EB-2010-0018

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B)

AND IN THE MATTER OF an Application by Natural Resource Gas Limited to the Ontario Energy Board for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, transmission and distribution of gas as of October 1, 2010.

RESPONSE TO INTERROGATORIES FROM THE TOWN OF AYLMER

May 17, 2010

NATURAL RESOURCE GAS LIMITED

RESPONSES TO INTERROGATORIES FROM THE TOWN OF AYLMER

ISSUE 2 – RATE BASE

Ref. Exhibit A3, Tab 1, Schs. 1 and 2

1. **Please explain and provide a breakdown of the increases in asset values associated with Franchises and Consents in NRG's 2008 and 2009 audited financial statements. Please specifically identify any such amounts attributable to regulatory costs.**

RESPONSE

Please see response to Board Staff IR 7(c).

Ref. Exhibits A3, Tab 1, Sch. 1 and B6, Tab 3, Schedule 1

2. Please provide a reconciliation of the asset values associated with Franchises and Consents in 2009, as shown in NRG's 2009 audited financial statements and in the last line of Exhibit B6, Tab 3, Schedule 1.

<u>RESPONSE</u>

Note 3 to NRG's 2009 Audited Financial Statements shows that the gross value of Franchises and Consents at year end was $413,057 and the Accumulated Depreciation was $159,282. This data reconciles with the data provided at Exhibit D6, Tab 4, Schedule 1 and is consistent with the monthly averages presented at Exhibit B6, Tab 3, Schedules 2 and 3.

Ref. Exhibits B6-B8, Tab 3, Schedule 1

3. Please explain the differences between the depreciation rate or rates used to arrive at the depreciation amounts applied to the asset values associated with Franchises and Consents for 2009, 2010 and 2011, and the rate or rates used in NRG's 2006, 2007 and 2008 audited financial statements (Exhibit A3, Tab 1, Schs. 2, 3 and 4)

RESPONSE

The depreciation rate for Franchises and Consents has not changed. It is based on the life of the franchise.

Ref. Exhibits B7-B8, Tab 4, Schedule 1

4. Please provide figures from 2006, 2007, 2008 and 2009, to permit a comparison to the calculations of the "Total" allowance for working capital in 2010 and 2011 shown in the last lines of the referenced Exhibits.

RESPONSE

Please refer to Tab 4, Schedule 1 of each of Exhibits B3, B4, B5 and B6.

ISSUE 5 – COST OF CAPITAL

Ref. Exhibit A3, Tab 1, Schedules 1-6

5. Please confirm that the terms associated with the retractability of the Class A, Class B, Class C and Class Z shares of NRG referred to in Note 11 to NRG's 2009 audited financial statements have not changed since the testimony of D. Pallett on behalf of NRG was heard in EB-2008-0273 (October 20, 2008).

(a) Are any changes to those terms planned?

(b) Please describe any changes to those terms that have occurred in that period, or that are planned.

RESPONSE

The retractable nature of the shares has not changed.

6. Please confirm that, as appears from NRG's audited financial statements, a change in its capital structure has occurred with the addition, in 2008 (Note 2), of the IGPC pipeline under construction with a net book value of $4,364,406, and related long term debt in the form of a term note payable to BNS assumed in 2009 (Note 8) in the amount of $4,723,333. Please confirm that all of this term note debt is associated with the IGPC pipeline, and if not please explain what else other amounts are included.

<u>RESPONSE</u>

This loan is not directly related to the IGPC pipeline. The interest cost is applicable to all rate classes.

7. NRG's Balance Sheet as at September 30, 2009 shows a "Temporary Investment" of $2,751,130 (2009, page 2).

(a) Please confirm that this is the Guaranteed Investment Certificate required to meet NRG's bank loan commitments related to the IGPC pipeline financing, referred to at lines 20-24 of Exhibit E1, Tab 1, Schedule 1 and at page 4 (lines111-113) of Katherine McShane's opinion, Exhibit E2, Tab 1, Schedule 1.

(b) What was the source of the $2.75 million used to establish this GIC?

(c) What are the forecast amounts of this temporary investment that are expected to be maintained or repaid after 2011, that are discussed by Ms. McShane at page 13 of her opinion? How is the amount of any repayment proposed to be calculated?

<u>RESPONSE</u>

(a) Confirmed. However, please refer to our response to Town of Aylmer IR 6. This loan should not be considered an "IGPC financing loan."

(b) The source of funds was a combination of earnings and bank borrowings.

(c) Please see response to IGPC IR 60.

8. Note 6 to NRG's 2009 audited financial statements indicates that, during the 2009 fiscal year, NRG repaid a term note payable to a related company in the amount of $795,264. What was the source of the funds used to make that repayment?

<u>RESPONSE</u>

See response to Town of Aylmer IR 9.

