

## 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 for an Order or Orders approving or fixing just and  
reasonable rates and other charges for the sale, distribution and  
storage of gas commencing October 1, 2010.

### SUBMISSIONS OF INTEGRATED GRAIN PROCESSORS CO-OPERATIVE INC. AND IGPC ETHANOL INC. (collectively “IGPC”)

#### **PART I. Introduction**

1. IGPC is a co-operative of approximately 840 area residents and the owner/operator of an 150million litre/year ethanol facility (“**Ethanol Facility**”). IGPC, a direct purchase customer, consumes more natural gas than the rest of NRG’s customers combined. IGPC’s submissions are primarily focussed on issues pertaining to the proposed Rate 6 and the capital of NRG (structure, return on equity and debt).
2. Pursuant to the rate application (“**Application**”) IGPC would be subjected to a rate increase of approximately 10.5%.<sup>1</sup> As the Application is intended to set the base for a further 4 years through a proposed incentive ratemaking (“**IRM**”) process (now deferred to Phase II), the real implication for IGPC is approximately \$8,565,000.<sup>2</sup> IGPC submits the amount sought to be recovered by NRG from all ratepayers, and in particular IGPC, is significantly overstated.

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<sup>1</sup> Settlement Agreement, Attachment.

<sup>2</sup> \$8,565,000 = 5\*1,713,000. This ignores any proposed escalation that would form part of an incentive rate making mechanism.

3. On May 5, 2009 the Board issued a decision and order in proceeding EB-2008-0413, (the “**Franchise Decision**”) requiring NRG to bring forward a rate application within 6 months of the decision. Subsequent to the Franchise Decision, NRG requested an extension to the deadline as it indicated that it would incur significant premiums (which would be recovered from ratepayers) to meet such a timeline. IGPC did not oppose the delay as it did not wish to unfairly burden ratepayers with premium costs associated with meeting the original deadline. Despite being granted additional time to reduce premium costs, NRG sought to recover more than \$500,000 to prepare the Application. Regulatory costs were eventually settled and included in the Settlement Agreement.
4. On February 2, 2010, the Board responded to the original NRG rate application with a letter noting the application would not be processed until NRG had corrected the deficiencies. The original NRG application included alternative rate proposals based upon different depreciation periods. The alternative proposal would have the effect of tripling rates.
5. On March 31, 2010, NRG resubmitted the Application with several corrections and removing the alternative rate proposal from the requested order. The deficiency claimed by NRG was \$462,417.<sup>3</sup> Following partial settlement of certain issues, the revenue deficiency now claimed was reduced to \$229,038.<sup>4</sup> IGPC has concluded that there is no revenue deficiency and is concerned the filing delay was intended by NRG to defer an order decreasing rates.
6. Over the past 4 years, NRG has had disputes involving IGPC<sup>5</sup>, other ratepayers (police investigation into security deposits), the Town of Aylmer [(“**Aylmer**”)(contested franchise renewal, motion to review, appeal to divisional court)] and Union Gas Limited. [(“**Union**”)(provision of financial assurance)]. IGPC acknowledges NRG’s day-to-day performance has improved. However, IGPC remains concerned about NRG’s lack of transparency and lack of financial discipline which fails to meet the expected the standard of regulated public utility. Section 36.(6) of the OEB Act<sup>6</sup>, see below, places the burden of

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<sup>3</sup> Exhibit A1, Tab 1, Schedule 1, page 1, line 4.

<sup>4</sup> Settlement Agreement, Continuity Schedule, col.4, last line.

<sup>5</sup> IGPC and NRG participated in two motions related to the leave to construct and there was a compliance order issued against NRG. NRG had filed an appeal of the compliance order. NRG had also commenced a civil suit for in excess of \$20,000,000 against IGPC related to a public announcement about the second motion.

<sup>6</sup> *Ontario Energy Board Act, 1998*, S.O.1998, c.15, Schedule B.

proof squarely upon NRG to demonstrate that its Application will lead to just and reasonable rates.

