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**BY EMAIL and RESS**

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Our File No. 20150166/175

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
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**Attn:  Kirsten Walli, Board Secretary**

Dear Ms. Walli:

**Re:  EB-2015-0166/175 – Union/Enbridge NEXUS Pre-Approval – SEC Final Argument**

We are counsel for the School Energy Coalition ("SEC"). This is SEC's Final Argument on the applications by Union Gas Ltd. ("Union") and Enbridge Gas Distribution Inc. ("Enbridge") for pre-approval of the cost consequences of transportation contracts for capacity on the NEXUS Gas Transmission Pipeline ("NEXUS").

While it appears that NEXUS and the transportation contracts of both Union and Enbridge are reasonable, SEC submits the applications should be denied.  Pre-approval of gas transportation contracts is an exception to the Board's normal practices, and only arises if certain specific conditions are met.  Those conditions are not met in this case.

***Overview***

It is important to distinguish between two related but separate issues:  a) pre-approval of the cost consequences of the NEXUS transportation contracts, and b) determination of the prudence of entering into those contracts.   Pre-approval requires a determination of prudence.  However, a determination of prudence does not lead necessarily to pre-approval.  The latter is only appropriate if the other conditions of pre-approval are met.

SEC submits that aside from some specific concerns regarding Union's application, both utilities have demonstrated that they should enter into upstream transportation contracts such as NEXUS. That is, these contracts, or something similar, would be prudent. SEC submits the NEXUS contracts are generally reasonable and benefit ratepayers as they provide a direct access to Appalachian gas (i.e. ability to purchase at the source), and thus provide for greater diversification of supply sources into Ontario. As discussed below, that does not mean that pre-approval should be given.

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Pre-approval of the cost consequences of the transportation contracts is a significant departure from the Board's practice of determining the prudence of gas supply and transportation arrangements after-the-fact. Pre-approval transfers the entire risk to ratepayers. In the normal course, utilities such as Enbridge and Union enter into a myriad of short and long-term transportation and supply arrangements. The prudence of those arrangements are determined during the utilities' respective annual rate adjustments and QRAM proceedings. While they are generally pass-through costs, in the sense the utility does not profit from them, they must still be "just and reasonable" pursuant to section 36 of the *Ontario Energy Board Act*. Contrary to Union's view during the oral hearing, they are compensated for the risk.[1] Any residual regulatory risks of disallowance are a business risk, and Union and Enbridge are compensated for that through their capital structure and return on equity. The risk is in fact extremely low. A disallowance has only occurred once for either of these utilities.[2]

SEC submits the purpose of the pre-approval process was to solve a specific regulatory problem. Utilities were not willing to sign high risk long-term contracts that were needed to enable required infrastructure development that would provide a broad benefit to consumers, due to regulatory risk of a future disallowance. It is not sufficient for there to be a finding that the contracts are needed to enable the build of a new pipeline. The pipeline itself must be required, dependent on the contracts, and beneficial to the ratepayers.

This initiative was borne out of the 2005 Natural Gas Forum, where the Board recognized that there may be a need for pre-approval of long-term contracts.[3] After consultations with stakeholders, the Board released draft pre-approval guidelines. In the accompanying report, it recognized there was agreement from all parties that there should be 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 ("LNG") plants and frontier production)."[4]

***NEXUS***

The conditions that would require pre-approval of the NEXUS contracts are not present in the current applications. NEXUS is not required to bring Appalachian, Utica and Marcellus gas, into Ontario. Neither of these sources of gas can be considered "frontier" production sources that can only be accessed through the building of this pipeline. This gas is already making its way to Ontario through Dawn and Niagara. Moreover, there are other pipeline projects already in the works that will provide even more supply to Ontario, including Rover, which is being built on a parallel path.[5]

In the 2011 Decision denying pre-approval of certain contracts on TransCanada Pipelines system from Niagara (EB-2010-0300/0333), the Board explained its considerations when the claim is approval is needed for access to a new basin:

> While it is true 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 is not so new that 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

[1] Tr.2, p.77

[2] Tr.2, p.144. JT2.2

[3] *Natural Gas Regulation in Ontario: A Renewed Policy Framework*, dated March 30 2005

[4] *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, p.1

[5] Tr.1, p.6,9. See also B.T1.Union.BOMA.7(e)

> noted earlier, the purpose of pre-approval process it 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 approval is not granted.[6]

Access to Appalachian basin gas (Marcellus and Utica), as much as it can be considered a wholly separate supply basins[7], is almost identical to the situation the Board considered in the EB-2010-0300/0333 decision, and thus the comments in that case are directly applicable. It is not frontier gas, and it still accessible without NEXUS.

