OGILVY RENAULT

Direct Dial: (416) 216-2311
Direct Fax: (416) 216-3930
rking@ogilvyrenault.com

SENT BY E-FILING AND COURIER

February 20, 2009

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, Suite 2700
Toronto, ON M4P 1E4

Dear Ms. Walli:

RE: Natural Resource Gas Limited (EB-2008-0413)
Argument-in-Chief

Please find enclosed Natural Resource Gas Limited's Argument-in-Chief ("AIG") in the above-referenced matter. The AIG is also being filed on the Board's RESS system, and served on all parties to the proceeding.

Please do not hesitate to contact me should you have any questions or concerns.

Yours very truly,

Richard King

/mnm
Encl.

c.c. Mr. Mark Bristoll, President, NRG
Mr. Philip Tunley, Stockwoods LLP
Ms. Heather Adams, Town of Aylmer
Mr. Patrick McMahon, Union Gas Limited
Mr. Scott Stoll, Aird & Berlis
Mr. Jim Grey, IGPC
Ms. Suzanna Mantel, Municipality of Bayham
Mr. Larry Thacker, Lenczner Slaght

EB-2008-0413

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Municipal Franchise Act*, R.S.O. 1980, Chapter 309, as amended;

AND IN THE MATTER OF the renewal of a franchise agreement between Natural Resource Gas Limited and the Corporation of the Town of Aylmer

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NATURAL RESOURCE GAS LIMITED
ARGUMENT-IN-CHIEF
February 20, 2008

Ogilvy Renault LLP
200 Bay Street, Suite 3800
Royal Bank Plaza, South Tower
Toronto, Ontario M5J 2Z4
Attention: Richard J. King
(416) 216-2311
(416) 216-3930
rking@ogilvyrenault.com

Lenczner Slaght Royce Smith Griffin LLP
130 Adelaide Street West
Suite 2600
Toronto, Ontario M5H 3P5
Attention: Larry Thacker
(416) 865-3097
(647) 297-6446
lthacker@litigate.com

A. LEGAL TEST FOR FRANCHISE RENEWAL AND ESTABLISHMENT OF FRANCHISE TERMS AND CONDITIONS

1. Section 10 of the *Municipal Franchises Act* (the "MFAct") governs situations in which a municipality and gas utility cannot reach agreement on the renewal of a franchise agreement.

> 10.(1) Where the term of a right referred to in clause 6(1)(a), (b) or (c) that is related to gas or of a right to operate works for the distribution of gas has expired or will expire within one year, **either the municipality or the party having the right** may apply to the Ontario Energy Board for an **order for a renewal** of or an extension of the term of the right.
>
> (2) The Ontario Energy Board has and may exercise jurisdiction and power necessary for the purposes of this section and, if **public convenience and necessity** appear to require it, may make an order **renewing or extending the term** of the right for such period of time and **upon such terms and conditions as may be prescribed by the Board**, or if public convenience and necessity do not appear to require a renewal or extension of the term of the right, may make an order refusing a renewal or extension of the right.

2. The Board has sole jurisdiction when it comes to determining: (a) whether or not to grant a franchise renewal; and (b) if a renewal is granted, the terms and conditions that it may establish in a franchise agreement.

> *Re City of Peterborough and Consumers Gas* (1980), 111 D.L.R. (3d) 234 (Div. Ct.).

3. At issue in the current proceeding is **not** whether or not to renew the franchise agreement between the Town of Aylmer ("Aylmer" or the "Town") and Natural Resource Gas Limited ("NRG"). Rather, the issue is the **term** of the franchise agreement, and to a lesser extent, the imposition of certain **conditions** requested by Aylmer in the renewed franchise agreement.

4. What is not at issue in this proceeding is: (a) the form of the renewed franchise agreement (both NRG and Aylmer are satisfied with the form of the Board's Model Franchise

Agreement); and (b) certain of the conditions sought by Aylmer which NRG has agreed to include in the renewed franchise agreement.

5. Thus, the only four issues outstanding, and for determination by this Board are:

(a) Term: Whether to renew the franchise agreement for a term of 20 years (as requested by NRG) or three years (as requested by Aylmer), or another term as determined by the Board.

(b) Rate Application Filing: Whether to require NRG to file a comprehensive rate application by December 31, 2009 (as requested by NRG) or "immediately upon the execution of [a renewed franchise agreement]" (as requested by Aylmer), or by some other date determined by the Board.

(c) Security Deposit Trust Fund: Whether to require NRG to keep all monies from consumer security deposits in a trust fund and not use such monies as working capital (as requested by Aylmer) or reject this condition (as requested by NRG).

(d) Provide Notice to Aylmer: Whether to require NRG to give notice to Aylmer of "any proceeding before the OEB that [NRG] is a party to" (as requested by Aylmer) or reject this condition (as requested by NRG).

6. In coming to a determination on the above four issues, the legal test set out in the MFAct is whether "the public convenience and necessity appear to require it." In other words:

- Does the public convenience and necessity require a shorter than normal term for the renewed franchise agreement?

- Does the public convenience and necessity require that it be a condition of the renewed franchise agreement that NRG file a rate application before the end of 2009?

- Does the public convenience and necessity require that it be a condition of the renewed franchise agreement that NRG's security deposit monies be held in a separate trust fund, and not be used as working capital?

- Does the public convenience and necessity require that it be a condition of the renewed franchise agreement that NRG provide notice to Aylmer of any OEB proceeding that NRG is a party to?

7. Before addressing each of these four questions further, it is necessary to examine the "public convenience and necessity" test as set out in the MFAct.

B. LEGAL PRINCIPLES TO GUIDE THE INTERPRETATION OF "PUBLIC CONVENIENCE AND NECESSITY"

8. The MFAct does not offer any guidance as to the interpretation of, or criteria to guide the interpretation of, the "public convenience and necessity". As a result, the matter is left entirely to the Board's discretion.

