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**Financial Post - Gas distributors sour over TransCanada's mainline conversion plan**

Jeff Lewis | 13/07/18 | Last Updated: 13/07/18 3:34 PM ET
More from Jeff Lewis | @JeffALewis

CALGARY – Canada's largest distributors of natural gas are digging their heels in against TransCanada Corp.'s plan to send Alberta crude to the East Coast, warning the scheme could result in higher costs for their customers in Ontario and Quebec.

The first drop of oil won't flow through Energy East for years, but a group led by Spectra Energy-owned Union Gas Ltd., Gaz Métro and Enbridge Gas Distribution Inc. is accusing TransCanada, Canada's No. 2 pipeline company, of abusing its market power as it begins to lay the groundwork for converting parts of its mainline natural gas system to carry oil.

TransCanada, which has yet to formally apply for the switch, is moving fast to rejig the way gas customers use the pipeline after seeking commercial support from oil companies and refineries interested in shipping crude on the 14,000-kilometre system.

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But distributors in Ontario and Quebec are balking at elements of the plan, which they say would remove critical pieces of short-haul infrastructure from gas service and force them to subscribe for new service at higher rates. The resulting costs — up to $138-million per year, by one estimate — would flow through to consumers, the distributors said in regulatory filings.

"What's going to happen if [TransCanada] succeeds the way it's going right now is the gas industries in Quebec will suffer, and we cannot let that happen," Patrick Cabana, vice-president, gas supply, procurement and regulatory affairs with Montreal-based Gaz Métro, said in an interview.

The dispute cuts to the heart of TransCanada's ongoing efforts to revitalize its ailing mainline, which has been undercut by large deposits of shale gas located closer to eastern markets.

Sending crude to Canada's East Coast, where it can be refined or exported, has become critical to those efforts. But the company now faces the prospect of a lengthy regulatory feud with gas distributors, who argue Energy East must not come at the expense of gas markets in Central and Eastern Canada.

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Gaz Métro, for example, estimates the project's 850,000 barrels a day of proposed crude shipments would require 40% of mainline capacity currently used to fuel homes and businesses in Ontario and Quebec during the coldest months of the winter heating season, when gas demand typically surges.

"That's not insignificant. That's huge," Mr. Cabana said. TransCanada needs to demonstrate how it would replace that lost capacity, and at what cost, he said. "Otherwise, we're facing a nightmare in our market."

TransCanada says those concerns are unfounded. The company also points out that it's abiding by a National Energy Board ruling this year that instructed the pipeline and power giant to find better uses for the mainline that allow it to more fully recover its costs.

In recent years, shippers have moved away from paying to reserve space on the pipeline under firm, long-term contracts in favour of booking short-haul capacity on an as-needed, or interruptible, basis – meaning they only pay for space when they actually use it.

TransCanada says the shift does not fully reflect the cost of providing the service, which is fixed. In changes announced last month, it asked would-be shippers to pay higher fees over a longer period under firm contracts in order to justify capacity additions in the Ontario and Quebec markets.

“At the end of the day this infrastructure has to recover its costs otherwise it’s not a sustainable business model,” said Stephen Clark, TransCanada’s senior vice-president, Canadian and Eastern U.S. gas pipelines.

In an interview, he disputed Gaz Métro’s assertion that the oil conversion would use 40% of existing mainline capacity. “We have existing capacity to meet virtually all of our firm customer requirements as they are today,” he said, adding: “And remember this was just a year ago that everyone was saying, ‘No we don’t want to use the system any longer, we want TransCanada to bear the cost of under-utilized pipe.’”

Energy East, he said, would cut at least $1-billion from the mainline’s overall rate base of roughly $5-billion, “so the shippers will see the benefit of that cost being removed.”

The project could well spark a second round of regulatory hearings over the mainline’s future. TransCanada, in documents before the NEB, insists Energy East is beyond the scope of its proposed rate changes. Gas distributors say the two are inseparable.

“TransCanada is looking for ways to better monetize its pipeline system and at least give itself an opportunity to recover a return on investment,” said Murray Newton, president of Enreg Group Inc. who has previously consulted in regulatory cases for the Industrial Gas Users Association.

“The concern is by doing so are they harming the captive folks at the other end of the pipeline who really don’t have a whole lot of choice?”