36.(6) Subject to subsection (7), in an application with respect to rates for the sale, transmission, distribution or storage of gas, the burden of proof is on the applicant.

7. In several instances NRG's evidence is inconsistent with regulatory principles or with the Board's *Accounting Procedures Handbook and Uniform System of Accounts (revised July 31, 2007)* (the "**Accounting Handbook**"), is incomplete and where information was requested, such has not been provided (i.e. insurance report) and has been found to contain substantial errors that had to be corrected during the proceeding. In most, if not all instances, the effect of such inconsistencies, omissions and errors have been solely to the benefit of NRG and not ratepayers. The rationale followed by NRG was solely to drive an increased revenue stream. As such, where there is any doubt, the Board should not provide NRG with the benefit of any interpretation as to whether NRG has met the statutory burden.
8. IGPC was a signatory of the Settlement Agreement (Partial) put forward by the Parties and has diligently attempted to narrow the issues and to deal with the issues and other intervenors and in a cost effective manner. However, certain issues did not settle, including:

*Issue 2.6 – Amounts related to IGPC Pipeline* – largely unsettled. There was agreement to the description of the issue and to remove approximately \$26,000 of interest charges.

*Issue 4.6 - IGPC Period Costs* – This issue remains unsettled. This includes both insurance costs and directly allocated maintenance costs for the IGPC Pipeline and Customer Station.

*Issue 4.8 - Depreciation Costs* – The appropriate amount of depreciation associated with the IGPC Pipeline is still in dispute. IGPC has settled a depreciation rate of 5% per year. However, the amount will be related to the amount closed to rate base and the date for which the pipeline should have been included in rate base.

*Issue 5 - Cost of Capital* – Unsettled.

*Issue 6 - Rate of Return* – Unsettled.

*Issue 7 - Cost Allocation* – Unsettled.

9. Pursuant to the direction of the Board given during the oral hearing, these submissions do not deal with the contractual matters or orders requested as part of the motion filed by IGPC dated August 3, 2010. The restricted submissions were discussed as part of the oral hearing and agreed to by the Parties; however, to be clear, IGPC does reserve all of its rights to proceed with the outstanding issues at a future date.

## **PART II. Rate Base Related to the IGPC Pipeline**

10. The amount to be included in the Rate 6 rate base is a function of the capital cost of the IGPC Pipeline and the accumulated depreciation. IGPC is contesting both the capital cost proposed to be closed to rate base and the date upon which such amount was closed.
11. IGPC's position is that the amount closed to rate base should be \$4,744,635 based upon a reduced capital cost of \$7,526,353 and that the amount should be closed no later than August 1, 2008. Therefore, rather than including \$4,428,306 contained in the Application, IGPC submits the proper amount to be included in rates for the 2011 Test Year is \$4,102,132, or a reduction of \$326,174 from the Application. **Table 1** below summarizes the amount to be included in rate base.

**Table 1. Summary of IGPC Pipeline in Rate Base**

	<b>Application</b>	<b>Undertaking J2.4</b>	<b>IGPC<sup>7</sup></b>
Capital Cost of Pipeline	\$8,652,814 <sup>8</sup>	\$8,626,353	\$7,526,353
Amount Closed to Rate Base	\$5,073,000	\$4,905,251	\$4,744,635 <sup>9</sup>
Accum. Depreciation Prior to Oct. 1, 2010	\$528,438	\$510,964	\$533,771
Opening Balance 2011 TestYear	\$4,544,563	\$4,394,287	\$4,210,864
Closing Balance 2011 Test Year	\$4,312,050	\$4,169,463	\$3,993,401
Mid Test Year 2011	\$4,428,306	\$4,281,875	\$4,102,132

12. NRG's continued reliance upon the planning cost estimate for determining the proper amount to be included in rate base is misplaced because it ignores the real issue, the actual reasonable

<sup>7</sup> Assumes an August 1, 2008 inclusion and a 5% depreciation rate.