9. However, the decision of the Supreme Court of Canada in *Baker v. Minister of Citizenship and Immigration* and that Court's earlier decision in *Re Athabasca Tribal Council* makes it clear that two key legal principles govern the exercise of administrative discretion such as the one entrusted to the Board in this case: (a) the exercise of a tribunal's discretion should be made **within the context of its governing statutes**; and (b) the exercise of a tribunal's discretion **should be consistent and governed by the purposes and interests which the statutes seek to protect.**

> *Baker v. Minister of Citizenship and Immigration* (1999), 174 D.L.R. (4th) 193, at pp. 224, 226, 229-230, and 232
>
> *Re Athabasca Tribal Council and Amoco Canada* (1981), 124 D.L.R. (3d) 1 (S.C.C.)

10. A contextual approach to the MFAct and the *Ontario Energy Board Act, 1998* ("OEB Act") requires that the Board take into account the following factors when exercising its discretion to determine whether the public convenience and necessity requires a franchise renewal:

(a) the purpose of section 10 of the MFAct;

(b) the objectives of the Board vis-à-vis the gas industry in Ontario, as set out in section 2 of the OEB Act;

(c) previous OEB decisions under section 10 of the MFAct; and

(d) previous judicial decisions regarding section 10 of the MFAct.

(a) The Purpose of Section 10 of the *Municipal Franchises Act*

11. Section 10 was added to the MFAct in 1969. Prior to that time a municipality had a common law right to terminate a franchise upon the expiry of the franchise agreement. The provision was introduced in the legislature by The Honourable Darcy McKeough, Minister of Municipal Affairs. In answer to opposition questions regarding the provision, The Honourable Mr. McKeough indicated that section 10 was specifically intended to allow the Board to implement a renewal of a franchise where there is no agreement between the municipality and the utility, and that the Board would have authority over the terms of the franchise being renewed.

Hansard, November 26, 1969, at p. 8936

12. Thus, the purposes of section 10 of the MFAct are to:

(a) provide a mechanism for the resolution of a franchise dispute when the relationship between the municipality and the utility has broken down and the parties cannot agree on a franchise renewal;

(b) ensure that the municipality's wishes are not paramount or determinative of when a franchise should be renewed; and,

(c) ensure that franchise renewal determinations are made in the broad public interest.

13. These purposes have been acknowledged and accepted by the Board and Courts in franchise renewal matters.

> *Kingston/Pittsburgh*, OEB Decision with Reasons, E.B.A. 825 (2000), paras. 4.0.2 to 4.0.5 (inclusive).
>
> *Union Gas* v. *Township of Dawn* (1977), 76 D.L.R. 613 at pp.621-622.

14. The importance of section 10's incorporation into the MFAct cannot be overlooked. The establishment of section 10 meant that franchise renewal and franchise terms and conditions were no longer to be decided based on the whims and wishes of an individual municipality, or the status of the municipality-utility relationship at any given point in time.

15. Instead, the Ontario Legislature recognized that the Board should determine contested franchise issues based on a public interest test (i.e. the public convenience and necessity), grounded in the Board's statutory objectives.

(b) <u>The Objectives of the Ontario Energy Board</u>

16. Section 2 of the OEB Act sets out the objectives that are to guide the Board in carrying out its responsibilities in relation to gas. The objectives of relevance to this proceeding include:

(a) protecting the interests of consumers with respect to prices and the reliability and quality of gas service (section 2(2), OEB Act);

(b) facilitating the rational expansion of transmission and distribution systems (section 2(3), OEB Act); and

(c) facilitating the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas (section 2(5), OEB Act).

17. These objectives are aimed at protecting the interests of both gas utilities and gas consumers in respect of the distribution and transmission of natural gas in Ontario.

(c) Previous Board Decisions under Section 10 of the *Municipal Franchises Act*

18. Contested franchise applications are not common. Of the two most recent, notable franchise renewal proceedings before the Board (i.e,. Sudbury and Kingston/Pittsburgh), the most on-point is the Board's Decision and Order in the Kingston/Pittsburgh case (E.B.A. 825).

19. The Kingston/Pittsburgh case set out the following basic criteria to guide Board decision-making on franchise renewal applications:

(a) the Board has sole jurisdiction when it comes to determining "public convenience and necessity" under section 10 of the MFAct;

(b) the Board is to be guided by the objectives of the OEB Act relating to the rational development of the supply, distribution and transmission of natural gas, including the maintenance of just and reasonable rates for the transmission, distribution and storage of gas and the facilitation of rational expansion of natural gas transmission and distribution systems;

(c) "public convenience and necessity" is broader than local, parochial interests and the Board is required to consider matters affecting provincial gas distribution as a whole and not just local interests;

(d) the Board must balance the specific interests of all stakeholders, including ratepayers, the municipality and the utility shareholder, against the broader public interest; and

(e) while the views of the municipality should be taken into account by the Board, they are not determinative of the issue of determining where public convenience and necessity lie (E.B.A. 825, Decision with Reasons, sections 4.0.2 to 4.0.5).

20. Thus, in its most recent comprehensive examination of a contested franchise renewal (and the "public convenience and necessity" test), the Board recognized that the views of the municipality are but one of a host of considerations that the Board must weigh, all against the backdrop of broader public interests in the energy sector.

(d) Previous Court Decisions under Section 10 of the *Municipal Franchises Act*

21. Court decisions under section 10 of the MFAct have focused primarily on the scope of the Board's jurisdiction.

22. The Divisional Court has held that the Board has the jurisdiction to impose the terms of the franchise in situations where the municipality and the utility cannot agree on the terms.

> *Re City of Peterborough and Consumers Gas* (1980), 111 D.L.R. (3d) 234 (Div. Ct.)

