEB staff is of the view that there would be ample opportunities for Union and Enbridge to purchase delivered supply at Dawn. With all of the gas supplies destined for Dawn, OEB staff submits that it is not necessary to contract for long-term transportation capacity to the supply basin to ensure security of supply.

In the context of the interconnectivity of the natural gas pipeline system in North America and the potential for the development of new direct paths from the Appalachian region to Ontario, it is very likely that Appalachian gas supplies will land at market hubs including Dawn and Chicago. Therefore, purchasing delivered supplies at Dawn and/or Chicago does not preclude access to Appalachian supplies. The same supply diversity benefits that arise through the NEXUS contract will also be available through the purchase of delivered supplies at a market hub.

OEB staff notes that each utility's NEXUS contract represents a very significant portion of total gas supply requirements being locked-in for a period of 15-years beginning November 1, 2017.[23] OEB staff submits that the long-term contracts on NEXUS proposed by Union and Enbridge reduce supply flexibility due to the 15-year term and the significant amount of capacity that is contracted. Purchasing delivered supplies at a market hub allows for short term contracting options, which increases supply flexibility. This was not disputed by Union nor Enbridge during cross-examination. However, the distributors noted that a price premium may apply with respect to shorter term contracting options for natural gas purchases at Dawn.[24] While this may be true, OEB staff submits that the benefits arising from the purchase of delivered supplies in terms of supply security, diversity and flexibility and an overall reduction of risk to ratepayers outweigh the costs.

OEB staff submits that significant change in the natural gas market will occur over a 15-year period. There could be a significant reduction of demand for natural gas in the province in response to government policy (e.g. cap-and-trade) associated with climate change. At a time where there is uncertainty in the natural gas market due to concerns around climate change, supply flexibility is paramount.

Union and Enbridge stated that they will handle future potential demand reductions through the non-renewal of contractual arrangements on existing shorter term

[22] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at pp. 34-36.
[23] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at p. 57; and EB-2015-0166/EB-2015-0175, Enbridge Argument-in-Chief at p. 1. Union stated that its NEXUS contract represents approximately 33% of its supply portfolio and Enbridge stated that its NEXUS contact represents 15% of its total system gas requirement.
[24] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at p. 38; and EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 2, November 16, 2015 at p. 126.

transportation contracts.[25] OEB staff submits that, given the significant portion of each utility's supply portfolio that the NEXUS contract represents, the result of these non-renewals could be a decrease in security of supply and supply diversity (as the NEXUS contracts begin to represent even greater portions of each utility's total supply portfolio).

Overall, it is OEB staff's position that there are alternatives to the proposed NEXUS contracts that can achieve the same benefits at an overall lower risk to ratepayers. OEB staff submits that purchasing delivered supplies at market hubs (Dawn and/or Chicago) will be a lower risk option for ratepayers than the NEXUS contracts due to the supply flexibility offered by the ability to purchase natural gas supplies over shorter contract terms. As mentioned previously, the purchase of delivered supplies will also result in similar security of supply and supply diversity benefits as those that arise from the NEXUS contracts.

All of which is respectfully submitted.

[25] EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 1, November 13, 2015 at pp. 56-57; and EB-2015-0166/EB-2015-0175, Oral Hearing Transcripts Vol. 2, November 16, 2015 at pp. 99-100, 140.