<sup>8</sup> In its response to Undertaking J2.4, NRG noted the contribution in aid of construction contained 3 errors. IGPC understands figure was generated prior to NRG's discovery of such errors.

<sup>9</sup> From response to Undertaking J2.4 where proposed capital cost of \$7,526,353 is used for contribution in aid of construction analysis.

costs required to build the IGPC pipeline. Further, NRG specifically and repeatedly required protection from the risk that actual costs would differ from estimated costs, and it is improper to now revert back to the estimate merely because it is advantageous.

13. Furthermore, NRG did not build the IGPC Pipeline and facilities that were included in the estimate provided to the Board. In the leave to construct application, EB-2006-0243, NRG applied for, and was granted, leave to construct approximately 28.5km of NPS 6 steel pipeline, a check measurement station (“**Check Measurement Station**”) where the pipeline meets the Union system, and a customer meter station at the IGPC Ethanol Facility. However, even though NRG told the Board it was going to build the Check Measurement Station and it was included in the \$9.1million estimate filed with the Board, NRG never built the Check Measurement Station.
14. The Board, in EB-2006-0243, recognized that the project was very large for NRG and it placed a significant reliance upon the terms of the Pipeline Cost Recovery Agreement (“**PCRA**”) and Gas Delivery Contract (“**GDC**”) in granting leave to construct.<sup>10</sup> The Board determined these agreements were in the public interest and provided adequate protection and balancing of interests for IGPC, NRG and its other ratepayers. The inclusion of costs in rates should be in accordance with the executed agreements and E.B.O. 188.

**(a) Actual Reasonable Capital Cost of the IGPC Pipeline**

15. It is IGPC’s position that only “reasonable, actual capital costs” are appropriate to include. This was provided for in the PCRA, the definition of Actual Capital Costs, subsection 1.2(b), and acknowledged by NRG’s witness.

*MR. COWAN: "Actual capital cost means the reasonable actual capital cost as provided for in article 3."*

*MR. STOLL: Right. So -- and would you agree that that definition incorporates three concepts regarding the cost: one, it must be reasonable; two, it must be actual; and, three, it must be capital in nature?*

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<sup>10</sup> EB-2006-0243, Decision and Order, February 2, 2007, page 3.

*MR. COWAN: I agree.*<sup>11</sup>

16. In its response to Undertaking J2.2, appended to these submissions, IGPC provided a detailed breakdown of the basis and amount of the contested charges. IGPC submits the claim of NRG is overstated by \$1,080,319 as summarized in the response to Undertaking J2.2 and as supported herein. In such circumstances, the reduction to rate base would be \$326,174, and Rate 6 would have a proportionately smaller percentage of rate base which would reduce its allocation of certain administrative and general (“A&G”) expenses, depreciation and cost of capital.

**Table 2. Summary of Disputed Costs of the IGPC Pipeline**

<b>Description</b>	<b>Disputed Amount</b>
Administrative Penalty	\$140,000.00
Legal Costs	\$362,782.65
Project Management	\$349,609.50
Interest	\$140,605.07
EB-2006-0243 (see J2.1)	\$6,281.09
Miscellaneous	\$81,041.00
<b>Total</b>	<b>\$1,080,319.31</b>

**(i) Administrative Penalty (\$140,000)**

17. There is no regulatory support for the inclusion of a penalty or fine imposed by a regulator in rate base. To permit recovery would be to encourage utilities to violate their legal obligations because ratepayers will pay for such non-compliance. Waiving the penalty would endorse the improper conduct and discourage the need to abide by the orders of the OEB and other regulators. NRG has provided no regulatory basis for the inclusion of such a cost – a cost which it has still not paid more than 3 years later.
18. During the course of the oral hearing, the Board indicated it was considering doing something with the administrative penalty. IGPC is opposed to the waiving of the penalty by the Board. NRG’s conduct throughout the construction of the IGPC pipeline has been obstructionist and unacceptable from a regulated public utility. To remove the penalty would

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<sup>11</sup> Transcript, Vol. 1, Dated September 7, 2010, page 31, lines 8 to 15.

sanction NRG's improper conduct and would be the absolute wrong message to send to the industry and ratepayers.