23. The Board's jurisdiction to impose the terms of a franchise arrangement contrary to a municipality's wishes demonstrates that just because a municipality wants a particular outcome does not mean that it is in the pubic interest.

> Ontario Energy Board, Decisions in EBA 304 at pp. 10 and 28; and EBA 767,768, 769, 783 at pp. 15-16.

(e) Summary: The Public Interest

24. The "public convenience and necessity" test in section 10 of the MFAct is a public interest test, requiring the Board to balance the interests of all stakeholders in furtherance of the Board's statutory objectives.

25. In the *Township of Dawn* case, the Divisional Court held that the "public interest" is broader than the local, parochial interest:

> I have stressed these points to illustrate firstly how insignificant are the local problems of the Township of Dawn when viewed in the perspective of the need for energy to be supplied to those millions of residents of Ontario beyond the township borders, and to call to mind the potential not only for chaos but the total frustration of any plan to serve this need if by reason of powers vested in each and every municipality by the *Planning Act*, each municipality were able to enact by-laws controlling gas transmission lines to suit what might be conceived to be local wishes... (at p. 619)

> These are all matters that are to be considered in light of the general public interest and not local or parochial interests. The words "in the public interest" which appear, for example, in s. 40(8), s. 41(3) and s. 43(3), which I have quoted, would seem to leave no room for doubt that it is the broad public interest that must be served. (at p. 622)
>
> *Union Gas v. Township of Dawn* (1977), 76 D.L.R. 613

26. The Supreme Court of Canada expressed similar views in *The Corporation of the District of Surrey v. British Columbia Electric*. In that case involving the British Columbia Public Utilities Commission, the Supreme Court held that the whole tenor of the legislation showed clearly "that the safeguarding of the interests of the public...was a duty vested in the Commission", and in discharging its duties the Commission was "required to consider the interest not merely of single municipalities but of districts as a whole and areas including many municipalities".

> *The Corporation of the District of Surrey v. British Columbia Electric Company Limited*, [1957] S.C.R. 121

27. In previous decisions the Board has made it clear that in considering the issue of "public convenience and necessity", it will have regard to matters affecting provincial gas distribution as a whole and not just local interests.

> Ontario Energy Board, Decision in *Cardinal Power*, E.B.R.O. 477 at para. 5.0.34
>
> Ontario Energy Board, Decision in *Village of Eireau*, E.B.C. 208, at par. 3.1.8 to 3.1.11

28. In deciding the four key issues in this proceeding, NRG submits that the Board must consider each issue in relation to:

- gas customers in Aylmer and in other franchise areas served by NRG,
- all other gas consumers in Ontario,
- the impact upon the shareholders of NRG,
- the impact upon Aylmer,

- the promotion of rational expansion of transmission and distribution systems in the Province, and

- the maintenance of just and reasonable rates in Aylmer, and in the other franchise areas serviced by NRG.

C. ISSUE 1: LENGTH OF TERM OF FRANCHISE RENEWAL

29. The first issue to be determined by the Board is: Does the public convenience and necessity require a shorter than normal term for the renewed franchise agreement?

30. In the Board's review proceeding on franchise renewals, the Board recommended that first-time franchise agreements should be of a duration of not less than 15 years and no longer than 20 years. For renewals, the Board determined that the duration need not be as long as an initial agreement because the risk to the utility is substantially lower, since the plant has been depreciated to a large extent during the initial term of the agreement. In the case of renewals, the Board considered that a term of 10 to 15 years would seem adequate.

> Ontario Energy Board, Decision in *Review of Franchise Agreements*, E.B.O. 125 (1986).

31. NRG has requested 20 years (longer than the minimum the Board considered adequate in E.B.O. 125) because the risk to NRG has not decreased over the initial term of the franchise agreement with Aylmer. NRG has vastly expanded the asset base of the utility in the initial franchise period. As a result, the risk to NRG has not decreased, because its undepreciated capital assets have increased.

32. As the evidence in this proceeding demonstrates, almost all of NRG's pipelines are new, and since 1979 NRG has grown its customer base from 2,000 customers to nearly 7,000 customers.

> NRG Evidence, Exhibit C, Tab 1, p.1, lines 26 to 28.

33. As noted in NRG's response to Aylmer Interrogatory #2, during the fifteen year period from 1991 to 2005, the gross assets of NRG nearly tripled as a result of capital

investment in NRG's franchise areas. NRG's rapid recent growth and massive asset expansion was explained at length in RP-2002-0147 (NRG Rates for Fiscal 2003/04) and at the Public Forum held as part of NRG's last rate case, and this explanation was accepted by the Board (see NRG Response to Aylmer Interrogatory #2).

34. This makes NRG unique among gas distributors in Ontario. The fact is that during the term of its franchise agreement with Aylmer, NRG did not start with an extensive system that merely depreciated over the term of the franchise agreement. Rather, NRG has spent the past twenty or so years improving and developing what was essentially a gathering system for local production into a true gas distribution utility.

35. As a result of its rapid expansion and increased capital asset base, NRG submits that NRG warrants a renewal term longer than the typical 10 to 15 years.

36. As noted above, facilitating the rational expansion of natural gas distribution systems in Ontario is a statutory objective of the Board.

37. To impose a franchise renewal term on NRG that is shorter than the typical term would not be consistent with the Board's stated rationale for determining the length of a renewal period.

38. In addition, there are several other important reasons for establishing a franchise renewal period that is within the normal range of renewal terms, including:

    (a) the Town is not arguing for a three-year term on any public interest grounds;

    (b) an abnormally short renewal term puts NRG at risk of losing its financing;

    (c) an abnormally short renewal term would leave NRG with no choice but to amortize its remaining asset base over the shortened period, which would cause rates to increase significantly;

    (d) Aylmer is seeking a short renewal term for improper purposes;

(e) nearly all of Aylmer's issues with NRG (i.e., Aylmer's proposed conditions to the renewed franchise agreement) have been agreed to by NRG, and could be enforced under a long-term franchise renewal agreement; and

(f) a three-year term would not provide any incentive to NRG to spend any money on capital assets, which the Town seeks to have happen.

