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BY EMAIL and RESS

December 14, 2016
Our File: EB20160186

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2016-0186– Union Panhandle Reinforcement Project – SEC Final Argument

We are counsel to the School Energy Coalition ("SEC"). Enclosed, please find SEC's Final Argument.

Yours very truly,
Jay Shepherd P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicant and intervenors (by email)

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ONTARIO ENERGY BOARD

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

AND IN THE MATTER of the OF the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, Sched. B, and in particular, s.36 thereof;

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders granting leave to construct natural gas pipelines and ancillary facilities in the Township of Dawn Euphemia, Township of St. Clair and the Municipality of Chatham-Kent;

AND IN THE MATTER OF an Application by Union Gas Limited for an Order or Orders for approval of recovery of the cost consequences of all facilities associates with development of the proposed Panhandle Reinforcement Pipeline Project.

FINAL ARGUMENT

OF THE

SCHOOL ENERGY COALITION

Overview

1. Union Gas Ltd ("Union") filed an application for leave to construct a 40km pipeline from its Dawn Compressor Station to its Dover Transmission Station, and approval of the cost consequences of the pipeline and related facilities, together known as the Panhandle Reinforcement Project. Union has proposed the project to serve the growing demand for firm service primarily in the Kingsville-Leamington area, which is served off Union's Panhandle system.

2. This is the Final Argument of the School Energy Coalition ("SEC").

3. SEC submits the Board should reject the proposed application for leave to construct. Union has not demonstrated that the project is the most cost-effective option to serve the increased demand that it has forecast. The evidence in this proceeding is clear that current facilities and contracting arrangements in place are sufficient to serve the increased demand for at least the next 3 years, perhaps significantly longer. This window of time will allow Union to *properly* determine if there are more cost-effective commercial alternatives to the pipeline project. It will also allow Union, ratepayers, and the Board, to get a better sense of some of the fundamental changes that are about to occur to the natural gas market in Ontario due to the introduction of Cap and Trade and the Climate Change Action Plan ("CCAP"). After sufficiently discharging its onus to explore commercial alternatives, and the forecast effects of the upcoming climate change policies, if Union still believes there is a need for the pipeline project, it can return to the Board with the project to seek approval.

4. SEC has worked closely with a number of ratepayer groups, specifically the Federation of Rental-Housing Providers of Ontario ("FRPO"), the Industrial Gas Users Association ("IGUA") and the Association of Power Producers of Ontario ("APPrO"), and adopts the very detailed analysis with respect to the commercial alternatives that may be available to Union as set out in the final arguments of FRPO and APPrO.

Bias Towards Building Facilities

5. This application once again reveals the incentives that the regulatory system creates for a gas utility such as Union to invest in system expansion when an equally or even more viable alternative cost-effective commercial service is available. This is because utilities receive a return on their invested capital, while transportation and supply arrangements are pass-through costs and do not provide the opportunity for profit. This incentive means that, in reviewing a leave to construct application, the Board and ratepayers must scrutinize the utility proposal particularly closely to ensure that all reasonable no-build commercial alternatives have been explored.

6. Making things harder is that ratepayers and the Board are at a significant disadvantage in determining if there are commercial no-build alternatives to a proposed pipeline project. As the

record in this proceeding has demonstrated, due to the dynamics of the upstream supply and transportation markets, they are complex, and often based on non-public information. Commercial alternatives in many cases require negotiation between a utility such as Union, who has little incentive to push for a successful no-build outcome, and one or more transporters and suppliers who are not regulated by the Board.

7. The evidence in this proceeding demonstrates that Union has clearly not fully explored solutions that allow for no-build commercial alternatives to the upcoming capacity challenges in the Leamington-Kingsville market. For example, there may be significant opportunity to increase imports at Ojibway Vale Station ("Ojibway"), in lieu of building a $264.5M pipeline.[1]

8. SEC recommends that the Board reject the pipeline project and tell Union that it must thoroughly investigate all alternatives before bringing an application to the Board for leave to construct.

Project Is Not Needed Yet

9. SEC has had an opportunity to review APPrO's Schedule 1 table which shows the surplus or shortfall in demand if the area were to be served from Ojibway. The table shows the remaining capacity on the Panhandle Eastern Pipeline ("PEPL") to Union's system at Ojibway, after considering each of: the existing firm contractual commitments Union has through 2022, capacity contracted by third-parties, and the remaining PEPL capacity and Ojibway. It also shows the cumulative incremental growth that Union has forecast, primarily from conversion of customers to firm service from interruptible, small increases in M1/M2 demand, and growth in contract customers (primarily greenhouses).

