TransCanada Corporation Is Hoping to Solve This Huge Problem

Description

Natural gas producers in western Canada have a big problem. It costs too much money to ship gas across the country, which puts them at a disadvantage to U.S. shale producers in the Marcellus and Utica shale plays. It is a problem that **TransCanada Corporation** (TSX:TRP)(NYSE:TRP) wants to fix, which is why it is currently offering producers a 42% discount on capacity fees if they will sign up for long-term contracts. That discount could be just what producers need.

Drilling into the problem

Pengrowth Energy Corp. (TSX:PGF)(NYSE:PGH) CEO Derek Evans detailed his frustrations on what's holding back the Montney on the company's second-quarter conference call:

> Don't get me started on how much I love the Montney and why I think it's the best gas play in North America. And truly I think it is a much stronger and better asset than what the Marcellus did. The challenge with the Montney is not so much the reservoir rock or productivity, but really talks to the transportation disadvantage that we have inside North America.

In Evans's view, the Montney is a world-class gas play. However, high transportation costs are holding back its potential because producers in places like the Marcellus and Utica don't have to pay as much to get gas to markets in eastern Canada because it is a shorter distance. Moreover, new pipelines in the U.S. could push even more gas into Canada, which would put Montney and Duvernay producers at a further disadvantage.

TransCanada to the rescue?

To combat this problem and to keep its mainline pipeline from becoming irrelevant, TransCanada is offering producers a significant discount. However, there are several conditions. First, shippers must sign up for a 10-year contract, and in aggregate they must commit to shipping at least 1.9 billion cubic feet per day of natural gas. That is longer term and higher volume than most shippers are used to. However, TransCanada needs those commitments to make up on volume what it is losing in price.

Major producers, such as **Canadian Natural Resources Limited** and **Encana Corporation**, are currently mulling over TransCanada's offer, which is a reduction from what it was initially offering. It is doing so after customers like Canadian Natural Resources said they weren't sure if the initial tolls were low enough to make western Canadian production competitive.

It is unclear if TransCanada's latest offer will entice enough producers to commit to the volumes it needs. That said, they don't have too many other options given that none of the proposed West Coast LNG facilities have yet to be approved.

Meanwhile, the U.S. has more gas than it needs, which is why it is exporting it to Canada, Mexico, and via its LNG export facilities. As a result, the only options for producers are to sign up for TransCanada's capacity or leave the gas in the ground until Canada finally moves forward with its LNG export facilities.

Investor takeaway

Western natural gas producers have long complained that they can't compete with rivals in the U.S. because they are paying too much to ship gas to the east. TransCanada is offering to fix that problem by offering them the opportunity to lock up capacity on its mainline pipeline at a huge discount.

While that will cut into its cash flow a bit in the short term, it will also ensure that its pipeline remains in use over the long term by preventing too much gas from the U.S. heading north.

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