(a) Town's Motives for a Short-Term Renewal are Not in the Public Interest

39. The overwhelming weight of the evidence establishes that:

(a) Aylmer has acted in bad faith in its negotiations with NRG and, more importantly, is not pursuing any valid public interest in opposing a standard franchise renewal; and

(b) from June 2008, NRG made at least 14 requests that Aylmer advise NRG as to whether it would approve or oppose a renewal of the NRG franchise. Notwithstanding NRG's requests and Aylmer's understanding of why NRG wanted to know Aylmer's position, Aylmer refused to disclose its position or have any substantive discussion about franchise renewal until December 16, 2008.

40. At the hearing, Aylmer revealed for the first time that it had formulated a plan to oppose a long-term renewal, and insist on a three year renewal term. However, Aylmer deliberately refused to disclose this information to NRG, and even deliberately concealed it from any public document including the reports that Heather Adams prepared for Aylmer Council.

41. The chronology of NRG's request for Aylmer's position on franchise renewal is indicative. On June 6, 2008, NRG requested a meeting with Aylmer by voicemail from Mr. Bristol to Heather Adams. Ms. Adams received Mr. Bristol's voicemail. On June 9, 2008, Mr. Bristol's secretary, Darlene Whitfield, sent an email and resent the same email on June 11, 2008. Mr. Bristol's email request was a follow up to his previous voicemail requesting a meeting with the Town. Ms. Adams received those emails. Ms. Adams knew that NRG was seeking a meeting with the Town.

42. By June 13, 2008, Ms. Adams had not responded to Mr. Bristoll.

43. On June 13, 2008, NRG's counsel sent a letter to the Town proposing a new franchise agreement for a term of 20 years. NRG attached a draft franchise agreement that was based on the Board's Model Franchise Agreement with a term of 20 years. Ms. Adams admitted that Mayor Bob Habkirk received that June 13 letter and provided it to Ms. Adams.

44. Ms. Adams knew that NRG was requesting an opportunity to meet with the Town to determine what position the Town was going to take. Ms. Adams also knew NRG wanted to meet with the Town as soon as possible so they could understand the Town's position.

45. On June 17, 2008, the Town finally responded to NRG and stated that the Town would not meet with NRG until "after natural gas is being provided by NRG to site of the Town's newest business, IGPC Ethanol Inc." Ms. Adams admitted that the Town was linking the renewal of the franchise to the flow of gas to IGPC. Ms. Adams also admitted that when the Town made its decision to refuse to meet with NRG, it did so without knowing when IGPC would be capable of receiving natural gas, and did so knowing that NRG was anxious to meet as soon as possible to ascertain the Town's position.

46. The evidence at the hearing established that NRG had completed its construction tasks on IGPC's facility by the agreed in-service date of July 15, while IGPC's construction delays resulted in it being behind schedule and unable to receive gas by July 15.

47. More importantly, the Town has now admitted to deliberately linking its position on franchise renewal and its willingness to meet with NRG to the flow of gas to IGPC, notwithstanding that IGPC's own construction delays and failures prevented it from receiving gas.

48. On June 20, 2008, NRG responded by letter from its counsel to Ms. Adams. NRG explained again that it wanted to move forward with the renewal process and needed to understand the Town's position as soon as possible. NRG also questioned whether and, if so, why the Town wanted to link franchise renewal to the opening of the IGPC facility.

Although Ms. Adams has admitted that the Town was linking franchise renewal to the IGPC facility opening, it again concealed its position and intentions from NRG. Ms. Adams admitted that, as of June 20, 2008, she had not made any response to NRG.

49. On June 27, 2008, NRG followed up on its June 20, 2008 letter requesting the Town's position and a meeting with the Town to satisfy any concerns the Town might have.

50. Despite the urgency and the repeated requests from NRG, the Town refused to respond to NRG at all until July 8, 2008 when the Town, through counsel, sent a letter. The essence of the letter was to refuse to disclose the Town's position, conceal the Town's agenda, and stall. Ms. Adams admitted that, throughout all of the correspondence and requests from NRG, the Town never told NRG, up to July 8, 2008, that it would approve a renewal of the franchise. In fact, Ms. Adams said that although the Town knew it would renew, the Town deliberately refused to tell NRG what it had already decided about renewal.

51. On July 17, 2008, NRG, through counsel, sent a letter to Mr. Tunley. Ms. Adams admitted she received that letter. Ms. Adams also admitted that she had no evidence to dispute that on the agreed IGPC in-service date of July 15, 2008, NRG was and remained ready, willing and able to deliver gas to IGPC. Ms. Adams also admitted that she understood NRG again to be asking, as it had done many times in the past, that the Town provide its position on whether or not it would support the renewal of the franchise.

52. The Town's only response was Ms. Adams' email of July 20, 2008 in which she suggested that because she would be on vacation for one month, the Town could not possibly meet with NRG until after mid-August. Ms. Adams was aware NRG desperately wanted to know if the Town would or would not support a renewal, but instead, she delayed answering that question for another month using her one-month vacation as an excuse.

53. On August 11, 2008, NRG, through counsel, requested that the meeting be scheduled as soon as possible so that NRG could finally learn whether or not the Town would support a renewal of the franchise.

54. Ms. Adams admitted that despite her understanding of the urgency and NRG's repeated requests which the Town had refused to answer, the earliest meeting date she was willing to agree to was September 11, 2008. Ms. Adams also admitted that at no time before September 11 did the Town ever provide an answer to NRG's numerous requests as to whether or not the Town would support a renewal.

