VINCENT J. DEROSE
T 613.787.3589
vderose@blg.com

Borden Ladner Gervais LLP
World Exchange Plaza
100 Queen St, Suite 1100
Ottawa, ON, Canada K1P 1J9
T 613.237.5160
F 613.230.8842
blg.com

Borden Ladner Gervais

File No. 339583/000211

November 26, 2015

By Electronic Filing

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th floor
Toronto, ON M4P 1E4

Dear Ms Walli,

Union Gas Limited and Enbridge Gas Distribution Inc. NEXUS Proceeding	
Board File Nos.:	**EB-2015-0166 / EB-2015-0175**

Please find enclosed the Final Argument of Canadian Manufacturers & Exporters ("CME") in the above-noted proceeding.

Yours very truly,

Vincent J. DeRose
VJD/kt
Encl.

c. All Interested Parties EB-2015-0166 / EB-2015-0175
Paul Clipsham and Ian Shaw (CME)

OTT01: 7343344: v1

ONTARIO ENERGY BOARD

EB-2015-0166
EB-2015-0175

IN THE MATTER OF: The Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Schedule B, and in particular, S. 36 thereof;

IN THE MATTER OF: an application by Union Gas Limited for: Pre-approval of the cost consequences of long-term natural gas transportation contracts with NEXUS Gas Transmission.

IN THE MATTER OF: an application by Enbridge Gas Distribution for: Pre-approval of the cost consequences of long-term natural gas transportation contracts with NEXUS Gas Transmission.

FINAL ARGUMENT of
CANADIAN MANUFACTURERS & EXPORTERS ("CME")

November 26, 2015

Vincent J. DeRose
Eden Alexander
Barristers & Solicitors
1300-100 Queen
Street
Ottawa, ON
K1P 1J9

Counsel for CME

INTRODUCTION

1. This argument, which is submitted on behalf of Canadian Manufacturers & Exporters ("CME"), addresses the issues that have arisen in the context of the combined hearing of applications by Union Gas Limited ("Union") and Enbridge Gas Distribution ("EGD") for the pre-approval of the cost consequences of long-term natural gas transportation contracts with NEXUS Gas Transmission ("Nexus") commencing November 1, 2017.

2. Nexus proposes a project with an estimated capital cost of $2.019 billion (USD)[1], which entails the use of existing infrastructure, as well as the construction 250 miles of greenfield pipeline. The Nexus project will source Appalachian shale gas from both the Marcellus and Utica basins[2], and has a planned capacity of 1.5 million dth/day[3]. Both Union and EGD have entered into Precedent Agreements with Nexus in respect of firm transportation commitments, to which Ontario Energy Board (the "OEB" or the "Board") pre-approval is a condition precedent[4].

3. On May 28, 2015, the same day that Union signed their Precedent Agreement, Union filed an application (EB-2015-0166) with the OEB seeking the pre-approval of the following long-term transportation contract with Nexus:

a. 150,000 dth/a day (roughly 158,000 GJs/day) for a term of 15 years;

b. The approximate cost of commitment is $47.7 million (USD) annually, which amounts to $715 million (USD) over the 15 year term.

4. On June 5, 2015, EGD filed an application (EB-2015-0175) with the OEB seeking the pre-approval of the following long-term transportation contract with Nexus:

a. 110,000 dth/a day for a term of 15 years, with the option to increase capacity to 150,000 dth/day before November 1, 2017;

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[1] *Transcript of Oral Hearing*, Vol. 2, p 169-170.
[2] *Transcript of Oral Hearing*, Vol. 2, pp 7, 71, 85.
[3] *Transcript of Oral Hearing*, Vol. 2, p 124. We note that the applications of EGD and Union, and the Sussex Report refer to the delivery of 1.5 Bcf/day of natural gas.
[4] *Union Restated Precedent Agreement,* signed May 28, 2015, Exhibit A, Schedule 1, p 16, s. 7(c)(ii); *EGD Restated Precedent Agreement,* signed December 17, 2014, Exhibit A, Tab 3, Schedule 1, Appendix D, p 22, s. 7(c)(v).

b. The approximate cost of commitment is $28.1 million (USD) annually, which amounts to $421.6 million (USD) over the 15 year term. Should they exercise their option to increase capacity, the total cost would be approximately $562.6 million (USD)[5].