Comparison of Capacity Availability from Ojibway and Union's Panhandle System Market Growth Forecast

(TJ/d)	W16/17	W17/18	W18/19	W19/20	W20/21	W21/22
Net Remaining PEPL Firm Capacity to Ojibway1	85	73	73	71	71	71
Cumulative Net Incremental Growth		56	71	84	94	104
Surplus/(Shortfall) if Demand Served from Ojibway		**17**	**2**	**-13**	**-23**	**-33**

Source: APPrO Final Argument, Schedule 1

[1] A-7, p.1

10. The evidence shows that new facilities are not required until at least the winter of 2019/2020 based on Union's incremental growth forecast. But even those figures are likely too high. First, they do not take into consideration any peak day DSM impacts for either existing or new customers.[2] Second, not a single one of the new forecast contract customers have actually signed a contract for capacity.[3] While there is no reason to expect that the majority of the contract customers will not eventually sign, it is far from certain it will end up being all of them, nor is it likely to be for the entire capacity that each have discussed with Union. SEC believes that, in the absence of signed contracts, it is reasonable to expect that not all the demand from these customers will materialize, once they see the significant increase in rates that will occur after January 1, 2017 due to Cap and Trade. It can be expected that the forecast contract demands will decrease, and the eventual contracts will be for lower minimum annual volumes.

Commercial Alternatives Need Be Explored Fully

11. Even if the entire forecast peak day demand materialized as projected, by winter 2019/2020, there are viable commercial alternatives that have not been adequately explored by Union which could result in additional pipeline facilities not being needed for a much longer time horizon (if ever). As a case in point, Union has not adequately explored the option of utilizing additional C1 contracts that exist on PEPL to Ojibway.

12. The evidence in this proceeding is that Rover currently has a C1 Contract from Ojibway to Dawn to complete the move supply from Rover to Dawn on PEPL.[4] This service allows Rover shippers to get their supply to Dawn via PEPL and through Ojibway along Union's Panhandle System. Union has not seriously looked at utilizing this significant capacity (35 TJ/d). There is an opportunity for Union to negotiate with Rover or PEPL (its affiliate) to create a "must nominate"[5] C1 service that would provide firm capacity to be delivered at Ojibway. In return for the Rover shippers essentially diverting their supply for Union's use at Ojibway, Union provides an exchange service delivering equivalent supply at Dawn.

[2] Tr.1, p.68
[3] Tr.1, p.66
[4] See J2.8, Attachment 2
[5] A 'must nominate' service is one where a shipper is provided a financial incentive to deliver their supply at a given receipt point when nominated to.

13. Union's evidence is that it considered a similar commercial alternative but through the Request for Proposals (RFP) that it issued, it was only able to secure 21 TJ/d of Ojibway deliveries from the only other holder of C1 capacity from Ojibway to Dawn.[6] However, a review of the RFP shows that Union did not seek out proposals for a 'must nominate' service at all. In the RFP, Union provided a limited view of what arrangements it would entertain:

> Union will entertain capacity offers facilitated via capacity on the Panhandle Pipeline system as well as capacity from customers holding capacity on Union's Ojibway to Dawn transmission system. Bids involving both a Panhandle Pipeline and Union Gas concurrent release will also be entertained.[7]

14. Union was primarily looking for a firm transportation service, not a delivered service. [8] The RFP makes no mention of seeking a 'must nominate' and complementary exchange service. More importantly, the RFP was rushed, and sent to a very limited amount of Rover shippers. Rover shippers would have been those who would have had interest in any such service, as they are the ones who are interested in bring gas to Dawn to sell.[9] The RFP was sent out on May 26th 2016, requiring responses by the 31st. With the US Memorial Day holiday, it left only one full business day to respond.[10] This is not enough time for an interested shipper to put together a complex proposal. The RFP was also only sent to one of the seven Rover shippers who had capacity on PEPL's system between Defiance and Ojibway (known as the PEPL North System).[11]

15. There may also be other capacity that could be obtained from PEPL or Rover directly. Union originally stated in response to an interrogatory that it bid into a previous PEPL open season and was unable to secure even replacement of the 60 TJ/d in contracts that it held until the end of October 2016.[12] The correspondence, which was provided as an update to the decision on the FRPO motion on the 2nd day of the hearing, shows that, in Rover's view, Union mischaracterized the discussions between the two parties at the Technical Conference. Rover

