

ONTARIO ENERGY BOARD

2010 NATURAL GAS MARKET REVIEW

Written Comments of the Industrial Gas Users Association (IGUA)

1. This proceeding was commenced by the Board in order to review and examine recent developments in North American natural gas supply markets, and to consider any potential implications of those developments for the Ontario natural gas market.¹
2. An overall objective of this review is to assess how natural gas markets in Ontario are responding or adapting to changing market conditions.²
3. A specific objective of this review is to determine whether there is a need for any regulatory changes in response to potential impacts.³

How Natural Gas Markets in Ontario are Responding or Adapting to Changing Market Conditions

4. IGUA views this initiative as one primarily focussed on educating the Board and Ontario's natural gas stakeholders on recent North American natural gas market developments. In many respects these developments are new, and while potentially "game changing" the markets are in the early stages of assimilating them. IGUA has found this process, and the ICF Report⁴ that supported it, helpful and informative.
5. The ICF Report provided a comprehensive presentation of the recent "facts" related to natural gas development, and shale gas development in particular, and provided a prognosis for shale gas development and movement in North America in the years to come. The commissioning and sharing of this report by the Board has enabled Ontario's natural gas sector stakeholders to be better informed, in tandem with the Board, on current and anticipated developments in the sector.

¹ July 13, 2010 Notice to All Interested Parties, para. 1.

² July 13, 2010 Notice to All Interested Parties, para. 3.

³ July 13, 2010 Notice to All Interested Parties, para. 4.

⁴ *2010 Natural Gas Market Review*, August 20, 2010

6. In respect of the "overall objective" of this review - to assess how natural gas markets in Ontario are responding or adapting to changing market conditions - it appears from the discussion that response in Ontario has only just begun, and at this very early stage remains tentative. Most of the discussion has focussed on emerging opportunities as opposed to initiatives underway.
7. One general insight that should be taken from this review is the degree to which Ontario's gas market is increasingly impacted by complex and interrelated continental gas market dynamics. For example, even as shale gas resources in the North Eastern United States, geographically proximal to Ontario, enter full production, Ontario gas consumers may well be faced with higher landed gas costs, rather than lower landed gas costs.
8. The ICF Report forecasts that shale gas development will result in displacement of historical export of Canadian Western Canadian Sedimentary Basin (WCSB) gas to the North Eastern U.S..
9. These exports to the U.S. have, in large measure, been transported across the continent through the TransCanada (TCPL) mainline. Absent a fundamental change in TCPL's current business model, as the mainline volumes historically destined for export decline, mainline tolls are expected to continue⁵ to significantly increase. The result is forecast to be much higher landed gas costs for Ontario consumers that are captive to the TCPL mainline.
10. Stakeholders should not underestimate the potential problem that Ontario gas consumers face as a result of these shifting gas transportation dynamics. The problem is complicated, and could well affect different geographic segments of Ontario's gas markets differently, with some areas seeing cost increases materially more significant than others.
11. That it is early in this "game changing " North American gas market evolution is apparent in the different, and sometimes conflicting, views of the future of gas flow in and around Ontario. For example, while the ICF Report concludes that import of North Eastern U.S.

⁵ IGUA strongly disagrees with the notion, and questions the assertion, that diversifying supply is the primary cause of declining TCPL main line transportation volumes.

shale gas to Ontario is not likely to be significant, Union Gas' presentation raised some interesting possibilities regarding reversing gas flows and feeding the Dawn Hub with gas from U.S. supply basins coming in to Dawn, and potentially in to Niagara. This presentation led to some consideration of whether Niagara might develop as an additional liquid natural gas trading hub.

12. Which of these, and other, prognostications will come to pass is anyone's guess. What is instructive from this preliminary information gathering process is an understanding that there is an increasingly complex interplay of gas supply and transportation market dynamics developing in North America, as traditional supply resources decline and new resource basins are developed to feed steadily growing demand.

Whether There is a Need for Regulatory Changes in Response to Potential Impacts

13. From a regulatory perspective, IGUA holds the general views that:
 - (a) Markets are better at determining overall economically optimal solutions than any single decision maker, where and when the markets function properly. This would generally be the case in the evolution of the North American gas supply market.⁶
 - (b) Gas transportation and distribution costs are a significant portion of the total landed cost of natural gas, and as such need to be carefully scrutinized by regulators.
 - (c) Where gas transportation facilities are effectively monopoly service providers to at least some portion of their customer base, regulators like the OEB and the National Energy Board (NEB) have a positive duty to exercise active and effective oversight of the operations of these facilities and the resulting rates/tolls.
14. IGUA is of the view that the NEB has an urgent duty to engage in the issues plaguing the TCPL mainline.
15. IGUA is also of the view that the OEB can, and should, properly consider the impact of its future decisions on TCPL mainline tolls. These tolls have a significant, and increasingly negative, impact on Ontario landed gas costs.

⁶ These general views are put forward subject to particular circumstances that might commend greater regulatory intervention.