**(ii) Legal Costs (\$362,783)**

19. IGPC has contested almost \$362,783 of the \$832,659.62. Even the undisputed cost of \$461,876 appears to be high relative to other leave to construct proceedings filed with the OEB. The capital cost of the IGPC Pipeline should not include any costs related to: (i) the costs for the two motions; (ii) the appeal of the motion; (iii) the police investigation; (iv) contingencies; or (v) the renewal of the Town of Aylmer's franchise. In addition, IGPC noted that NRG had multiple law firms and lawyers reviewing the same issues and was, in some circumstances, paying a lawyer's rate of over \$600/hour for project management. The detail for IGPC's position was provided in its response to Undertaking J2.2, attached, and is adopted for these submissions.
20. NRG has attempted to re-litigate the appropriateness of the Board's June 2007 decision in the Motion using after-the-fact evidence. The Board made its decision and order. Those decisions and orders stand. Partial re-litigation is inappropriate.
21. The first motion was precipitated by NRG's refusal to sign its own Bundled T Agreement, despite such agreement having been sent for execution by legal counsel, Mr. P. Moran, two weeks earlier.<sup>12</sup> Further, a review of Mr. Bristoll's timesheet and Ogilvey Renault invoices indicate that several hours had been spent on reviewing this standard form agreement prior to the refusal to execute. NRG never provided an explanation for not signing. The imposition of a severe penalty was the critical to the survival of the project. Mr. Grey was very clear in his testimony that the Board's order was crucial.

*"MR. KING: It was an annoyance?"*

*MR. GREY: No, it was not. In fact, it is my understanding -- again I wasn't there -- that if it wasn't for the fact that the Board had ruled so severely against NRG in that motion, that the deal would have fallen apart, that we would have had to return the funds out of escrow.*

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<sup>12</sup> Ogilvey Renault invoice confirms execution copy forward to M. Bristoll by Mr. P. Moran on June 15, 2008.



*That would have led to our financing falling apart, which would have led to our government support falling apart.*

*MR. KING: How can you be sure of that? How can you be sure of that? There was no - what comfort would anyone have taken that NRG would have signed the contracts?*

*I am not disputing people were displeased with NRG not signing the contracts.*

*MR. GREY: This goes beyond being displeased. This is something -- and I have had very detailed discussions with our creditors about as well, and -- because I wanted to understand this.*

***And they have confirmed that this was, in fact, a very, very real and distinct threat to our project.” (Emphasis added)***

22. NRG commenced an appeal of the first motion, but such appeal is still outstanding more than 3 years later.

23. The second motion was precipitated by NRG’s demand for \$32million in financial assurance.<sup>13</sup> The Board confirmed the appropriate amount of financial assurance was approximately \$5.3million as provided in the PCRA. Again, NRG’s demand was without merit and put the completion of the pipeline and thereby the Ethanol Facility in jeopardy. Further, IGPC was put to great expense merely to have NRG perform its obligated tasks.

24. Throughout the second motion, and in much of the remainder of the dispute, NRG has asserted that IGPC had not provided the Delivery Letter of Credit. The Delivery Letter of Credit requires the parties to know the cost of the Construction Agreement in order to calculate the amount of the Delivery Letter of Credit.<sup>14</sup> However, the Construction Agreement was not finalized until weeks after the second motion occurred and so no proper demand, or obligation to provide such financial assurance, could have existed prior to March

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<sup>13</sup> Transcript, Vol. 2, September 9, 2010, page 22, lines 3 to 22.