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[6] B.Staff.3
[7] B.Staff.3, Attachment 3
[8] Tr.2, p.155
[9] Tr.2, p.70
[10] B.Staff.3, Attachment 3; Tr.2, p.157
[11] Tr.2, p.156; K2.3, p.15
[12] See B.Staff.3

was interested in obtaining up to 79 TJ/d (75,000 Dth/d) from Ojibway to Dawn beginning in November 2017 and working on a service with its shippers to provide delivery at Ojibway.[13]

16. For 18 months Union did nothing to pursue a must nominate service, something Rover appeared interested pursuing. Rover was still interested in this option days before the beginning of the hearing, as communicated to Union in its letter dated November 17th, 2016:

> Let me reiterate that we have been and continue to be seriously desirable in obtaining C1 capacity from Ojibway to Dawn for up to 75,000 Dtd/d effective from Rover in-service date (currently expected to be 11-1-2017) for a period of up to 15 years. Further, if a delivery commitment is required for the supply on the 75,000 Dth/d, Rover would be happy to pursue such, including by providing the avenue for Union to work with Rover shippers to accommodate that. We stand ready, as we have for the last 18 months, to discuss this with you.[14]

17. If PEPL or Rover want to obtain up to 79 TJ/d of capacity from Union to provide a service to Dawn, there is significant opportunity for some form of commercial arrangement to ensure supply reaches Ojibway for Union to use, and an equivalent amount be delivered to those capacity holders at Dawn.

18. From the C1 shippers' perspective, it is a win-win proposition. They want to sell their gas at Dawn, where the market is liquid with many buyers. A 'must nominate' service would have the effect of Union paying them an incentive fee to "drop off" their gas at Ojibway. The C1 shipper would be required to deliver their volumes to Ojibway if requested by Union. Union would then exchange an equivalent amount of gas that it owned at Dawn (that was targeted for the Windsor area market) with the 'must nominate' gas it received at Ojibway, and Union would use this 'must nominate' gas to meet local demand. These shippers still get to sell the same quantity of gas at Dawn, to meet their contractual commitments, while getting paid extra to deliver quantities to Ojibway for Union. Union's customers benefit as the cost of the incentive to these shippers is still significantly less than the cost of building new facilities. Considering the indicative cost per GJ of capacity for the Panhandle Reinforcement Project is 70 cents[15], there

[13] Letter from John Reid (Rover Pipeline) to Chris Shorts (Union), K2.1, Attachment 1, p.4-5)
[14] Letter from John Reid (Rover Pipeline) to Chris Shorts (Union), K2.1, Attachment 1, p.4-5)
[15] Tr.2, p.144

appears to be significant room to provide for an incentive fee.[16] A similar service has been used successfully by TransCanada Pipelines to meet its firm obligations at Dawn.[17]

19. Union's position at the oral hearing was that this is not an appropriate solution since it would not control the underlying supply.[18] This was a new concern that was not discussed at all in the evidence regarding the appropriateness of other commercial alternatives.[19] Further, it is not clear why Ojibway is much different from its arrangements for supply contracts it buys at Dawn. Those contracts also do not involve controlling the gas upstream at the production basins. There are penalty provisions within contracts to ensure that supply shows up to the delivery point. When questioned about the risk of the gas supply not showing up at Ojibway, Mr. Shorts said that it was "quite infrequent", and that there has never been a supply failure on its PEPL deliveries.[20]

20. While a contract was signed on the eve of the hearing to bring Union back to 60 TJ/d from PEPL beginning in 2019[21], there is significantly more capacity available for Union to attempt to negotiate access upstream Ojibway on PEPL. In the same November 17th, 2016 letter referenced above, Rover (the affiliate of PEPL) stated that "we have expressly made proposals from 57,000 to 95,000 Dth/d of capacity to Ojibway".[22]

21. From a system design standpoint, the evidence shows that significant additional imports at Ojibway can be accommodated to service the Leamington-Kingsville area, with no new facilities needed. This is confirmed by previous experience where Union has, on numerous instances, received at least 140 TJ/d at Ojibway[23], significantly more than the 102 TJ/d that are currently contracted to be received at Ojibway this winter.[24] As well, the flow diagram scenario

[16] Tr.2, p.127, 146-147;
[17] B.FRPO.5a)
[18] Tr.1, p.13
[19] See Ex.A-6; B.Staff.3
[20] Tr.2, p.180
[21] Tr.1, p.11-12
[22] Letter from John Reid (Rover Pipeline) to Chris Shorts (Union), K2.1, Attachment 1, p.4)
[23] JT 10.9 and JT1.10. See calculations done at p.32 of K2.2
[24] See APPro Final Argument, Schedule 1, Winter 16/17.

provided as a response to Technical Conference Undertaking JT1.8 shows that Union's system can handle the increased Ojibway deliveries using existing infrastructure.