5. On July 28, 2015, Union and EGD filed a joint letter with the OEB seeking the consolidation of the two applications within a joint regulatory proceeding. Procedural Order No. 1, dated July 31, 2015, remarks that consolidation was sought on the basis that the two filings are aligned, that the two applications are supported by the jointly sponsored Sussex Report, and that greater regulatory efficiency can be achieved if the cases are reviewed together. The Board acknowledged the interrelation of the applications and, accordingly, the two applications have been heard together.

6. In Procedural Order No. 1, the Board stated:

> I find that it is important to consider the related issues in a cohesive and rational manner. Further I find that it will be administratively more efficient to hear the proceedings in combination[6].

7. Correspondingly, CME is of the position that, irrespective of the unique contracts between each utility and Nexus, the overarching question in this proceeding as to whether the benefits of the project justify the assumption by the ratepayer of the risks that come with pre-approval, is a question in common. Consideration of the anticipated benefits and possible risks of pre-approval to the ratepayer are equally relevant to both applications and CME's position on pre-approval applies to both the Union and EGD applications.

8. To a large extent, CME supports these applications. Any step to lower gas prices at Dawn is in the interest of ratepayers, in so far as it does not implicate the absorption of unreasonable risks that could otherwise be mitigated.

9. If the Board is satisfied that all the ratepayer risks associated with pre-approval are sufficiently mitigated, the applications of Union and EGD should be approved. If not, CME

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[5] EGD Application, Exhibit A, Tab 3, Schedule 1, p 20.
[6] Procedural Order No. 1, July 28, 2015.

proposes that it is appropriate for the Board to impose special conditions for pre-approval in order to protect ratepayer interest.

BACKGROUND TO THE APPLICATIONS

10. The combined applications are, in part, a reaction to declining gas production in the Western Canadian Sedimentary Basin and the emergence and growth of alternative supply sources closer to Ontario. The ability to directly access gas produced in the Appalachian basin suggests an opportunity to ensure security of supply for Ontario consumers, and the ability to access gas at the Dawn hub is increasingly desirable to many market participants.

11. The central focus for CME is to ensure that Ontario businesses can compete with those in neighbouring jurisdictions. Manufacturers in Ontario seek to have access to economic sources of supply at the Dawn hub. To the extent that the Dawn hub becomes increasingly more liquid, and where this liquidity has a positive effect on gas prices at Dawn, CME supports the construction of infrastructure connecting the Appalachian basin to Dawn. CME is of the opinion that, over the long run, construction of the Nexus pipeline should result in an increase in price competitive gas supply options for Ontario customers, which will benefit manufacturers and ratepayers generally. This position is consistent with CME's previous submissions in respect of earlier pre-approval applications[7].

12. In this proceeding however, CME is concerned about the risks associated with pre-approval of each Utility's cost consequences for their respective 15 year transportation contracts. We are concerned that the risks associated with pre-approval have been insufficiently explored by the Utilities and that the provisions intended to mitigate these risks may be overestimated.

13. To grant pre-approval in these applications will be precedent setting. The Board has never granted pre-approval for the cost consequences associated with long-term transportation contracts[8], and in previous pre-approval applications, the Board has confirmed that the bar for

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[7] For example, *Submissions of CME,* November 15, 2013, combined proceedings: EB-2012-0452/EB-2015-0433/EB-2013-0074.