Enbridge has come to the same conclusion. In its own internal memorandum, it found that the NEXUS contract would likely not meet the Board's pre-approval requirements:

> The likelihood of OEB pre-approval of the NEXUS contract is low. Given the multitude of projects that have been or will be developed in the U.S. NE, the Board will more than likely view the NEXUS project as a standard build and not one, for example, that is accessing "frontier gas". Pre-approval would also require the Board to satisfy itself that absent NEXUS incremental supplies would not be able to access Dawn. This is unlikely given the number of new projects seeking to connect to Dawn and the possibility of future expansions of existing facilities allowing access to Dawn.[8]

The evidence confirms this view. For example, Rover, which filed its FERC application before NEXUS, is exclusively supported through long-term contracts by suppliers.[9] This is a strong indication that the supply market is pushing expansion, and there is no requirement for distribution utilities to contract upstream of Dawn to access supply. SEC does not dispute that there is a benefit in doing so, for the purpose of supply diversification and risk mitigation, but it is not required, and thus pre-approval  Is also not required.

Furthermore, Union is seeking pre-approval of not just greenfield, but also existing, pipeline. A significant portion of Union's proposed path (Willow Run to St. Clair) uses DTE's existing infrastructure[10], as compared to Enbridge, which is only seeking pre-approval of the greenfield portions of the eventual full path to Ontario and not the existing pipelines (Vector from Mildford to Dawn).[11]

The Board should be very wary of the comments of Union that without pre-approval they will not enter into the NEXUS contract.[12] If the project is as beneficial as they say it is, and the potential risks are as low as their analysis states, then it would be the prudent choice for them to enter into the contracts in the ordinary course of their regulated business.  If they ultimately elect not to do so, that

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[6] Decision and Order (EB-2010-0300/0333), January 27 2011, p.9-10

[7] There was a lot of discussion during the oral hearing as to whether Appalachian gas is a separate basin to Utica and Marcellus. SEC notes what Union witness Mr. Short said at the beginning of the hearing: "The NEXUS project is designed to provide direct access to the growing Appalachian basin, primarily Utica and Marcellus gas, to markets in Ohio, Michigan, and to Dawn." (Tr.1, p.4). See also Union Profiled Evidence, Ex.A, p.7-8

[8] Exhibit I.T1.EGDI.FRPO.3, Attachment 2, p.7

[9] Tr.1, p.26, 35-36.

[10] Union Pre-filed Evidence, Ex. A, p.14-17

[11] Tr.1, p.8-9, Tr.2, p.105

[12] Tr.1, p.69

may raise concerns about any alternatives they ultimately choose. In short, Union cannot say "we will not act in a prudent manner unless we get pre-approval." Their obligation is to procure gas in a prudent manner. That obligation is part of their regulatory compact. Pre-approval is a very narrow regulatory exception. If they don't meet the conditions, they cannot demand it anyway as a condition of meeting their obligations.

The Board should be even more skeptical of the Union's view that there if it is unable to get pre-approval, there is a "significant risk that producers, who are also anchor shippers on NEXUS, may interpret Union's action as a lack of endorsement of Dawn as an important market hub and an indication of weak market for the supplies at Dawn".[13] For a number of reasons this bald assertion should be rejected.

First, producers who are contracting on NEXUS and other pipelines are sophisticated entities. They are able to interpret a regulatory decision by this Board and will not interpret a rejection of pre-approval of NEXUS as broad ranging pronouncement on Dawn. Second, the fact that the majority of NEXUS capacity and the entirety of Rover capacity has been contracted by producers is a pretty clear indication that they believe Dawn is an important market hub. Third, paramount to producers is price. As Mr. LeBlanc from Enbridge best put it, "[producers] will sell the gas to the highest price that they can get along that path, and they may or may not sell it at Dawn."[14]

***Union Specific Concerns***

**a. Affiliate Relationship**

Union has a special relationship with NEXUS, as its parent Spectra is a 50% partner in NEXUS.[15] There was discussion during the oral hearing about the applicability of the *Affiliate Relationship Code for Gas Utilities* ("ARC"). While there seemed to be some confusion as to the exact basis for Union's view that it did not apply[16], it nevertheless agreed to be bound by the ARC.[17] Regardless of the legal applicability of the ARC, the Board has been clear that any affiliate relationships between a utility and upstream pipeline is important information in assessing the appropriateness of pre-approval.[18]