<sup>14</sup> PCRA, Section 7.3 “Prior to the award of the Construction Agreement by the Utility, the Customer shall provide to the Utility an irrevocable letter of credit (“Delivery Letter of Credit”) in an amount equal to difference between the Revised Estimated Capital Cost and the Revised Estimated Aid-to-Construct.” Section 3.6 provides “The contingency amount to be included in the Resaved Estimated Capital Cost shall be limited to a maximum of ten percent of the Construction Agreement cost.” Without the cost of the Construction Agreement, the Revised Estimated Capital Cost can’t be determined and the Delivery Letter of Credit can also not be calculated or demanded.



2008. IGPC provided the Letter of Credit in the amount of \$5,214,173 as required by the PCRA in the spring of 2008.

25. One of the difficulties for IGPC was that several invoices were not provided to IGPC until the affidavit of Mr. Cowan was filed on August 26, 2010, more than 2 years after the pipeline was placed into service.<sup>15</sup> Further, the amount claimed in respect of each law firm has changed and the associated contingency has also varied from \$88,000 to \$132,000. NRG admitted during the technical conference that it had no plans for where this money would be spent.<sup>16</sup> It is contrary to regulatory principles to capitalize costs that have not been incurred. Also, it is not appropriate to include costs not related to the construction of the pipeline or that were unreasonable in the circumstances.

**(iii) Project Management (\$349,609.50)**

26. IGPC has contested the majority of the cost of project managing the construction, based upon both the time and the hourly rate charged by Mr. Mark Bristoll. Mr. Bristoll had no demonstrated experience in the project management of a leave to construct application or the construction of a steel pipeline. Further, prior to working for NRG, Mr. Bristoll had no experience working for a regulated utility. The hourly rate claimed is 2.5 times the price of Senior Project Engineers, licensed professionals, from MIG Engineering – a rate that includes a profit for the engineering firm.<sup>17</sup>

27. The PCRA is premised on actual reasonable capital costs. Further, the Board's Accounting Handbook, see excerpt below, indicates that a utility may include the cost of internal labour. At no place is a "market" based approach to internal labour charges contemplated.

*"If the plant is constructed by or for the utility, the cost to be recorded shall include the cost of labour, material and supplies, special machine and heavy work equipment expense, transportation, contract work, insurance, injuries and damages, privileges and*

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<sup>15</sup> PCRA, section 3.13 contemplated the reconciliation would be completed within 45 Business Days of the pipeline being put into service.

<sup>16</sup> Technical Conference Transcript, June 14, 2010, page 27, lines 6-13.

<sup>17</sup> Affidavit of Robert Cowan dated August 26, 2010, Exhibit C, page 2.

*permits, overhead charged to construction and allowance for funds used during construction.*

*A. Components of Construction Costs*

*(a) Labour: includes the amount paid for labour, (including fringe benefits) to the utility's own employees. When employees are specifically assigned to construction work, their pay, while thus engaged, shall be included in the cost of the work.....*<sup>18</sup>

28. NRG admits that it used a market based rate, not a cost based rate as provided in the Accounting Handbook. NRG attempted to justify its position that the hourly rate is reasonable based upon a “fully allocated cost” of \$600/hour which IGPC disputes is inaccurate and which IGPC submits is not relevant given the provisions of the Accounting Handbook. NRG did not provide Mr. Bristoll’s pay and the Board has been left without information needed for a proper decision. IGPC provided its own estimate of the labour rate based upon an assumed salary (\$150,000/year) and a 33% loading factor, which IGPC feels is reasonable. Further, NRG’s support for the hours claimed (a review of timesheets by its auditor) provided no detail on the tasks performed and relied on the number of emails sent as evidence of hours worked. The auditor could not substantiate the number of hours claimed only that emails had been sent. As it is NRG’s obligation to justify its costs, and it has failed to do so, these costs should be denied.