16. The report prepared by John Rosenkranz for a group of ratepayer interests, and the Stakeholder Conference discussion of that report, directly addressed the topic of whether there is a current need for regulatory intervention by the OEB in response to emerging North American gas market dynamics.
17. One of the propositions discussed was the advisability of the Board initiating a review of utility integrated gas supply plans.
18. IGUA believes that when future infrastructure and contracting proposals are brought forward for review and approval by Ontario's gas distributors and transmitters, a detailed evaluation of the overall economic impacts of such proposals would be warranted. The information brought forward through this review should assist in such evaluation. IGUA does not believe, however, that time and resources would be well spent at this time evaluating utility integrated gas supply plans per se, without a live proposal for particular consideration within the context of such a plan.
19. The "game changing" developments in the North American gas market have only just begun, and while it is very early to predict impacts with any certainty, what is certain is that the implications of these developments are complex.
20. In IGUA's respectful view, the Board would be well advised to examine these emerging issues incrementally, and in the context of specific applications. This incremental approach would, at this early stage, enable a better understanding of the new market dynamics as they unfold, and the gradual development of responsive policy which will work in the specific context of the applications coming before the Board for consideration.
21. Another possibility for regulatory intervention that arose from the discussions herein was a review of the Board's *Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts* (issued April 23, 2009) (the *Filing Guidelines*). While these guidelines were written little more than a year ago, the new gas supply sources that were then contemplated were LNG and "frontier

production"⁷, and there was no mention of shale gas. Still, review of the guidelines, and the accompanying *Report of the Board*, indicates that the guidelines as they currently stand contemplate that review of utility proposed long-term supply or transportation contracts would include consideration of;

- (a) how the contract fits into the utility's overall transportation and natural gas supply portfolio; and
 - (b) potential impacts of the contract on existing transportation pipeline facilities in the market (in terms of Ontario customers).
22. These aspects of the current *Filing Guidelines* seem sufficiently robust to permit the Board and interested parties to include the types of issues canvassed in this review in future examination of utility long-term contract proposals.
23. IGUA understands Mr. Rosenkranz to have also suggested reconsideration of the some of the principles applicable to rate treatment of utility transmission expansion. In particular, Mr. Rosenkranz suggests that:
- (a) Transmission expansions to serve ex-franchise customers should be approved on the basis that revenues from such ex-franchise services, rather than from in-franchise customers, will cover the expansion costs (i.e. Mr. Rosenkranz recommends against "rolled in tolling" for such transmission expansions).
 - (b) The risk of transmission asset over-building/stranding inherent in a dynamically evolving North American gas market be borne by utility shareholders and not in-franchise ratepayers.
 - (c) The Board should be wary of approving long-term contracts that could lock utility customers into high-cost supply sources.
24. While IGUA agrees in principle with some of what Mr. Rosenkranz suggests, IGUA is also mindful of the complex commercial proposals likely to emerge in the coming years in response to complicated gas market changes. IGUA commends further examination of the principles suggested by Mr. Rosenkranz, and of other relevant principles, within particular, project specific contexts. Given the preliminary stages of the new evolution of North American gas markets, the readily apparent complexity of that evolution, and the

⁷ *Report of the Board: Draft Filing Guidelines for the Pre-Approval of Long-Term Natural Gas Supply and/or Upstream Transportation Contracts*, EB-2008-0280, February 11, 2009.

nascent understanding of that evolution even by experts, an incremental approach would better ensure prudent choices and better avoid unintended consequences for regulated utilities and their ratepayers.

Additional Comments - The TCPL Mainline Issue

25. IGUA would like to formally note two specific concerns with some of the messages that it understands TransCanada to have presented at the Stakeholder Conference on October 7th.
26. IGUA does not agree that diversity of supply is solely, or even primarily, responsible for the emptying of the TransCanada system. TransCanada's mainline problems arose long before shale gas emerged as a "game changing" North American gas supply source.
27. The Alliance Vector pipeline, which has captured a significant amount of volume from TCPL's mainline, responded to a market need for more market-based and commercially responsive services than TCPL was prepared to provide.
28. In today's market context, the TransCanada mainline is clearly overbuilt. The resulting rising and uncertain future tolls continue to push volumes off of the system.
29. The causes of this very difficult (for shippers as well as TCPL) circumstance are perhaps not immediately relevant to this Board, but they are very relevant to solutions for which IGUA believes both TransCanada and the NEB must accept greater responsibility, and in respect of which both TransCanada and the NEB must be more proactive. TCPL must learn from its past and become more market responsive in its mainline services.
30. IGUA also does not agree with the suggestions made by TransCanada related to its slide #6 from the presentation that it provided at the Stakeholder Conference. IGUA understands TransCanada to have suggested, through that slide, that the impact of TCPL mainline transportation toll fluctuations on Ontario customers is muted by the relative stability of gas commodity costs.
31. What this position fails to consider is that while customers in other North American markets experience the same degree of gas cost stability (as a result of a significantly

integrated continental gas supply market), customers in such other markets do not face the same significant transportation cost increases as do those customers physically or contractually captive to the TCPL mainline. The precipitously rising tolls on the TCPL mainline directly affect landed gas supply costs in the Ontario market relative to other North American markets, thus effectively dragging up the landed costs of gas fed to Ontario from other gas supply sources and routes. This upward Ontario landed gas cost pressure affects all Ontario gas consumers. From an industrial gas consumer perspective, the impact could be significant deterioration in competitive position in North America.

Conclusion

32. IGUA commends the Board for having convened this review, which has helped Ontario's natural gas stakeholders to better understand North America's changing gas supply markets.
33. Given the very early stages of the significant changes emerging in these markets, IGUA commends a cautious and incremental approach to regulatory response.

ALL OF WHICH IS RESPECTFULLY SUBMITTED by:



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