Union's Ojibway Import Limit Is Artificial

22. One of the major reasons that Union has been driven towards its proposed solution to serving the increased demand, as opposed to a no-build commercial alternative, is that it has artificially limited potential imports at Ojibway to 115 TJ/d.[25] It is this reason that a broader range of commercial alternatives was not considered by Union. The 115 TJ/d represents the amount that can be accepted in the summer months only due to the operational need for the gas to be consumed in the Windsor area and the capacity of the Sandwich Compressor station.[26]

23. In the winter months, more gas will be consumed in the Windsor area and so more than 115 TJ/d can be received at Ojibway. Union simply prefers to purchase firm supply on a full year basis and utilize its storage facilities for excess amounts in the summer months. While that generally may be Union's past practice, in the current situation it would appear that is not the most prudent course of action.

24. Even if Union contracted for additional capacity along PEPL above the 115 TJ/d level all year, and only purchased supply for the winter months, the unutilized demand charges would be a fraction of the annual revenue requirement of the proposed project.[27] While Defiance, from which the gas supply would likely be purchased, is a less liquid point than Dawn, the Board should reject Union's view that it is simply too uncertain to purchase from there. [28] The Rover pipeline, which is scheduled for completion in November 1, 2017, will connect at Defiance with PEPL and bring over 3.1 BCF/d of new capacity to what is already a busy interconnection point with the ANR pipeline.[29] While Defiance may not have much active trading today, that will change as the Rover pipeline, which is producer driven, is completed. In addition, there should be spillover benefits from NEXUS, even though it does not have a direct connection at Defiance.

[25] Ex.A-4, p.4
[26] *Ibid*
[27] The full year demand charges of 71 TJ/d (71,000 GJ/d), which represents the incremental remaining maximum firm export capacity of PEPL available (See APPrO Schedule 1, Line 18) multiplied by the demand charge on PEPL between the interconnection with Rover (Defiance) and Ojibway of $0.1381 GJ/d (J2.6, Attach A) X 365 days a year = $3.58M. This compares to the approximately $25.6M revenue requirement of the project in 2018 (Ex.A-8,p.20).
[28] Tr.2, p.136-137
[29] Tr.2, p.222

The upstream market is likely to change dramatically in the next year as both of these come into service.

Board Should Send Strong Message To Union

25. The Board should send a strong message to Union that expects all reasonable alternatives to be explored, including Union entering into good faith negotiations to reach commercial arrangements. The timeline for the project development is just one example of Union's predisposition to build versus seek commercial alternatives. Its public consultations on the project began in February, and yet it only issued the RFP for commercial alternatives in late May[30], just weeks before it filed the application in early June.[31]

26. SEC understands the rationale for this behavior. It is driven by the incentives of the regulatory system in which Union operates. Its shareholders benefit from return on facilities, and not from commercial arrangements. This bias towards build solutions is natural, and is not necessarily a sign of any nefarious intent. But it exists, and it is why the Board must be scrupulous to ensure that ratepayers are protected from this perverse incentive by ensuring that all reasonable alternatives are explored in good faith. This includes requiring negotiations where Union has an incentive for those negotiations to fail.

27. SEC is concerned with some specific Union's actions in investigating alternatives in this proceeding. If not for the motion brought by FRPO, the Board would not have had any indication of what had really transpired between Union and PEPL and Rover, on their behalf. Further, if it were not for the last minute intervention at the hearing by counsel to IGUA to update the documents produced as a result of the FRPO motion[32], the details regarding the alleged misstatements by Union at Technical Conference would never have been made public.[33]

28. While Union denies that there was a deal between themselves and Energy Transfer Partners LP (parent of Rover and PEPL) to withdraw the allegations made by Rover of Union's misrepresentation of their positions and negotiations to the Board, the evidence strongly suggests

[30] B.Staff.3
[31] Union filed this application on June 10th.
[32] Tr.1, p.107-108
[33] See Letter from John Reid (Rover Pipeline) to Chris Shorts (Union), K2.1, Attachment 1, p.4-5)

otherwise.[34] The emails between the parties would suggest that Union agreed to a contract on PEPL beginning in 2019 in exchange for rescinding Rover's letter regarding the alleged serious misrepresentations to the Board.[35] This is a contract for capacity that has been available for a long time, as indicated in the November letter from Rover.

Cost Consequences

29. If the Board grants leave to construct, SEC accepts that the project meets the capital pass-through mechanism under the Board-approved IRM Settlement Agreement. SEC does have concerns with two aspects of the calculation of those costs to be passed-through to ratepayers, and their allocation to specific rate classes. Union has proposed two changes to the current Board-approved methodology. The Board should reject Union's proposal to change both the depreciation rate and the cost allocation methodology.