29. IGPC has also contended that the time charged for project management of the construction of the pipeline is inappropriate. NRG did not provide an invoice for Mr. Bristoll’s work for the period June 2006 through November 30, 2007, until January 2008. Despite having 2 fiscal year ends during that period, and despite being obligated to provide invoices to IGPC on a monthly basis, NRG never provided IGPC with the information. NRG has claimed 1,349 hours or approximately 2/3 of a complete year and has charged IGPC almost \$400,000 for those claimed hours of work. IGPC has uncovered instances of double counting, and many hours included in the tally are for dates after the IGPC commenced paying full distribution rates. However, as detail has not been provided, IGPC can’t provide an accurate assessment of the reasonable number of hours.

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<sup>18</sup> Accounting Handbook, Appendix A, Plant Accounting Instructions, section 1.

**(iv) Interest**

30. IGPC has submitted that interest or allowance for funds used during construction should be approximately \$50,000. IGPC contends the applicable interest rate is prime plus 1% for the applicable period as set out in section 3.8 of the PCRA and that no interest should accrue after IGPC commenced paying full distribution rates. Further, IGPC contended that interest should only begin to accrue after the period stipulated in the PCRA, not from the date NRG received the invoice.<sup>19</sup> IGPC's position is in keeping with the PCRA and the Accounting Handbook.
31. According to Undertaking J1.5, NRG is still claiming \$105,109.40 in interest of which \$73,606.10 relates to interest accrued after July 15, 2008 – the date when NRG commenced charging full distribution rates. Therefore, by NRG's calculation, using an overstated interest rate, only \$31,503.30 in interest accrued prior to July 15, 2008. Using a correct interest rate would mean the proper inclusion for interest would be approximately \$25,000.
32. The Board's Accounting Handbook provides that interest, or allowance for funds used during construction, should cease once the pipeline is placed into service. The relevant section is provided below. It is IGPC's position that the pipeline was in service as of July 15, 2008, as the pipeline was in operation and NRG was charging and collecting full contracted distribution rates.

*"C. Date Placed In Service*

*On the date the plant is placed in service, the utility should cease to record an allowance for funds used during construction on such plant. From that date the utility shall compute and charge to expenses or other appropriate accounts an amount representing depreciation as determined under Section 5, "Depreciation", of these Instructions. Operating revenues received and operating expenses incurred after the date that the asset is placed in service shall be included in the appropriate operating revenue and expense accounts."*<sup>20</sup>

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<sup>19</sup> NRG's calculation of interest, prepared by M. Bristoll, claimed \$190,605 but was calculated based upon the time NRG received the invoice. In some instances, NRG did not provide the invoice to IGPC for several months for payment yet NRG was accruing interest contrary to section 3.8 of the PCRA.

<sup>20</sup> Accounting Handbook, Appendix A, Plant Accounting Instructions, Section 1, Part C.

33. To permit a utility to continue to accrue interest while collecting full distribution rates would permit the utility to double recover such money. IGPC would request the Board to reduce the interest claimed by at least \$140,605 to \$165,000 to reflect the determination of interest in accordance with the terms of the PCRA.

**(v) Miscellaneous (Insurance and other)**

34. IGPC request the Board exclude the \$62,000 allocated insurance cost which is based upon an allocation of 1/3 of the annual insurance expense which is already recovered through distribution rates. No additional insurance was purchased for the construction of the pipeline. The Application and past practice of NRG does not demonstrate that it allocates any insurance to capital spending. Therefore, permitting NRG to recover such an amount as part of the capital cost of the IGPC Pipeline is not appropriate because: (i) it would permit NRG to double recover the amount – from NRG’s ratepayers and from IGPC; and (ii) the cost of insurance is an O&M expense not capital. IGPC would have commenced contributing to the insurance on July 15, 2008 when it began paying full delivery charges. Finally, the rationale of a 1/3 allocator is not supportable as the pipeline took only 3 months to build and is less than 25% of the total rate base – or 1/12<sup>th</sup> the annual amount.<sup>21</sup> However, IGPC submits that no insurance should be included in the capital cost.

