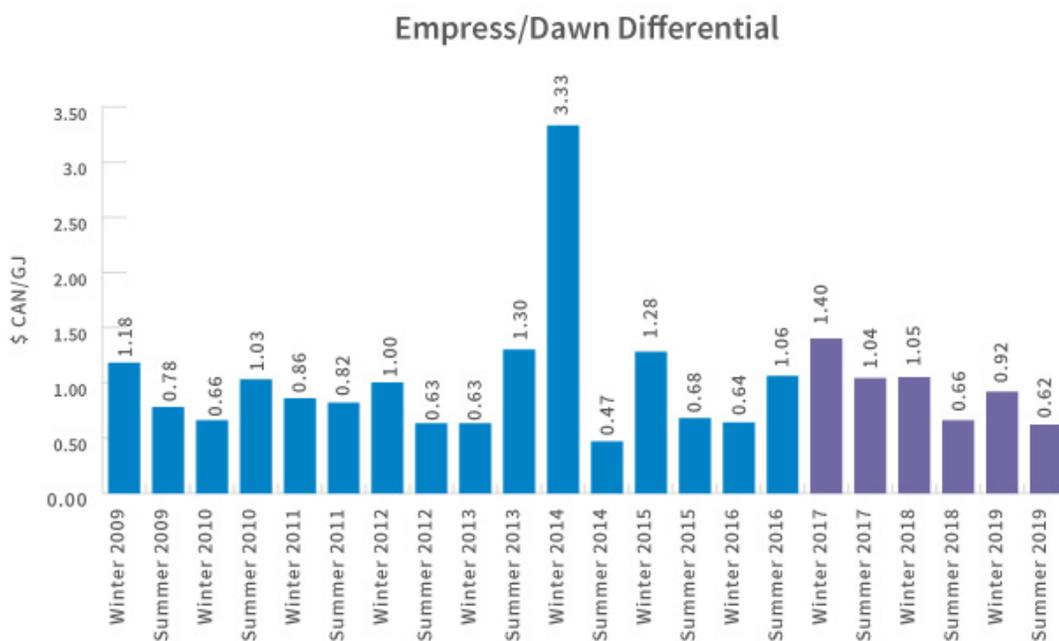


# Taking Stock of the Widening Price Differential Between Dawn and Empress

The price of natural gas in Western Canada has been rising since the spring, but at a lower pace than anywhere else on the continent and, in particular, at Dawn. The price differential between Empress and Dawn is widening, which has changed – at least temporarily – the cost savings associated with moving the Gaz Métro supply structure from Empress to Dawn.

The following graph shows seasonal changes in the price differential between Empress and Dawn. Historical prices (blue bars) correspond to the average daily spot prices. Prices for future periods (purple bars) correspond to the financial market price as at September 8, 2016.

The average historical differential between Empress and Dawn is approximately \$0.85/GJ<sup>1</sup>, which is below the Empress-to-Dawn transportation rate. For winter 2016-2017, the differential has been established at \$1.40/GJ while for the year 2016-2017, it was at \$1.20/GJ.



These observations may raise some questions, including:

- What factors could account for a possible increase to the price differential between Dawn and Empress next winter?
- Is this situation cyclical (short-term) or structural (long-term)?
- Is the move to Dawn still cost-effective?
- In the case of Gaz Métro, what could account for the apparent difference between the service rates offered and the posted market rates?
- Why do some customers feel that their bills have not gone down despite the reduction to supply structure costs?

### A. What factors could account for a possible increase to the price differential between Dawn and Empress next winter, even though the forecasts suggest that prices at Dawn will remain favourable?

Among others and to varying degrees, this can be explained by:

- The significant surplus of natural gas accumulated in the West, due to:
  - Temperatures last winter that were far milder than normal, which exerted downward pressure on prices<sup>2</sup>; and
  - The temporary oil production decline in Alberta, a major consumer of natural gas, due in particular to the Fort McMurray wildfire<sup>3</sup> a few months ago; and
- The increase in relative prices at Dawn for the coming winter is likely caused by uncertainties about the market's reaction to moving Eastern Canada's main distributors to Dawn.