30. ***Depreciation.*** Union is seeking approval to depreciate on the project over a 20 year useful life instead of the weighted average useful life of approximately 50 years which is based on the Board-approved depreciation rates.[36] Union's position is that this is based on management's judgement that the changes being proposed by 2030 will allow for the entire facility to be recovered by 2037. SEC submits the Board should deny this request. The current Board-approved IRM Settlement Agreement, which governs the capital pass through mechanism, is clear that the 2013 depreciation rates are to be used. Regardless, as a matter of policy, it is not appropriate to make piecemeal changes on an asset-by-asset basis, especially in the present circumstances where Union will be conducting a full depreciation study for its 2019 rebasing proceeding.

31. The approved IRM Settlement Agreement is clear that Union must use the 2013 Board approved depreciation rates when passing eligible projects' cost consequences into rates through the capital pass through mechanism. Section 6.6 provides that for eligible major capital projects,

[34] Tr.2, p.176-177

[35] Email from Ms. Hockey (Energy Transfer) to Chris Shorts and Jim Redford (Union) dated November 21 2016 (K2.1, Attachment, p.13):

> "We would have an agreement in principal and would agree to rescind our letter if you can get to a 10 yr term on your pepl portfolio"

[36] A, 3, p.7

the "net delivery revenue requirement impacts of those projects will be treated as a Y-factor".[37] Subsection (i), that sets out the criteria, states that the "the rate adjustment for each year will be based on the forecast net delivery revenue requirement impacts for each specific year, subject to the true-up to actuals…."[38] It specifically provides that the parameters used to calculate the net delivery requirement, include that the "depreciation expense will be calculated using the 2013 Board-approved depredation rates.[39] This is in contrast to the cost allocation methodology to be used in allocating the net delivery requirement of an eligible major capital project, which the IRM Settlement Agreement specifically provides that any party, including Union, may take any position with respect to the proposed allocation.[40]

32. Even if the Board finds that the IRM Settlement Agreement doesn't constrain the selection of a different depreciation rate, the Board should still decline to approve Union's proposed deviation from the 2013 Board approved rate. Union has filed no specific evidence on this issue; it has simply referenced a section of the CCAP and made a determination "based on management's judgement".[41] While CCAP and Cap and Trade will have significant effects on the useful life of natural gas assets, what is required is a more rigorous assessment of the forecast effects on the assets' use. Mr. Isherwood, on behalf of Union, confirmed that Union is undertaking a depreciation study of its entire system to be presented for its rebasing application of 2019 rates. It is that proceeding, for rates to go into effect 14 months later than the proposed facilities (November 2017 versus January 2019), where it is appropriate to have a fulsome review of the appropriate changes that may need to be made to depreciation rates. The Board should not make a change on an asset by asset basis, but wait for a full review of the entire system, which is upcoming.

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[37] IRM Settlement Agreement (EB-2013-0202, Ex. A, Tab 2), p.18 (K1.5)
[38] *Ibid*
[39] *Ibid*., p.19:

> In determining net delivery revenue requirement for any year, the following parameters will be applied:
> - Depreciation expenses will be calculated using 2013 Board-approved depreciation rates;
>
>   ….

[40] *Ibid*, p.21
[41] A-3, p.5-7

33. ***Cost Allocation.*** Union has proposed a different cost allocation methodology for allocation of the net delivery revenue of the proposed project, rather than the Board-approved methodology.[42] While SEC recognizes that unlike the change in the depreciation rate, the IRM Settlement Agreement allows for such a proposal to be made, the Board should still reject it.

34. The change would have the effect of allocating more costs to in-franchise customers and less to ex-franchise, in addition to separating the St. Clair system from the Panhandle system cost allocation methodology for this project.[43]

35. The problem with changing the methodology of one project, which sits within a broader Union regional pipeline sub-system (the Panhandle System) is that you are not properly re-allocating costs but selectively making changes to one part of it, to try to deal with what, on the surface, may appear to be fundamental problems that are beginning to arise in the specific system's allocation. The project, if approved, will be in-service for 14 months before Union's rebasing application in 2019, for which it will present a full cost allocation study[44]. A full review at rebasing of the entire Panhandle system, of which this project is only one part, would be a more sound and fair approach.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

Original signed by

Mark Rubenstein
Counsel for the School Energy Coalition

[42] Ex.A-8-4
[43] J1.2, Attachment 2, p.1
[44] J1.2, Attachment 2, p.4