9. According to NRG's audited financial statements (2007, page 2 and Note 5, 2008, page 2 and Note 6, and 2009, page 2 and Note 6), between 2006 and 2009, NRG made a substantial loan to a related company. What was the source of funds used by NRG to make that loan? What return did NRG receive on that loan? Was any adjustment made to NRG's return on capital earned from its gas ratepayers while that loan was outstanding?

RESPONSE

In 2009, NRG paid off a loan from a related company in an amount of $795,264. This loan to NRG was interest-free.

Part of the funds used to pay off that loan was via a related company paying off a loan from NRG in the amount of $492,505. That loan from NRG had an interest rate of 4.59% payable monthly.

10. Please confirm that NRG has not received, nor does it expect to receive, any new equity injection since 2006.

RESPONSE

NRG has not received since 2006, nor does it expect to receive, any new equity injection.

11. Please explain what the "Shareholders' Equity Deficit", offsetting NRG's share capital on its Balance Sheet in each year, represents. If it is simply an adjusting or reconciling entry, please explain why the amount of this Deficit has decreased from $9,090,159 in 2006 (audited), to $7,511,626 in 2011 (projected). In addition:

(a) Please explain what accounts for this decrease, and what role this plays in decision-making regarding NRG's budgeting process.

(b) Please confirm that it results in an apparent, offsetting increase in NRG's net Shareholders' Equity from $4,371,280 in 2006 to $5,949, 813 in 2011.

RESPONSE

Shareholders' deficit/earnings is a cumulative balance of the net earnings/losses of the company. If you refer to the Statement of Deficit you will see how this accumulates on an annual basis. It is not an "adjustment or reconciling entry". The change from 2006 to 2011 will be the result of actual and projected net earnings over that period.

Since there is no capital injection during this period, the Shareholders' Equity total change noted in 11(b) directly relates to the change in the Shareholders' Deficit.

Ref. Exhibit E1, Tab 1, Schedules 1 and 4

12. What are the sources of funds used to make the principal repayments on NRG's total long term debt referred to at lines 5-10 of Exhibit E1, Tab 1, Schedule 1, since the IGPC pipeline transactions? Please provide detail on what amounts have been repaid, on which long term debts, when. What funds or sources of funds will be used to maintain these principal repayments over the IRP term, as proposed.

RESPONSE

Exhibit E8, Tab 1, Schedule 3 outlines the carrying cost of the long term debt and the repayments will continue to be made out of the operating funds generated from the business. The amounts have been paid in accordance with the terms and are noted in Note 8 of the 2009 Audited Financial Statements.

13. The Board's allowance of a 42% equity ratio in its Decision With Reasons dated September 20, 2006 in EB-2005-0544 (at pp. 25-26) was based on NRG's actual equity ratio. Please explain why the "Actual" 2006 and 2007 equity ratios shown on the referenced Exhibits are 22%, and provide a calculation reconciling the two ratios.

RESPONSE

The revised corrected schedules are attached (to now read 42% and not 22%).

NATURAL RESOURCE GAS LIMITED

Capital Structure - Cost of Capital
2006 Actual

	Capital Structure ($'s)	Ratios (%)	Cost Rate (%)	Return Component (%)
Long-Term Debt	4,993,015	53.79%	8.58%	4.62%
Short-Term Debt				
Operating Loan	95,750	1.03%	8.00%	0.08%
Unfunded Debt	295,351	3.18%	8.00%	0.25%
Common Equity	3,898,843	42.00%	9.20%	3.86%
Total	9,282,959	100.00%		8.81%

Calculation of the Cost Rates for Capital Structure Components

Long-Term Debt	Calculated Cost Rate (Exhibit E3, Tab 1, Schedule 3)	8.58%
Short-Term Debt		
Operating Loan	Calculated Cost Rate (Exhibit E3, Tab 1, Schedule 3)	8.00%
Common Equity	Requested Rate of Return	9.20%

NATURAL RESOURCE GAS LIMITED

Capital Structure - Cost of Capital
2007 Actual

	Capital Structure ($'s)	Ratios (%)	Cost Rate (%)	Return Component (%)
Long-Term Debt	6,406,924	71.02%	8.36%	5.94%
Short-Term Debt				
Operating Loan	0	0.00%	6.00%	0.00%
Unfunded Debt	-1,174,596	-13.02%	6.00%	-0.78%
Common Equity	3,788,927	42.00%	9.20%	3.86%
Total	9,021,255	100.00%		9.02%

Calculation of the Cost Rates for Capital Structure Components

Long-Term Debt	Calculated Cost Rate (Exhibit E4, Tab 1, Schedule 3)	8.36%
Short-Term Debt		
Operating Loan	Calculated Cost Rate (Exhibit E4, Tab 1, Schedule 3)	6.00%
Common Equity	Requested Rate of Return	9.20%