35. IGPC has disputed \$9,360 in claimed costs from Ayerswood Development, a related company to NRG. NRG has failed to provide any information as to what goods or services were provided for this fee and so there is no basis upon which to assess the prudence of such expenditures. IGPC has also disputed \$9,681 for Neal, Pallett & Townsend, who are NRG’s auditors. It is unclear what services an auditor would provide that are directly related to the construction of the IGPC Pipeline. It appears some of the advice related to shareholder taxation issues. As NRG has not demonstrated the appropriateness of the charges, IGPC submits the Board should not permit such charges to be included in the Actual Capital Cost of the IGPC Pipeline.

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<sup>21</sup> The calculated value of 1/12<sup>th</sup> the annual spend is  $\$180,000/12 = \$15,000$ .

**(b) Date for Closing to Rate Base**

36. IGPC submits that the pipeline should close to rate base no later than August 1, 2008. On June 30, 2008 NRG nominated gas for delivery to the IGPC Ethanol Facility. Union Gas commenced charging for distribution services commencing July 1, 2008. NRG commenced invoicing, and IGPC commenced paying, the full delivery charges permitted by the GDC as at July 15, 2008. During the period from July 15, 2008 through September 30, 2008, IGPC paid \$372,949.82<sup>22</sup> to NRG for distribution services.
37. The OEB's Accounting Handbook, see excerpt below, provides that the utility is to cease charging interest and to commence charging depreciation when the pipeline is placed into service. It is IGPC's position that the IGPC Pipeline was placed into service on or before July 15, 2008. NRG has recognized the amount of depreciation as material and IGPC would submit that the half month of depreciation should be applied.

*"C. Date Placed In Service*

*On the date the plant is placed in service, the utility should cease to record an allowance for funds used during construction on such plant. From that date the utility shall compute and charge to expenses or other appropriate accounts an amount representing depreciation as determined under Section 5, "Depreciation", of these Instructions. Operating revenues received and operating expenses incurred after the date that the asset is placed in service shall be included in the appropriate operating revenue and expense accounts."*<sup>23</sup>

38. NRG's witness, Ms. O'Meara, properly acknowledged<sup>24</sup> that the full distribution rate includes amounts attributable to depreciation, a return on equity and a cost for debt. Therefore, commencing July 15, 2008, NRG was being compensated through rates paid by IGPC as if NRG had already made the entire capital expenditure. As such, NRG was effectively being paid in advance through the payment of full distribution rates when NRG

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<sup>22</sup> IGPC Submissions dated August 27, 2010, Tab K. This figure is the sum of the invoices for the period July 15, 2008 through September 30, 2008.

<sup>23</sup> Accounting Handbook, Appendix A, Plant Accounting Instructions, Section 1, Part C.

<sup>24</sup> Transcript Vol. 1, page 60, line 28 thru page 61 line 12.

had yet to actually incur the expense. Depreciation is accounted for on a monthly basis and the amount of depreciation prior to October 1, 2010 is \$514,002<sup>25</sup>.

39. In the alternative, if October 1, 2008 is the proper date for including the IGPC Pipeline in rate base, then IGPC would submit that it is inappropriate for NRG to charge full delivery rates for the period July 15, 2008 through September 30, 2008. The GDC provides<sup>26</sup> that Rate 1 is to be used for amounts prior to the commencement date. IGPC submits it is appropriate for NRG to repay IGPC the amount received from IGPC net of any amounts paid to Union and any amounts payable pursuant to Rate 1. If the Board determines July 15, 2008 is not the correct date, IGPC will make a formal request the Board to order NRG to repay the amount of \$372,949.82 less any amounts paid to Union and less any amounts payable pursuant to Rate 1 if NRG does not voluntarily refund such amount.
40. IGPC has put forth a consistent approach, even where such position is not to its financial benefit and has tried to make reasonable assumptions when information has not been forthcoming from NRG. IGPC position is consistent with regulatory principles and is in accordance with the PCRA and GDC.

### **PART III. Operating and Maintenance Expenses**

41. IGPC has provided a table of the periodic costs that it is disputing and the rationale for such dispute in the Table 3 below. IGPC has not accounted for the gross up taxes which would result from the exclusion of such costs.

