3.0 NGEIR ISSUE III – TRANSPORTATION CAPACITY BIDDING PROCESS AND ALLOCATION

Q1. How is this section of TransCanada's evidence organized?

A1. Section 3.1 provides background information on recent Union Gas Limited (Union) open seasons for new firm M12 transportation capacity, including Union's use of rate premiums. Section 3.2 describes TransCanada's concerns about Union's open season process. Section 3.3 addresses TransCanada's concerns with Union's use of rate premiums as a criterion to allocate long-term firm transportation capacity. Lastly, Section 3.4 contains a summary of TransCanada's position on Issue III.

3.1 RECENT UNION OPEN SEASONS

Q2. Please describe Union's use of rate premiums as part of its long-term firm transportation capacity allocation criteria in its recent binding open seasons for Dawn-Parkway capacity.

A2. In late 2004, Union conducted an open season for long-term firm transportation expansion capacity on its system from Dawn to Parkway and Kirkwall. Union invited parties to submit a binding offer for service commencing November 1, 2006. Union held two more open seasons, in February and October 2005, for service commencing November 1, 2007.

In each of these open seasons, Union advised parties that it would evaluate all binding offers using the product of rate and terms, with bids resulting in the highest overall total Value having the highest priority.[1] In particular, Union

[1] For example, see Duke Energy Gas Transmission letter to Customer Contact dated November 17, 2004, regarding Union Gas Limited Long Term Firm Dawn to Parkway /Kirkwall Transportation Offer. Filed with the Board as EB-2005-0201, Section 3, Schedule 2, p.1 of 21.

provided an opportunity to parties to bid a rate for expansion capacity in excess of Union's posted, cost-based M12 service rate.

Q3. Did Union explain in its open season documents why it provided an opportunity for parties to bid a rate premium?

A3. No. Union's open season documents did not provide any reasons for the use of rate premiums, nor did it provide customers with any information on anticipated capacity constraints. The discussion of rate premiums was limited to the following statement:

> Union will evaluate all binding offers using the product of rate (M12 tolls + premium) and term (years) (the "Value"), with bids resulting in the highest overall total Value having the highest priority. If two or more bids have an equivalent Value, and insufficient capacity exists to satisfy all bids with an equivalent Value, the remaining capacity will be prorated.[2]

Q4. Has Union previously used an allocation methodology similar to the one used in its 2006 and 2007 open seasons?

A4. No. To TransCanada's knowledge, the open season for 2006 capacity was the first use of bid premiums by Union for the purpose of allocating long-term, firm transportation capacity. Union indicated in the EB-2005-0201 proceeding regarding its 2006 Trafalgar Facilities Expansion Program that for past expansions on the Dawn-Trafalgar system, the circumstances were such that no bid-evaluation criteria were required.[3]

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[2] *Ibid* and EB-2005-0550, Application, Section 3, Schedule 5.
[3] EB-2005-0201, Tab 1, Union's response to Interrogatory #20 from Board Staff.

Q5. Has the Board addressed the issue of bid premiums in past proceedings?

A5. Yes. In the EB-2005-0201 proceeding, Union relied on a provision contained in the M12 rate schedule since the RP-1999-0017 in support of its position that it is authorized to use rate premiums. This provision, as modified through the RP-2003-0063 Decision, provides that:

> The identified rates represent maximum prices for service. These rates may change periodically. Multi-year prices may also be negotiated which may be higher or lower than the identified rates.[4]

In Decision EB-2005-0201, the Board found:

> In that decision [RP-2003-0063], it turns out, there is no mention of this matter of rate premiums or negotiated rates. The Board obviously did not turn its mind to this matter.[5]

The Board also referred to the EB-2005-0201 Procedural Order in which it stated:

> The evidence filed in support of the application refers to a binding open season process to determine market interest in Trafalgar system capacity. The binding open season process led to a number of contracts between Union and the successful bidders. The Board will consider these contracts when reviewing the need for the proposed expansion. However, services that Union would provide utilizing the proposed facilities, rates and contractual terms for these services and transportation capacity allocation are policy issues beyond the scope of a leave to construct proceeding and as such may be more appropriately dealt by the Board in a generic policy process.[6]

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[4] Union is currently seeking approval to remove the words "or lower" as part of its 2007 Cost of Service Application (EB-2005-0520, Exhibit H1, Tab 1, Pages 24-25).
[5] Ontario Energy Board Decision EB-2005-0201, Volume 2 Transcript, Page 88, Lines 24 to 25.
[6] Ontario Energy Board, Procedural Order EB-2005-0201 dated April 14, 2005.

Subsequently, the Board issued the EB-2005-0551 Notice of Proceeding and confirmed that the NGEIR proceeding would be the forum where it would examine the issues concerning the M12 rate premiums identified in Decision EB-2005-0201.