NATURAL RESOURCE GAS LIMITED

Summary of Capital
($'s)

Capital Structure

	Actual 2006	Actual 2007	EB-2005-0544 Board Approved	Actual 2008	Actual 2009	Bridge 2010	Test 2011
Long-Term Debt	53.79%	71.02%	66.21%	71.12%	78.44%	74.99%	72.80%
Short-Term Debt							
Operating Loan	1.03%	0.00%	0.00%	0.00%	-20.07%	-19.55%	-20.20%
Unfunded Debt	3.18%	-13.02%	-8.21%	-13.12%	-0.37%	2.56%	5.40%
Total Debt	58.00%	58.00%	58.00%	58.00%	58.00%	58.00%	58.00%
Common Equity	42.00%	42.00%	42.00%	42.00%	42.00%	42.00%	42.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

Cost of Debt

	Actual 2006	Actual 2007	EB-2005-0544 Board Approved	Actual 2008	Actual 2009	Bridge 2010	Test 2011
Long-Term Debt	8.58%	8.36%	8.31%	8.37%	6.10%	6.10%	6.69%
Short-Term Debt							
Operating Loan	8.00%	6.00%	6.00%	6.00%	0.50%	0.50%	0.50%
Unfunded Debt	8.00%	6.00%	6.00%	6.00%	0.50%	0.50%	0.50%
Total Overall Debt	9.07%	8.40%	8.64%	8.91%	8.05%	7.74%	8.26%

Return on Equity

	Actual 2006	Actual 2007	EB-2005-0544 Board Approved	Actual 2008	Actual 2009	Bridge 2010	Test 2011
Return on Equity	9.20%	9.20%	9.20%	9.20%	9.20%	9.20%	10.35%
Actual Return	2.51%	8.15%	9.20%	7.29%	9.16%	8.60%	4.25%

Ref. Exhibits E2, Tab 1, Schedule 1

14. Please provide the detailed calculations underlying Ms. McShane's statement that "The 2009 year-end actual capital structure ratios … were 61.3% debt and 38.7% equity", and identify the source, in the Exhibits, of the amounts used in these calculations. Please provide comparable calculations for the 2006, 2007, and 2008 year ends, and for the projected 2010 and 2011 year ends.

RESPONSE

Refer to Attachment.

Attachment to Aylmer 14

Aylmer Interrogatory 14

	2011 ***		**2010 ****		**2009 ***		**2008 ***		**2007 ***		**2006 ***		**2010 ****		**2011**	
	$ of capital	Ratios	$ of capital	Ratios	$ of capital	Ratios	$ of capital	Ratios	$ of capital	Ratios	$ of capital	Ratios	$ of capital	Ratios	$ of capital	Ratios
Bank Indebtedness			189,212		-		217,422		-		-		189,212			
Line of Credit					-		806,763		-		-					
Affiliate Loan					-		795,264		-		-					
Term Notes Payable	9,583,165		10,231,316		10,870,177		6,257,192		6,359,538		6,454,484		10,231,316		9,583,165	
Less: Temporary Investments	2,751,130		2,750,000		2,751,130		492,505	Note 1	668,347	Note 1	-		2,750,000		2,751,130	
Net Debt	6,832,035	53.5%	7,670,528	57.5%	8,119,047	61.3%	7,584,136	62.0%	5,691,191	62.0%	6,454,484	62.0%	7,670,528	57.5%	6,832,035	53.5%
Shareholders Equity	5,949,813	46.5%	5,666,718	42.5%	5,131,458	38.7%	4,651,411	38.0%	4,754,354	38.0%	4,371,280	38.0%	5,666,718	42.5%	5,949,813	46.5%
Total Capital	$ 12,781,848		$ 13,337,246		13,250,505		12,235,547		10,445,545		10,825,764		$ 13,337,246		$ 12,781,848	

Note 1: Loan due from Affiliate

Excluding loan due from Affiliate as offset to gross debt

	2008		2007	
Net Debt	8,076,641	63.5%	6,359,538	57.2%
Equity	4,651,411	36.5%	4,754,354	42.8%
Total	12,728,052		11,113,892	

2006 to 2009 from Audited Financial Statements

* - From 2006 - 2009 Audited Financial Statements
** - From A7, Tab 2, Schedule 4, page 2 of 5
*** - From A8, Tab 2, Schedule 3, Updated

Ref. Exhibits E1, Tab 1, Schedule 1; E3, Tab 1, Schedules 2 and 3; E4, Tab 1, Schedule 1; E3, Tab 1, Schedules 2 and 3; E3, Tab 1, Schedules 2 and 3; E4, Tab 1, Schedule 1; Exhibit E5, Tab 1, Schedule 1; Exhibit E6, Tab 1, Schedule 1; and E8, Tab 1, Schedule 1