55. On September 11, 2008, a meeting was held between NRG and the Town. At that time, NRG provided the Town with the Model Franchise Agreement and asked for the Town's comments. The Town advised NRG that it would provide comments on the Model Franchise Agreement shortly. Despite this assurance, the Town refused to provide any comments.

56. NRG sent follow up letters on September 11 and 16 thanking the Town for the meeting and stressing its willingness to work together with the Town on many initiatives including NRG's attendance at pre-construction meetings, NRG's involvement at Emergency Planning Committee meetings, and participating in business development opportunities.

57. The Town failed to respond.

58. On October 14, 2008, Mr. Bristoll telephoned the Town to again advise that NRG was eagerly anticipating the Town's comments on the Model Franchise Agreement. Yet again, the Town failed to respond.

59. Finally, on November 19, 2008, NRG wrote to Mayor Habkirk and Ms. Adams once again requesting that Aylmer provide its comments on the Model Franchise Agreement, as it had agreed to do nine weeks earlier on September 11.

60. On November 26, 2008, Ms. Adams responded stating that Aylmer would not meet with NRG until December 16, 2008.

61. Ms. Adams admitted that she knew, on November 19, 2008, that NRG was asking for an opportunity to meet with the Town and resolve any outstanding concerns. However, she refused to meet until December 16, 2008.

62. The December 16, 2008 meeting was set by Ms. Adams knowing that the Town Council would be meeting on December 15, and would be considering Ms. Adams' December 11 report to the Town Council.

63. Ms. Adams also admitted that despite the detailed chronology in her December 11 report to Town Council, there is no reference to any of the many letters and verbal requests by NRG for an opportunity to meet with the Town and to know whether or not the Town would support a renewal of the franchise. Ms. Adams admitted that the Town's refusal to meet with NRG between November 19 and December 16 was her decision.

64. NRG learned for the first time on December 16, 2008 that the Town would be opposing a renewal of the franchise for the ordinary term of 20 years. Immediately upon discovering this, NRG filed its application for a hearing.

65. Ms. Adams made vague references to "off the record discussions". However, Mr. Bristoll testified that NRG's evidence is clear and unequivocal that it had no knowledge that the Town would be demanding a three-year renewal term or any other shortened renewal term until December 16. NRG learned about the Town's three-year renewal demand for the first time on December 16.

66. There is not a single written record, note, or memo that would evidence any disclosure by the Town to NRG of its position prior to December 16, 2008. Moreover, the actions of NRG confirm that immediately upon becoming aware of the Town's three-year renewal demand, it filed its application with the OEB.

67. Mr. Bristoll's evidence was not challenged on cross-examination. In the circumstances, the specific unequivocal, unchallenged evidence of Mr. Bristoll should be accepted, and this Board should find as a fact that the Town never disclosed to NRG that it would be demanding a three-year or other shortened renewal term until December 16, 2008.

68. The Town has never alleged that NRG has breached the existing franchise agreement. The conditions being sought by NRG have either been agreed to by NRG or are easily resolvable by other means. In any event, they do not rise to the level of materiality to warrant a short-term renewal. If the Town had valid public interest reasons about the

franchise renewal, it would not have stonewalled NRG over the entire latter half of 2008. It would have negotiated in good faith with NRG to attempt to resolve the issues.

(b) Financial Risk of a Short Renewal Term

69. In the past, the Board has recognized that the length of a franchise term is of critical importance to a utility's ability to finance.

> Ontario Energy Board, Decision in *Northern and Central Gas Corporation Limited*, E.B.A. 194 (December 3, 1976).

70. NRG will have to re-finance the bulk of its debt on or before early 2011. Given that the Town of Aylmer is the main urban centre in NRG's franchise area, an abnormally short renewal period would not be viewed favourably by any potential lenders to NRG.

71. NRG's existing financing is in the form of third-party demand loans. Those loans can be called at any time and would have to be repaid in full immediately. No breach of any term of the loan is required. It is NRG's view, based on its experience with the lender during the main financing, that the lender would view an abnormally short renewal period as a significant new risk to the utility. NRG believes that the financing could be called by the bank.

> NRG Response to Board Staff IR #2(ii)
>
> NRG Response to IGPC IR#1(d)

72. As noted in Appendix A to IGPC Interrogatory #1, the Bank requested (from NRG's counsel) information about the Board's franchise renewal process prior to NRG's last main financing. Intuitively, this only makes sense. Why would a bank lend money to a utility if that utility's right to carry on business, and ability to generate any renewal, was uncertain, and out of the control of the utility?

73. Aylmer has pointed to the fact that NRG's recent financing was arranged at a point in time when a few of its franchise agreements were coming up for renewal. However, as Mr. Bristoll confirmed, the bank(s) renewed on the belief that franchise renewals were

routine, and that there would be no risk of non-renewal or a "probationary" renewal term (which is what Aylmer is requesting).

NRG Response to Board Staff IR #2

(c) NRG's Would Have to Amortize its Assets Over a Much Shorter Term

74. If the NRG franchise with Aylmer were renewed for an abnormally short period of time (e.g., three years), NRG would likely have to amortize its assets (at least those in Aylmer) over that period of time in its next rate application.

75. The rationale for this is straightforward. If the Board were to establish an abnormally short renewal period, it would likely be viewed by NRG's existing financing institution and other potential lenders as a truly unprecedented step, and would clearly send the signal that any further renewal was clearly at risk. Consequently, NRG would have to treat an abnormally short renewal period as a *de facto* final franchise term and file a rate application on that basis.