3.2 ALLOCATION OF LONG TERM FIRM TRANSPORTATION CAPACITY

Q6. Did Union advise potential participants in its 2006 and 2007 open seasons of any limits or constraints to transportation capacity Union was prepared to construct?

A6. No, not to TransCanada's knowledge. Union did not provide any information in the open season documents about constraints to capacity additions. Consequently, TransCanada, and presumably other prospective shippers, was uncertain whether Union might face constraints which could necessitate the allocation of capacity.

Q7. Did Union provide information on how many shippers submitted bids containing rate or term premiums in its 2006 and 2007 open seasons?

A7. Yes. While Union did not identify the customers who bid a rate premium, it did indicate that in the 2006 open season, the premiums that were bid ranged from 0 to 6 ¢/GJ/day (Cdn $),[7] and that four shippers chose to bid premiums over the posted, cost-based M12 transportation rate, which totalled $143,000 per year. In the 2007 open seasons, one customer bid a premium amounting to $6,800 per year.[8]

Table 3.1 summarizes the terms associated with the successful bids received by Union in its 2006 and 2007 open seasons. In the 2006 open season, 17 of 23 customers who were awarded capacity submitted bids that included a term longer

[7] EB-2005-0201, Tab 1, Union's response to Interrogatory #13 from Board Staff.
[8] EB-2005-0551, Prefiled evidence of Union, Tab 5 – M12 Premium, Page 3 of 3.

than ten years. In the 2007 open seasons, nine of 11 customers bid a term longer than ten years.

Table 3.1

2006 and 2007 Open Season – Dawn Trafalgar
Shippers Awarded Capacity[9]

Party	Term (year)	Party	Term (year)
Open Season for 2006 Capacity		**February Open Season for 2007 Capacity**	
Enbridge Gas Distribution	12	Keyspan Energy Delivery Long Island	11
TransAlta Cogeneration LP	10	Southern Connecticut	11
Connecticut Natural Gas Corp	11	Connecticut Natural	11
Southern Connecticut Natural Gas Corp	11	Keyspan Gas East	11
Brooklyn Union Gas Company	11	Keyspan Gas West	11
Keyspan Gas East Corporation	11	Yankee Gas	11
Boston Gas Company	11	Enbridge Gas Distribution	12
Colonial Gas Company	11	Gaz Metro LP	20
Essex Gas Company	11		
EnergyNorth Natural Gas	11		
Bay State Gas Company	11		
Northern Utilities Inc	11		
Yankee Gas Services Co	11		
Central Hudson Gas & Electric	11		
National Fuel Gas Distribution	11		
Energy Source Canada Inc.	10	**October Open Season for 2007 Capacity**	
Energy Source Canada Inc.	15	GTAA	11
UBS Energy Canada Inc.	10	Vermont Gas System	10
Stelco Inc.	12	Sithe Goreway	10
TransCanada PipeLines Limited*	10		
BP Canada Energy Company	16		
City of Kitchener	10		
Gaz Metro	10		

* Capacity awarded to TransCanada represents the substitution of one contract for delivery at the inlet side of the Parkway compression plant by an equal amount contract for delivery at the outlet side of the Parkway compression plant.

Q8. Was Union required to allocate capacity in its 2006 and 2007 open seasons?

A8. No. Union indicated that all shippers that met the minimum bid requirements (ten year term and posted M12 rates) were ultimately awarded capacity in both the

[9] Compiled from EB-2005-0201, Tab 1, Union's response to Interrogatory #20 from Board Staff, and EB-2005-0550 Application, Section 3, Schedule 2.

2006 and 2007 open seasons.[10] There was no need to allocate capacity since all the requests for service were accommodated by Union. The magnitude of the premiums, in both terms and rates, clearly indicates that customers bid well in excess of the normal requirements to underpin an expansion by Union.

Q9. Is it common for North American gas transportation pipelines to allocate capacity during an open season for expansion capacity?

A9. No. Generally, there is no need for a gas pipeline to allocate new long term firm transportation capacity. A pipeline will normally build sufficient capacity to meet all service requests made by shippers meeting the minimum requirements to underpin expansion capacity (typically the cost-based rate for a minimum term). In unusual circumstances, it may be impractical or uneconomic to build sufficient capacity to meet all service requests for a specified in-service date. In circumstances where allocation of long term firm transportation capacity may be needed, pipelines generally have well-established, published procedures that ensure transparency and fair access by all prospective customers.

Q10. Does Union have a published allocation procedure that has been approved by the Board?