15. Please confirm that the "small unfunded portion of short term debt ("STD")" referred to in Exhibit E1, Tab 1, Schedule 1 (lines 18-20), in the case of NRG, was $1,722,274 in 2005 (Exhibit E3, Tab 1, Schedule 2), $2,095,778 in 2006 (Exhibit E3, Tab 1, Schedule 3), $629,655 in 2007 (Exhibit E4, Tab 1, Schedule 1), minus-$1,163,938 in 2008 (Exhibit E5, Tab 1, Schedule 1), minus-$50,125 in 2009 after removing the "Compensating Balance" of a further minus-$2,751,130 relating to the Guaranteed Investment Certificate required to meet NRG's bank loan commitments related to the IGPC pipeline financing (Exhibit E6, Tab 1, Schedule 1).

(a) Please explain the rationale behind these changes in the unfunded portion of NRG's short term debt. If it is simply an adjusting or reconciling entry, please explain the causes of this year-on-year variability.

(b) Please explain the effects these changes have had, if any, in both percentage and dollar terms, on the returns NRG has received from its gas ratepayers on its debt, and on its equity or deemed equity. If these effects are detailed in the Exhibits, please provide the references.

(c) Please explain why it is proposed that this amount increase to $741,798 in the 2011 test year (Exhibit E8, Tab 1, Schedule 1), and what effect this has, in both percentage and dollar terms, on the returns NRG expects to receive from its gas ratepayers on its debt, and on its equity or deemed equity.

<u>RESPONSE</u>

Confirmed. Please note that if the 50% hypothetical common equity ratio is applied to 2006 data that the level of unfunded short term debt is -$387,539.

(a) Unfunded debt is a reconciling entry that is relied on to force the capital structure to equate to the rate base. The year over year variability in NRG's unfunded short term debt: (i) reflects changes in rate base that are not financed in the same period through changes to long term debt; and (ii) assumes that the previously authorized hypothetical common equity ratio is 50% and does not vary over the period.

(b) Exhibits F3-8, Tab 1, Schedule 1 provides NRG's achieved ROE for the years 2006 to 2009, projected for 2010 and forecast for 2011. If the level of unfunded short term debt is positive and the associated rate is lower than either NRG's long-term debt rate or its previously authorized

ROE then the unfunded debt will, all other things being equal, lower NRG's weighted average cost of capital.

(c) Please see the response to part (a) above. Assuming that NRG's capital structure used for rate-making purposes equals its rate base, that unfunded debt is not to be used as a reconciling entry and that NRG's long-term debt in the 2011 test year will amount to $9,908k then the balancing entry becomes equity. In this scenario, the equity component of the rate base will amount to $3,711k, or 27.2% which is an uncommonly low common equity ratio; the computed weighted cost of capital would be 7.69%.

16. Please explain why these same Exhibits show NRG's "Common Equity" as $4,700,203 in 2005, $2,026,410 in 2006, $1,984,676 in 2007, $3,725,852 in 2008, and $5,756,753 in 2009, and why it is proposed that this be $5,719,867 in the 2011 test year. How do these numbers relate, if at all, to the shareholders' equity shown on NRG's audited financial statements?

RESPONSE

NRG's "Common Equity" for rate making purposes is computed using the capital structure ratios of the hypothetical capital structure. NRG's shareholder's equity, as quantified on its financial statements, and NRG's hypothetical common equity are determined using independent methodologies.

ISSUE 8 – RATE DESIGN

17. Please provide, in a single chart for comparison purposes, with any adjustments, appendices and explanatory notes that NRG believe are appropriate, the rates for monthly fixed charges, delivery charges, and gas supply charges (if applicable) charged to residential general service and seasonal service customers by (1) NRG in its currently approved rate schedule; (2) Union Gas in its currently approved rate schedule(s) for franchise area(s) surrounding NRG; and (3) NRG's proposed rate schedule for the 2011 test year.

RESPONSE

NRG's current and proposed charges are attached. NRG does not prepare its evidence based on Union's charges.

Attachment to Aylmer 17

NRG
2011 rates
Reponse to Aylmer IR 17

	NRG Proposed 2011	NRG Currently Authorized
Residential		
Distribution - Monthly Charge	$ 13.50	$ 11.50
Distribution - Variable Charge		
0-999 m3	0.155753	0.152999
1000+ m3	0.111874	0.104073
Gas Supply Charge	0.000348	0.001828
Seasonal - R2		
Distribution - Monthly Charge	$ 12.75	$ 15.00
Distribution - Variable Charge		
	0.145000	0.143470
	0.100431	0.099370
	0.065417	0.064726
Gas Supply Charge	0.000348	0.001828