[8] EB-2010-0300 and EB-2013-0074 as noted in Exhibit B.T1.Union. Staff.2 (also responsive to Exhibit B.T1.Union.CME.1); EB-2010-0333 as noted in Exhibit B.T1.EDGI.STAFF.3 (also responsive to Exhibit I.T1.EGDI.CME.1(a), (b)).

pre-approval is high – pre-approval is a departure from the Board's conventional approach, and the reallocation of risk to the ratepayer through pre-approval is reserved only for compelling cases[9].

14. For example, in EB-2010-0300/EB-2010-0333, the Board issued a decision in respect of applications filed by both Union and EGD for pre-approval of ten year transportation contracts on the Trans Canada Pipeline system from the Marcellus basin to Niagara. The annual costs of the contracts were approximately $697,000 (CAD) and $1,325,000 (CAD) respectively. The Board denied the applications and stated the following:

> 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.... 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 gas supplies would remain beyond the reach of the market. The applicants have not met this standard[10].

15. CME acknowledges that both the term and the costs of Union and EGD's Nexus contracts are greater than contracts for which pre-approval has previously been sought and has been denied[11]. Given the scope and size of the Nexus project, CME understands why Union and EGD shareholders are reticent to take on the associated financial risks and, accordingly, why the Utilities are seeking pre-approval.

16. CME does not, however, believe that the magnitude of the project and the increased financial risk this magnitude implicates, necessarily implies that pre-approval of long term transportation costs is appropriate.

17. CME also acknowledges that both Union and EGD have taken steps to ensure that their applications rectify issues that have previously been the cause for pre-approval denial. For example, in EB-2013-0074 the Board refused Union's application for pre-approval of two TransCanada long-term (ten year term) short-haul transportation contracts with demand charges in excess of $110 million, stating that it was contrary to the public interest to approve cost

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[9] *Decision and Order of the OEB,* January 27, 2011, combined proceedings: EB-2010-0300/EB-2010-0333, p 10.
[10] *Decision and Order of the OEB,* January 27, 2011, combined proceedings: EB-2010-0300/EB-2010-0333, p 10.
[11] *Transcript of Oral Hearing*, Vol. 2, pp 9-11.

consequences for a project in the absence of contractual agreements that gave greater certainty to the implicated costs. In these proceedings, the existence of a the Precedent Agreements between Nexus and the Utilities, and provisions within these agreements that are said to mitigate the risks of pre-approval, are central to the Board's determination of both Union and EGD's applications.

PRE-APPROVAL AND THE BOARD FILING GUIDELINES

18. These proceedings demonstrate the complexity and uncertainty surrounding the development of long-term, economic, and secure natural gas supply in Ontario. This complexity and uncertainty underpin the pre-approval process in that it recognizes the existence of a scenario where it is in the public's interest to encourage the development of new gas supply infrastructure through the assumption of risks that would otherwise belong to the shareholder.

19. Accordingly, the overarching question in this proceeding is whether the benefits of the project justify the assumption by the ratepayer of the risks associated with pre-approval of the Nexus contracts, and correspondingly whether the steps taken by Union and EGD to mitigate and allocate risk are sufficient.

Should Pre-Approval of the Cost Consequences of the Long-term Transportation Contracts with Nexus Be Granted?

20. Applications for pre-approval of the cost consequences associated with long-term natural gas supply contracts are decided according to the Board *Filing Guidelines for Pre-Approval of Long-Term Natural Gas Supply* as established in EB-2008-0280 (the "Filing Guidelines")[12].

21. Union has argued that the purpose of the pre-approval process according to these Filing Guidelines is to bring comfort to the utility regarding the extent of regulatory risk entailed by long-term contracts of significant volumes[13]. CME disagrees with this position. In our respectful submission, the Filing Guidelines should be interpreted so as to as facilitate a Board decision as to whether the needs and benefits of a long-term contract outweigh the risks to ratepayers in assuming the costs of the contract.