A10. No. Unlike most Canadian pipelines, Union does not have a Board-approved, published procedure to enable existing and prospective customers to understand with certainty how Union will allocate capacity in open seasons.[11]

Q11. What are the key features of an effective allocation procedure for long term firm gas transportation capacity?

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[10] *Ibid.*
[11] EB-2005-0520, Exhibit J27.17

A11. First and foremost, an allocation procedure should ensure that any capacity constraints are clearly identified in the open season documents. By clearly identifying how much capacity can be provided by a certain in-service date and in subsequent years, all market participants can make an informed decision as to whether or not to take part in an open season and determine what their bid should be. If capacity is constrained, some customers may opt to wait a year when the constraint may no longer be present, rather than bid above the minimum term required. In contrast, other customers who require the capacity may choose to bid a longer term.

In contrast, the absence of a clear allocation procedure, or the use of procedures where such information is not disclosed, creates uncertainty as to whether capacity is likely to be constrained. Such disclosure is particularly important in situations where the pipeline has the potential ability to exercise market power. In the absence of disclosure, it becomes possible for the pipeline to take advantage of its position by creating or permitting a perception of scarcity of capacity when no capacity constraints exist.

Second, a gas pipeline's allocation procedure for long term firm transportation capacity should be approved by the regulator, published, and used consistently in all open seasons. A procedure with these characteristics ensures the regulated pipeline does not have an ability to exercise market power.

Q12. Do most major Canadian gas transportation pipelines have established procedures to allocate long-term firm transportation capacity?

A12. Yes. TransCanada has reviewed the tariffs of several major Canadian gas transportation pipelines and all have an allocation or access procedure that is part of their tariff and subject to approval by the applicable regulator.[12] The criteria used to allocate capacity vary slightly between the pipelines, based on their unique circumstances, but typically, the term of the contract is the main allocation criterion. None of these pipelines includes rate premiums as a criterion to allocate long-term firm capacity.

The existence of an allocation procedure that is approved by the regulator and published as part of a pipeline's tariff ensures fair, transparent and non-discriminatory access to the services offered by the pipeline. Union's provision of service would be enhanced through the adoption of an allocation procedure approved by the Board and incorporated as part of Union's Tariff.

Q13. Please describe key features of the Mainline allocation procedure.

A13. As an example of how other pipelines typically allocate expansion capacity, TransCanada has included in Appendix IB to its evidence on Issue I, a copy of the Mainline's Transportation Access Procedure (TAP) highlighting amendments to the TAP required to implement TransCanada's proposed FT-SN and SNB services. The TAP is part of the Mainline's Tariff. Section 4 of the TAP governs access to new system capacity, with sub-section 4.1 clearly codifying the Mainline's new capacity open season process, and sub-section 4.3 the allocation of capacity. Of particular relevance, Article 4.3(a) defines how TransCanada will allocate new capacity in the event of capacity constraints. The main allocation criterion is the product of the NEB-approved demand toll in effect for the service and by the contract term. Priority is also given to requests with earlier requested commencement dates. Article 4.1(a)(vi) requires that TransCanada identify any system segments where the total capacity that may be made available could be

[12] Tariffs considered were those of Alliance Pipeline Limited Partnership, ATCO Pipelines, Maritimes & Northeast Pipeline Limited Partnership, Westcoast Energy Inc, as well as TransCanada's four wholly-owned Canadian pipelines (the Canadian Mainline, the Alberta System, the B.C. System and the Foothills System).

limited and the time such capacity could become available. Also of interest, Article 4.3(c) allows shippers to specify a minimum level of acceptable capacity, thus providing an effective means of addressing a prospective shipper's concerns regarding pro-rating, without relying on rate premiums.

3.3 RATE PREMIUMS

Q14. Is Union's use of rate premiums to allocate long-term firm M12 capacity appropriate?

A14. No. TransCanada retained Dr. J. Stephen Gaske, President of Zinder Companies Inc., to provide expert testimony on this issue. Dr. Gaske's written evidence is provided in Appendix III-A.

Dr. Gaske concludes that the bid premium mechanism used by Union resembles the type of pricing associated with an unregulated exercise of market power. Dr. Gaske also concludes that the long-term price discrimination that can result from Union's bid premium approach may provide incentives to maintain capacity shortages and may encourage inefficient decisions in those competitive markets that are affected by the long-term bid premium mechanism.

Q15. Are there circumstances where the use of bidding or auction mechanisms to allocate gas transportation capacity is appropriate?

A15. Yes. TransCanada's concerns with respect to rate premiums pertain to the allocation of long-term, firm transportation capacity. As Dr. Gaske notes in his evidence, in the short run, when the amount of capacity cannot be readily changed, it is generally efficient to use an auction or other pricing mechanism to allocate access to a fixed amount of capacity. In certain circumstances, it may be appropriate to allow customers to bid rates in excess of the cost-based rates to allocate short-term capacity or sell certain discretionary services. Indeed, a number of the Mainline's short-term, discretionary services, such as Interruptible Transportation and Short-Term Firm Transportation services, are offered through NEB-approved bidding mechanisms.