The ARC requires that where "a reasonably competitive market exists for a service, product, resource or use of asset, a utility shall pay no more than the market price when acquiring that service, product, resource or use of asset from an affiliate."[19] Further, it stipulates that "[a] fair and open competitive bidding process shall be used to establish the market price, before a utility enters into or renews a contract with an affiliate."[20] If there is no reasonably competitive market for the service, then a utility "shall pay no more than the fully-allocated cost for the service, but that any return on capital included in the fully allocated cost "shall be no higher than the utility's approved weighted average cost of capital."[21]

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[13] Union Argument-in-Chief, para. 62

[14] Tr.2, p.125

[15] Union Pre-filed Evidence, p.1-2

[16] Tr.1, p.65-66

[17] Tr.1,p.64

[18] *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, p.5

[19] *Affiliate Relationship Code for Gas Utilities,* s. 2.3.4

[20] *Ibid.* s.2.3.5

[21] *Ibid.* s.2.3.10

SEC accepts there is *likely* a competitive market to bring gas to Dawn, but Union has not done, nor could it realistically do, a competitive bidding process for transportation services as required by the ARC. Utilities bid into transportation providers' open seasons, not the other way around. Unlike procurement of other services, including supply, because of the structure of the transportation market, Union may not, on its face, be able to meet the technical requirements of the ARC. SEC submits this is an issue the Board should review at some point, especially as the parent companies to Enbridge and Union get more involved in upstream pipeline construction.

There are stark differences in how Union and Enbridge went about considering the appropriateness of bidding into the NEXUS open-season. Union admitted that Spectra would have had a say in Union's decision to sign the Precedent Agreement.[22] At the same time, it recognized that Spectra, as a 50% partner in NEXUS, is not a passive participant. Spectra wants to see the pipeline built and fully utilized, and will act to support that goal.[23]

Enbridge took a completely different approach (even though its parent Enbridge Inc. was itself a partner in NEXUS at the time of the open season). As Mr. LeBlanc testified:

> We sort of agreed that the best thing for us to do is evaluate this on a stand-alone basis, so EGD will go and evaluate this from a gas-supply point of view, and they will go on their way and evaluate NEXUS from an investment point of view, and so we tried to keep that separation, because we thought it was the right thing just so that folks would understand that we're making this decision because we think it's the right one for the ratepayer.[24]

SEC submits that Enbridge took the appropriate approach. The Board must guard against undue influence in transportation contracting decisions between interested parties even if the relationship does not meet the technical requirements of an affiliate under the ARC. This is especially important since it is not an easy task to determine which, between the competing upstream pipelines, provides the best value to ratepayers over a 15 year time horizon based primarily on landed gas cost forecast analysis.

**b. Size of the Commitment**

Union's contractual commitment of 158,258 GJ/d (15,000 DTE/d) is, as a proportion of its overall supply portfolio, very significant.[25] It is the largest single contractual commitment Union has made in at least the last 30 years.[26] As much as supply and path diversity is important, so is contract diversity. SEC is concerned that Union may be making too large a commitment to one single contract.

At the same time, SEC is not saying that the size of the commitment is so large as to be unreasonable, since we recognize that the capacity contracted is the amount required for anchor shipper status, which in turn enables favorable rates and terms.[27] This is a benefit that Enbridge, at this time, does not receive as a non-anchor shipper. The issue is that it is not clear that - if the risk from pre-approval is shifted entirely to ratepayers - the additional risk of the size of the commitment, even with some preferential rates and terms, is appropriate.

[22] Tr.1, p.69.

[23] Tr.1, p.68. Tr.2, p.27

[24] Tr.2, p.142

[25] Union Pre-filed Evidence, Ex.A, p.31

[26] Tr.2, p.69-70

[27] Union Pre-filed Evidence, Ex.A, p.43-44

In the event that the Board determines that pre-approval should be considered, the Board should, in our view, address this concern by limiting the amount of capacity for which it pre-approves the cost consequences to an amount less than requested.

***Summary***

SEC submits the Board should deny pre-approval of the cost consequences of the NEXUS contracts signed by Union and Enbridge, as they do not meet the regulatory requirements for pre-approval. Ratepayers should not be required to bear the entire risk of the contracts.

At the same time, the Board should be clear that such a denial in no way presupposes the prudence of those contracts. In fact, on the evidence, it appears that they are reasonable long-term contract arrangements, and likely will benefit Ontario natural gas ratepayers.

All of which is respectfully submitted.

Yours very truly,
**JAY SHEPHERD P. C.**

*Original signed by*

Mark Rubenstein

cc: Wayne McNally, SEC (email)
Interested Parties (email)