76. The rates applied for by NRG would be materially higher than they are currently.

77. Such an outcome is not in the interests of NRG's gas customers (both within the Town of Aylmer and outside Aylmer).

(d) Aylmer's Term Proposal is Based on Improper Purposes

78. Aylmer has offered two reasons for requesting a three year renewal term. First, Aylmer seeks a three year term:

(a) "to allow NRG an opportunity in this time frame to regain the confidence of its customers within [Aylmer] as their incumbent gas supplier"; and

(b) "to permit the next renewal to come up in 2012, at a time to coincide with the pending renewals of NRG's Franchise Agreements with the Township of Malahide, the Municipality of Thames Centre, and the Municipality of Bayham."

79. With respect to regaining the confidence of NRG's customers, the alleged lack of confidence would seem to stem from NRG's decision in 2005 to implement its security deposit policy. Previous management at NRG had not been diligent about implementing the policy.

80. First, NRG's view is that there are no outstanding complaints. Second, any complaints made to outside sources (i.e., the OEB or Aylmer Police) about the security deposit were either resolved, or investigated and determined to be without merit.

NRG Response to Aylmer IR No. 5(vii).

81. Third, as Mr. Bristoll outlined in his responses to questions by Board Member Quesnelle, it is likely the case that security deposit levels may level off or start to decline somewhat, because the implementation of the policy is now complete and sufficient time has passed for some customers to see returns on their security deposits.

82. Finally, and most importantly, NRG agreed (at the oral phase of this proceeding in Aylmer) to implement the security deposit policy that is currently proposed by the Board as an amendment to the Gas Distribution Access Rule. Thus, NRG is agreeing to establish a highly prescriptive, Board-approved security deposit policy. This settles the matter.

83. With respect to Aylmer's desire to align its franchise expiry dates with other municipalities, NRG notes that no other municipality sought to intervene in this proceeding. Further, all but one of Aylmer's "letters of support" pre-date NRG's franchise renewal application.

84. Aylmer does not speak for the other municipalities.

85. Even if the other municipalities were on-side with Aylmer, the Board should reject the notion that aligning expiry dates is a valid criteria to be weighed in exercising the Board's public interest discretion to determine a franchise renewal term.

86. The issue of aligning franchise expiry dates was contemplated by the Board in its franchise renewal proceeding (on the basis that smaller municipalities would have more

negotiating power with utilities if franchise renewals expired at the same time). The issue was not dealt with in the decision but ultimately sent to a committee, where the step taken appears to be not to align expiry dates but rather to standardize the form of franchise agreement (i.e., the Model Franchise Agreement).

87. Ms. Adams has told two contradictory stories. On the one hand she has testified under oath that her October 8 Report contains her understanding of the views of the other municipalities. However, there is no reference whatsoever in the October 8 Report to any limitation on the standard renewal term. There is no reference to any concern at all about the length of the franchise agreement to be renewed and no mention of any desire or reason to link the expiry of the franchise renewal to other franchise agreements. On the other hand, Ms. Adams testified that she had only one meeting at which she learned this understanding, and has now confirmed that this meeting occurred on October 1.

> MR. MILLAR: "Mr. Tunley: A specific question is, at the time you prepared and submitted this report to council in or about October 8th, had you had discussions with the other five municipalities in the area, and does your report reflect what you learned from them about any shared concerns?
>
> "MS. ADAMS: Yes."
>
> MR. THACKER: That was true when you gave that evidence, wasn't it?
>
> MS. ADAMS: Yes
>
> MR. THACKER: All right. And so what we have in this October 8 report is your shared understanding of the view of the other municipalities.
>
> MS. ADAMS: It's my understanding, yes.

88. There are only two possibilities. Either:

(a) the other five municipalities had no concerns about the length of the Town franchise renewal and no desire to link the next Town franchise expiry to any other NRG franchise; or

(b) the Town had formulated a plan with other municipalities to undermine NRG and make it easier to replace NRG with another service provider, that the Town deliberately concealed that hidden agenda from NRG, refused to negotiate fairly and in good faith with NRG, and even created an extensive record of public documentation that deliberately omitted this hidden agenda.

> MR. THACKER: So the town council is being asked to accept a recommendation from you, and you don't even tell them that it has anything to do with linking up the expiry dates for the other five municipality franchise, right?
>
> MS. ADAMS: Not in the context of the report, no.
>
> MR. THACKER: You didn't tell the town council.
>
> MS. ADAMS: I may have, in terms of questions. I don't know.
>
> MR. THACKER: You may have. But you have no evidence that you actually did, do you?
>
> MS. ADAMS: Don't recall one way or the other.
>
> MR. THACKER: No. So from October 8 on to December, is it your evidence that you have the understanding of these other five municipalities, but you have omitted it from your two reports?
>
> MS. ADAMS: The CEOs had had a discussion about the concept of having them renew at a similar time frame so we could work together.
>
> MS. THACKER: I know.
>
> MS. ADAMS: That is not in either report; that's correct.
>
> MR. THACKER: Right. And you left it out.
>
> MS. ADAMS: Yes.

89. Ms. Adams' evidence about the other municipalities was not credible. In her testimony she presented a lengthy rationale for what she claimed to be the mutual desire of all of the Town and five other municipalities to restrict NRG to a three-year renewal so that all franchise agreements would come up for renewal at the same time.

90. However, on cross examination she revealed that the Town had had only one meeting with other municipalities, and that she could not remember when that meeting occurred (although she later confirmed it was October 1). Ms. Adams prepared her detailed lengthy October 8 Report to Town Council which contains her recommendations on how to proceed yet Ms. Adams deliberately omits any reference to any limitation or restriction on the term of renewal.

> MR. THACKER: Right. Okay. And so as of October 8 you were not recommending any coordinated renewal at all, were you? Because I read it carefully, and there is not one reference.
>
> MS. ADAMS: Mm-hmm. Not at that time, no.
>
> MR. THACKER: Right. In fact, you weren't even recommending, as of October 8, a three-year renewal period, were you? Because that's not in the report either.
>
> MS. ADAMS: No. We were still in discussions with NRG with respect to details of the renewal.