### B. Is this situation cyclical (short-term) or structural (long-term)?

Since the financial market indicates that low relative prices in Western Canada are expected to continue into next year, gradually subsiding thereafter, the situation appears to be short-term.

- Indeed, the gas surplus should progressively diminish with the return of winter and the expected dip in production in Western Canada (*from 15.1 Bcf/j in 2015 to 14.5 Bcf/j in 2018 according to the NEB*); and
- As for the natural gas price at Dawn, the financial market also foresees a drop in prices in that regard. The potential commissioning of pipeline projects or a new TCPL Empress-to-Dawn transportation service will enhance the capacity to supply Dawn with gas, which in turn will boost natural gas price competition and liquidity in Eastern Canada.

### C. Is the move to Dawn still cost-effective?

Based on transportation prices in the primary market, the market prices for the 2017 gas year (November 2016 to October 2017) as at September 8 reconfirm that supplies from Dawn will be cheaper than supplies from Empress.

We should also specify that one of the main advantages to moving supply to Dawn is that this point remains linked to Empress. Accordingly, natural gas produced in the West is redirected in part to Dawn. Gaz Métro and its customers therefore benefit from the market opportunities that arise from the two trading hubs and are implicitly reflected in the commodity price at Dawn.

	Supply	Transportation	Compression	Total
<b>Empress</b>	\$2.80	\$2.19	\$0.12	\$5.11
<b>Dawn</b>	\$4.00	\$0.77	\$0.05	\$4.82
<b>Economic benefit</b>	\$1.20	-\$1.42	-\$0.07	-\$0.29

#### D. In the case of Gaz Métro, what could account for the apparent difference between the service rates offered and the posted market rates?

The transportation rate billed by Gaz Métro to its customers is based on the proportion of purchases made from Empress and Dawn. It takes into account all Gaz Métro transportation contracts on the primary and secondary markets (*average contract price = \$0.99/GJ for 2016-2017*). Over the years, the more short-haul contracts from Dawn there are in Gaz Métro's portfolio, the more the average rate will resemble the short-haul rate posted on the market.

Also note that GM's rate in a given year includes an adjustment corresponding to the difference between revenue collected from customers and tool acquisition costs from the previous year (overpayment or shortfall). This has no effect on the calculation of savings related to the adoption of a specific supply strategy at a given point, since it remains invariable under all scenarios in a given year.

The planned adjustment to the 2016-2017 rates is equivalent to an increase of \$0.20/GJ (versus a reduction of \$0.03/GJ the previous year).

	2016/2017 (\$/GJ)
Price before shortfall/overpayment	0.99
Shortfall (overpayment)	0.20
Transportation price	1.19 <sup>4</sup>

#### E. Why do some customers feel that their bills have not gone down despite the reduction to supply structure costs?

Customers may be tempted to compare their bills to last year's. This comparison, however, is unsuitable for concluding the advantages or disadvantages of the move to Dawn, since the annual variation in the total bill hinges on a number of other variables unassociated with the move.

For example, you cannot add last year's transportation costs to this year's commodity price at Empress, then compare this cost to the transportation rate this year and add the commodity price at Dawn. This calculation fails in particular to take into account the fact that last year's supply structure would not be the same as this year's, even if the structure had remained at Empress. Nor does it take into account this year's shortfall to recover, which also differs from last year's.

For a true comparison, you need to take this year's supply structure and estimate the costs if it were still at Empress rather than Dawn. This is exactly what was done to put the savings brought about by the move at \$51 M for 2016-2017. What these savings mean is, had the structure stayed at Empress, the "transportation + commodity" cost would have been higher than moving the structure to Dawn.

1 This average was calculated over the period from November 2008 to today, leaving out the period of high volatility from January to March 2014.

2 As at August 12, 2016, storage sites in the West were more than 95% full, with 11 weeks of injection still to go before winter. For the past several weeks now, stocks have even exceeded the levels typically reached at the end of the injection season (end of October).

3 While the flames had caused negligible damage to oil sands operations, the evacuation of the entire population of Fort McMurray, a northern Alberta oil town, has substantially delayed the revival of oil production.

4 The price of \$1.19 is what Gaz Métro presented to the Régie. We are presently awaiting confirmation of this transportation price given the Régie's forthcoming ruling on the 2017 rate application.