[12] The Filing Guidelines are filed at Tab1 of Exhibit K1.3 of the OEB Staff Compendium for the Union Panel.
[13] *Transcript of Oral Hearing*, Vol. 2, p 2.

22. The Filing Guidelines require that utilities provide the Board with the information necessary to identify the risks associated with pre-approval and how these risks have been mitigated and allocated. It is CME's position that a fulsome understanding of both the benefits and risks that ratepayers could potentially encounter is integral to the success or failure of the Utilities' pre-approval applications.

23. The value of identifying the risks associated with pre-approval was acknowledged by the Board when the Filing Guidelines were created. In the *Report of the Board: Draft Filing Guidelines*, the Board stated:

> Stakeholders also noted that there are risks, separate and apart from regulatory risk, associated with long-term contracts. For example, large infrastructure projects with long lead times may increase the risk of cost overruns and forecasting errors. <u>Therefore, risks should be identified in the application</u> [emphasis added][14].

24. Thus, Appendix A to the Filing Guidelines, which sets out the form that applies to all applicants who are requesting pre-approval, directs utilities to identify:

> all of the risks…and plans on how these risks are to be minimized and allocated between ratepayers, parties to the contract and/or the applicant's shareholders[15].

25. It is CME's submission that while efforts were made by Union and EGD to comply with the Filing Guidelines in this respect, the reluctance demonstrated by the Utilities to discuss the existence of ratepayer risk[16] has made the Board's assessment of the merit of pre-approval more difficult.

Transfer of Risk from Shareholders to Ratepayers

26. During the hearing in this matter, Union and EGD have stated that Nexus will lead to increased liquidity at Dawn, which it turn, will lead to lower gas costs[17]. If these type of benefits

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[14] *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, EB-2008-0280, p 5, filed at Tab 2 of Exhibit K1.3 of the OEB Staff Compendium for the Union Panel [*Report of the Board*].
[15] Appendix A to the Filing Guidelines; this was also articulated in Appendix A to the *Report of the Board*, p 8.
[16] For example, the testimony of Mr. Isherwood: *Transcript of Oral Hearing*, Vol. 2, p 23 and 25.
[17] *Transcript of Oral Hearing*, Vol. 2, pp 2, 123.

materialize, the energy costs incurred by Ontario manufactures will presumably become more competitive *vis a vis* other jurisdictions. Such an outcome is supported by CME

27. That said, during the hearing in this matter, it has become apparent that accessing Appalachian gas from either Marcellus or Utica on the terms proposed by the applications of Union and EGD is not without risk[18]. The pre-approval sought by the Utilities will result in a transfer of risk from shareholders to ratepayers.

28. Both Union and EGD have argued that pre-approval in this instance is appropriate specifically because the project poses financial risk of a magnitude too great for their shareholders to bear[19]. Conversely however, the Utilities argue that upon assuming the costs of the contracts, ratepayers will not bear any risk, or nominal risk, as the contractual structure negotiated by the Utilities has mitigated these risks. This position has inhibited the Utilities from effectively articulating the extent of the risks that exist should pre-approval be granted.

29. It remains unclear as to how risks which are so burdensome to shareholders do not shift to ratepayers should they assume the same costs under the same contract, or how the mitigation measures that are said to insulate ratepayers from risk would not similarly insulate the shareholders from the risk inherent in the prudency review process.

30. Pre-approval of the Union and EGD contracts will result in a transfer of risk from the shareholder to the ratepayer. The risks to which the ratepayer would be exposed if pre-approval is granted include:

a. Forecasting risks, including future demand and future supply, volatility in prices, actual landed costs and performance of the basin, TransCanada mainline risk;

b. Commercial risks including competitiveness of service provided, creditworthiness of service provider;

c. Operational risks include capital cost variances, cost escalations, project delays, reliability issues pertaining to new constructions or cancellation risks;

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[18] *Transcript of Oral Hearing*, Vol. 2, p 12.
[19] *Transcript of Oral Hearing*, Vol. 2, p 10.

d. Gas interchangeability and quality issues; and

e. Regulatory risks[20].