91. Eventually, under cross examination, Ms. Adams admitted that her understanding of the position of other municipalities as of October 8 had nothing to do with the three year term:

> MR. THACKER: I was just going to get to that. So the first time you told or made any recommendation to the town about a restricted renewal period was in your December 11 report; correct?
>
> MS. ADAMS: That's the first time the report went to a council meeting, yes.
>
> MR. THACKER: Right. So can we agree, then, that – well, no. The real point is that is the first time you ever suggested to council there should be a restriction on the length of renewal?
>
> MS. ADAMS: In a report context, yes.
>
> MR. THACKER: Well, that's the first written record --
>
> MS. ADAMS: Right.
>
> MR. THACKER: -- you have produced of ever making that recommendation to council; right?

MS. ADAMS: That's the first written record.

MR. THACKER: There is no evidence that that was ever discussed with any municipality before October 8, is there?

MS. ADAMS: A three-year term, no.

MR. THACKER: Right. So when you talk about the position of other municipalities as you understood it as of October 8, it had nothing to do with a three-year term, did it?

MS. ADAMS: No.

92. NRG submits that the Town failed to negotiate with NRG in good faith. Moreover, the Town's insistence on a three year renewal period is not based in any legitimate public interest concern or any desire to allow NRG to rebuild trust where NRG had been requesting an opportunity to understand the Town's position and rectify any of the Town's concerns since June. The Town instead refused to meet with NRG, refused to advise whether or not it would support a renewal of the franchise and most importantly refused to allow NRG an opportunity to rectify any customer service or other concerns the Town might have.

93. The Town was actively trying to prevent NRG from addressing any concerns and was preventing NRG from having time to address these issues in a productive manner and satisfy any public interest concerns. Instead, the Town was advancing its own interests to the detriment of NRG and NRG's customers.

94. There is no public interest served by the Town's demand for a three year renewal period. Moreover, the Town's well-established history of refusing to disclose its position to NRG and refusing to allow NRG any opportunity to rectify any customer service or other concerns establishes that the Town was acting in bad faith and not in any public interest.

(e) <u>Nearly All of Aylmer's Conditions Have Been Agreed To By NRG</u>

95. Prior to, and during the course of, this proceeding, NRG has agreed to most of Aylmer's conditions. The remaining conditions will be decided upon by this Board, and complied with by NRG.

96. Counsel for Aylmer stated that even if NRG and Aylmer agreed on the conditions, Aylmer would still insist on a three-year term because it would allow the Board to "check-in" on whether NRG is complying with those conditions. With respect, a three-year check-in with the Board is not the best way to ensure compliance with the Model Franchise Agreement.

97. The Model Franchise Agreement has no provisions dealing with non-compliance or dispute settlement. It is silent on this point.

98. The existing franchise agreement states that in the event of a dispute or disagreement, either NRG or the Town could refer the matter to arbitration.

NRG Evidence, Exhibit C, Tab 2, section 9.

99. The Model Franchise Agreement is a contract, and in the absence of anything to the contrary in the agreement, any contractual dispute could be resolved in Court. In the alternative, dispute resolution provisions could be inserted in the renewed franchise agreement making binding arbitration or the OEB the forum for hearing alleged non-compliance matters.

(f) No Incentive to Add Capital Assets

100. If NRG were granted a three-year renewal, it would have no incentive to add to, or improve, its capital assets.

101. This incentive runs contrary to: (a) the Town's stated wish that NRG be an active participant in trying to attract new industry to Aylmer; and (b) the Board's statutory objective to facilitate the rational expansion of the gas distribution system in Ontario.

D. ISSUE 2: TIMING OF RATE APPLICATION

102. The second issue to be determined by the Board is: Does the public convenience and necessity require that it be a condition of the renewed franchise agreement that NRG file a rate application before the end of 2009?

103. NRG has stated on the record in this proceeding that it would be prepared to file an application by December 31, 2009. The rationale for this date is to allow NRG to: (a) understand any rate implications arising from the Board's decision in this case; and (b) allow sufficient time for NRG to properly prepare a comprehensive application.

104. The preparation of a cost-of-service rate application (and pre-filed evidence) by a smaller utility such as NRG involves a significant financial and personnel commitment on the part of the utility. A decision in this case would, it seems, come out no later than early April 2009, and potentially as late as the beginning of June 2009.

105. NRG will obviously comply with whatever the Board orders in terms of a rate filing deadline, but simply requests that the Board keep in mind the significant work and time involved in the preparation of a rate application.

E. ISSUE 3: TRUST ACCOUNT FOR SECURITY DEPOSITS

106. The third issue to be determined by the Board is: Does the public convenience and necessity require that it be a condition of the renewed franchise agreement that NRG's security deposit monies be held in a separate trust fund, and not be used as working capital?

107. As mentioned at the hearing, NRG does not support holding security deposits in a separate trust fund, for three reasons:

(a) NRG does not believe that its financial well-being warrants holding security deposit monies in a segregated account;

(b) at present, the security deposits held by NRG (and by the other two gas utilities) reduce the utility's rate base, but placing these funds in a trust account would increase NRG's rate base; and,

(c) there are other costs associated with managing and auditing a trust account that are currently do not have to be incurred by NRG.

Obviously, the concern with items (b) and (c) is that they result in higher rates for NRG's customers.

108. The security deposits held by NRG reduce NRG's rate base through working capital. The same is true for Enbridge and Union.

109. NRG's rate base is comprised of:

> Net Book Value of NRG's Assets
> plus Inventory
> plus Working Cash Allowance (i.e., lead-lag)
> minus Average Value of Security Deposits

110. The Board treats security deposits for the three gas utilities in this manner because it has always been considered a source of operating funds (i.e., they are funds that do not have to be returned immediately, so can be used for short-term financing).