Q16. Could Union's continued use of rate premiums to allocate long-term firm transportation capacity possibly have negative impacts on the Ontario market?

A16. Yes. Should a party pay a premium for services provided by Union, such a premium could lead to higher costs to that party's customers. For example, if an Ontario gas-fired power generator pays a premium for transportation services offered by Union, it may pass these costs on through higher electricity prices, thus negatively impacting its customers.

TransCanada acknowledges that the cumulative value of the rate premiums paid to date have not been substantial relative to Union's overall revenue requirement. However, some premiums have been significant on an individual basis. The Board recognized, in Decision EB-2005-0201 in respect of Union's 2006 Facilities Application, that in some cases the premiums were substantial.[13] In one instance, the premium represented 78 percent increase over the cost-based M12 rate.[14] Continuation of Union's bid premium practice could lead to significant unnecessary costs ultimately being borne by Ontario consumers.

[13] Ontario Energy Board Decision EB-2005-0201, Volume 2 Transcript, p. 87, Line 9.
[14] Ontario Energy Board EB-2005-0201, Volume 1 Transcript, p.82, Lines 6 through 9.

Q17. Has Union's use of rate premiums had any impact on TransCanada?

A17. Yes. Union's use of rate premiums in its recent open seasons created uncertainty that contributed to TransCanada's reluctance to take part in the open seasons. TransCanada was unsure of the size of the rate or term premium that might be required to provide it with some certainty that it would be successful in acquiring M12 capacity. This uncertainty, combined with other concerns related to the terms of M12 service, contributed to TransCanada informing prospective shippers on its Mainline system that there may be some risk in its ability to acquire M12 capacity that may be required to provided incremental seamless service from Dawn.

Q18. Are there any other factors which contribute to TransCanada's concerns with Union's use of rate premiums?

A18. Yes. TransCanada's concerns with the use of rate premiums are elevated by the lack of consistency and transparency in the terms and conditions governing Union's provision of transportation services. For example, some, but not all M12 customers have been entitled to westerly flow rights in the past, and one customer continues to have such an entitlement.[15] At the same time, other customers are required to pay for westerly flow service provided through Union's C1 rate schedule. Customers have no ability to determine the terms and conditions that may exist in other customers' contracts, since Union has refused to disclose its contracts on the basis that the terms are confidential.[16] No stakeholders besides Union and the applicable shipper, has access to complete information on the nature of the negotiated terms and conditions. Therefore, no stakeholder can assess with certainty whether the negotiated terms represent valuable additional rights.

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[15] EB-2005-0520, Exhibit J27.26.
[16] EB-2005-0201, Union's response to Interrogatory #5 from TransCanada PipeLines Limited.

In the case of M12 service, where the service is not uniform between shippers, the use of rate premiums means that a prospective shipper seeking “basic” M12 service may be disadvantaged over another shipper which is seeking M12 service with the addition of valuable negotiated terms. It is possible that a prospective shipper may have been willing to bid a rate premium, not because it values basic M12 service more than another prospective shipper, but because of the value of the additional terms and conditions negotiated by that prospective shipper. This issue not only highlights the need for greater consistency and transparency in the provision of service by Union, but also makes the use of rate premiums to allocate long-term firm transportation capacity even more inappropriate.

3.4 SUMMARY OF TRANSCANADA’S EVIDENCE ON ISSUE III

Q19. Please summarize TransCanada’s evidence on Issue III.

A19. Union should develop a clear and consistent allocation procedure, which is approved by the Board, published and incorporated in Union’s Tariff. That procedure should include a requirement for Union to identify, as part of its open season documents, any constraints to capacity additions that are anticipated.

Union’s use of bid premiums for allocating long-term, firm transportation capacity is inappropriate. This practice represents a potential exercise of market power and is unjustly discriminatory.

Accordingly, for the reasons stated in its evidence, TransCanada requests that the Board direct Union to:

1. Develop an allocation procedure which defines the criteria by which Union will allocate long term firm transportation capacity, in the event it is unable to meet all service requests. This allocation procedure should be approved by the Board, published by Union, applied consistently in all open seasons, and be put in place prior to Union’s next open season;

2. Include in its allocation procedure or otherwise, a requirement that Union identify in its open season documents any anticipated capacity constraints; and

3. Cease using bid premiums as a criterion to allocate long-term firm transportation capacity.

Q20. Does this conclude TransCanada's written evidence on Issue III?

A20. Yes.