31. EGD and Union claim that these risks have been mitigated, many through the Nexus project itself. For example, EGD states that the following elements of the project are mitigating in themselves:

a. It provides for increased diversity to EGD's portfolio; and

b. Mitigates price volatility at the Dawn hub due to the increased supply[21].

32. Union further claims that these risks have been managed through the provisions in their Precedent Agreement which allows for the following:

a. A overall rate of $0.77 USD/dth plus fuel, which is said to be a discounted rate in light of Union's anchor shipper status and competitive with the other anchor shippers;

b. A rate that is capped by a capital cost tracker that will result in a maximum adjustment of +/- 15%. This amounts to a rate on the greenfield portion of the project between $0.67 USD/dth and $0.87 USD/dth;

c. The ability to renegotiate the Precedent Agreement should another similar shipper negotiate more favourable terms (Most Favourable Nations Clause);

d. The option to choose the reservation rate instead of the negotiated rate after the project has been completed; and

e. The ability to withdraw from the project if delayed beyond November 1, 2018[22].

33. EGD further claims that the Precedent Agreement affords the following additional mitigation:

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[20] Union's Application, Exhibit A, pp 46 – 52; EGD's Application, Exhibit A, Tab 3, Schedule 1, pp 35-43.
[21] EGD's Application, Exhibit A, Tab 3, Schedule 1, p 37.
[22] *Argument in Chief of Union Gas Limited,* November 18, 2015, pp 4, 5, 17.

a. The Precedent Agreement provides the option to increase capacity if needed;

b. Nexus bears the risks associated with the construction and bringing into operation of a greenfield pipeline;

c. Capital cost tracking mechanism caps the increase or decrease in reservation rates to plus or minus %15;

d. Under the Precedent Agreement, the risk of delays re mitigated through requirements that Nexus must take necessary steps to have it in service by November 1, 2017; and

e. Precedent Agreement incorporates provisions that allow for the right to terminate the contract should Nexus or EGD fail to obtain the necessary permits[23].

34. If pre-approval of the contracts did not pose any risk, there would be no need for mitigation measures. The fact that both Utilities have undertaken risk mitigation measures demonstrates the existence of risk.

35. CME acknowledges that both Utilities have undertaken risk mitigation measures. That said, CME is not able to conclude with certainty whether those mitigation measures have fully mitigated all of the risks such that pre-approval should be granted. In this regard, CME relies upon the expertise of the Board and its staff in determining whether, under all of the circumstances, there remains an unacceptable level of risk on ratepayers such that unconditional pre-approval should be granted.

CONCLUSIONS / CONDITIONAL PROPOSAL

36. If the Board in its review is satisfied that all the risks of the project are sufficiently mitigated and allocated, then pre-approval should be granted. If not, CME urges the Board to,

[23] EGD's Application, Exhibit A, Tab 3, Schedule 1, pp 35-43.

rather than rejecting the applications out right, impose conditional pre-approval that introduces further ratepayer protections.

37. The nature of such a mechanism would depend directly upon the risks which the Board concludes have not been appropriately mitigated. This is, we submit, something that could be developed after conditional pre-approval is granted.

38. By doing so, the Board could balance the Utilities' need for pre-approval with the importance of protecting the ratepayer. The Board could balance the desire to have direct access to increased supply at Dawn without the absorption of unreasonable risks on the part of the ratepayer.

COSTS

39. CME requests that it be awarded 100% of its reasonably incurred costs for participating in this proceeding.

40. In CME's submission, it participated reasonably throughout the entire hearing. In writing these submissions, CME has worked closely with other intervenors throughout the proceeding, and efforts were made to ensure that CME did not unnecessarily duplicate the work of other parties.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 26TH DAY OF NOVEMBER, 2015

Vincent J. DeRose
Eden F. Alexander
Counsel for CME