111. If the funds were to be held in a trust account, and not accessible by NRG, they obviously would not be used to reduce rate base.

112. The result would be increased rates for NRG customers because NRG would still need those funds.

113. In addition to the cost implications of removing the security deposit funds from the rate base calculation, there will be operating expenses associated with the maintenance of a trust account (e.g., auditing costs) that are currently do not form part of NRG's budget.

114. It is NRG's submission that there is no good reason to incur these additional costs (which are ultimately borne by the customers). NRG's view is that the most recent financial statements filed with the Board reflect a financially healthy utility. It is also NRG's position that to the extent the change in GAAP reporting of NRG's retractable shares was cause for any concern, the Board has evaluated it and dealt with it by ensuring the shares are postponed: (a) to NRG's creditor; and (b) to Union Gas.

F. ISSUE 4: MANDATORY NOTIFICATION OF AYLMER

115. The fourth and final issue to be determined by the Board is: Does the public convenience and necessity require that it be a condition of the renewed franchise agreement that NRG provide notice to Aylmer of any OEB proceeding that NRG is a party to?

116. NRG believes this condition is unnecessary, and should not be inserted as a special condition to a renewed franchise agreement.

117. The Board's long-established practices and procedures for managing regulatory proceedings ensure that adequate notice of all proceedings is provided to the general public, and particularly to stakeholders who would reasonably be expected to have a particular interest in a given proceeding.

118. As the Board is aware, upon receipt of an application or upon commencing a proceeding on its own initiative, prior to holding a public hearing, the Board publishes a Notice of Application or a Notice of Public Hearing that describes the subject matter of the proceeding and the steps that interested persons can take in order to participate. Such notices are typically published in those newspapers within Ontario that have the highest levels of readership or circulation for the community or communities most likely to have an interest in the particular proceeding. The basis for this process is enshrined in the Board's Rules of Practice and Procedure (Rule 21).

119. All NRG applications typically get published in the Aylmer Express. For NRG rate applications, the Board always requires (in addition to publication) that NRG serve the Aylmer Town Clerk, and NRG has always done so.

120. Only recently has the Town started to participate in NRG proceedings (e.g., related to the Ethanol plant, Union's application to discontinue service, and the franchise application). Now that the Town has formally begun to participate in NRG proceedings, it will likely receive automatic notice of any applications to the Board by NRG (since the Board's normal practice is to notify past intervenors of any new applications for a particular utility).

121. NRG is not opposed to Aylmer participation in any OEB proceedings, but believes that the condition as drafted by the Town: (a) is too broad (in that it requires notification of any proceeding NRG participates in, not only those where NRG is the applicant); (b) can be met via the Board's traditional notification procedures (as explained above); and (c) is minor in nature, and not significant to warrant inclusion as a special condition to a franchise agreement.

122. On this last point, part of NRG's concern is that it is the type of condition that could easily be overlooked or "fall between the cracks", ultimately have little consequence to Aylmer, but nevertheless be a breach of the franchise agreement. For example, it would not be in anyone's interest for NRG to be in breach of its franchise agreement merely because NRG inadvertently failed to notify Aylmer about a generic proceeding that NRG was only tangentially involved in.

123. For these reasons, NRG submits that the inclusion of this condition in a renewed franchise agreement is not in the public interest.

G. COSTS

124. NRG submits that this hearing was necessary only because of the Town's failure to negotiate with the Town in good faith, and the Town's insistence on advancing a private agenda at the expense of the public interest and NRG and its stakeholders.

125. Since June 2008, NRG has been requesting that the Town advise them as to whether or not it would approve a renewal of the franchise. The evidence has established beyond any doubt that the Town deliberately refused, over a period of six months, to tell NRG whether or not it would approve a renewal of the franchise. Moreover, the Town concealed from NRG its hidden agenda and the position it would eventually take concerning a demand for a three-year renewal term.

126. Finally, the Town deliberately allowed time to run and did not disclose its position until the latest possible moment, which required NRG to commence this application for a contested hearing.

127. NRG submits that, in these circumstances, any presumption that the applicant should be responsible for the costs of the hearing does not apply. Instead, this Board should determine costs liability by examining the degree of success in the outcome of the hearing and the conduct of the parties prior to and during the hearing.

128. Applying these criteria, NRG submits that, given the Town's conduct, NRG could simply have done nothing and stopped supplying gas at the expiry of the franchise agreement. This would certainly have been disastrous for NRG's customers and the Town. However, the Town refused to take any proactive steps to deal with the impending expiry of the franchise agreement, and refused to cooperate with NRG when NRG attempted to deal with this matter in a proactive and reasonable manner.

129. As a result of the Town's conduct, NRG has incurred significant legal expenses, and this Board has been put to the expense of a contested hearing, under the pressure of an imminent expiry of the NRG franchise agreement. This was all unnecessary, and was caused by the Town's conduct, including its refusal to negotiation with NRG in good faith.

130. As a result, NRG respectfully submits that the Towns should bear its own costs of this hearing. NRG also submits that the Town should pay the costs of NRG and the Board.

H. MISCELLANEOUS ISSUES

131. With respect to the matter raised by the Chair at the conclusion of the oral phase of the proceeding, NRG is reviewing the Chair's proposal concerning the pending appeal (and administrative fine which has been stayed pending the appeal). Specifically, NRG is examining the tax and other financial implications for NRG and its stakeholders.

All of which is respectfully submitted this 20th day of February, 2008,

NATURAL RESOURCE GAS LIMITED

By its Counsel, Ogilvy Renault LLP
Per: Richard J. King

per

By its Counsel, Lenczner Slaght Royce Smith Griffin LLP
Per: Lawrence E. Thacker