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<sup>25</sup> The amount is determined by  $\$4,744,635 \times 0.05 \times 1/12$  for a period of 26 months. A July 15, 2008 date would increase the depreciation to \$523,886.

<sup>26</sup> Gas Delivery Contract, Part 7, "The Utility's Rate 1 shall apply to any gas volumes delivered prior to the Commencement Date." IGPC Motion, Tab 4, page 4.

**Table 3. Summary of Reductions in Periodic Costs**

<b>Item</b>	<b>Amount of Reduction in Rate 6 from Application</b>	<b>Reason</b>
Depreciation	\$16,423	Reduced Amount closed to Rate Base.
Insurance	\$117,592	Denial of Business Interruption and re-allocation of other coverages. The reduction from Undertaking J2.6 is \$69,329.
Pipeline Maintenance	\$72,609	Allocation, Capital Expenditure,
Station Maintenance	\$3,189	Removal of PST
<b>Subtotal</b>	<b>\$209,813</b>	
Administration & General	To be determined	Reduced allocation based on revised formula Undertaking J2.6
<b>Total Reduction</b>	<b>\$209,813 + A&amp;G</b>	

**(a) Depreciation**

42. IGPC submits that the annual depreciation included in Rate 6 is overstated as a result of the overstatement of the rate base. NRG closed \$5,073,000 to rate base in 2008. The agreed to depreciation rate is 5%. Based upon NRG's application, \$253,650 is included for depreciation related to the IGPC Pipeline. IGPC has agreed to the 5% rate, but based upon NRG response to Undertaking J2.4, the amount that should have been closed to rate base is \$4,744,635. A 5% depreciation rate would result in an annual depreciation amount of \$237,231 or a reduction of \$16,419 from that included in the Application.

**(b) Insurance**

43. NRG is seeking to have ratepayers commit annual insurance costs of \$284,925 or \$1,424,625 over the five year period without the benefit of a competitive tender and without providing any support regarding the amount and type of coverage being provided. Further, under the original submission, IGPC was to bear \$221,330 without any detailed rationale being provided. The Application would have resulted in other ratepayers obtaining more coverage while being allocated only 1/3 the prior cost (\$63,595). Finally, NRG indicated that it did



not obtain multiple quotations nor did it have the ability to provide even the most basic information in respect of the purchased coverage.

44. IGPC requested detailed information about the insurance procured by NRG during the interrogatory stage. No report, providing any detailed information was ever provided. Even NRG's witness, Mr. Cowan, acknowledged the insurance letter did not provide the information sought. Board Staff, in its submissions, was concerned about the lack of consistency of NRG in its allocation of certain insurance costs.
45. Pursuant to Undertaking J.2.6, NRG has reduced the amount sought from IGPC from \$221,330 to \$173,067. However, IGPC submits that NRG's revision still overstates the appropriate cost of insurance for IGPC to bear.
46. It is IGPC's view that the letter provided by the insurance company does not provide sufficient detail to be selectively applied to some components of insurance and not others. It is not by any means clear from the letter what coverages were reviewed; the intent of the writer may well have been that 40% represents his or her view of an appropriate level of responsibility for IGPC of the aggregate of all of the insurance costs, rather than of certain specific coverages.
- a. **Business Interruption Insurance** – this is a new insurance policy that NRG is proposing to recover through rates and directly allocate 100% of the cost to IGPC. To date NRG has not furnished any further information on this insurance which would allow the Board, IGPC or other Interveners to form an opinion as to whether or not this insurance: (i) is a prudently incurred cost; (ii) is an appropriate expense for recovery from ratepayers; and (iii) addresses a risk specific to IGPC and is therefore, as NRG proposes, allocated entirely to IGPC. In the opinion of IGPC:
- i. Prudence: There is no evidence as to the prudence of the expenditure—i.e. the value that would be received for the money. For example, is there a waiting period before any insurance payout, if so, how long? This is relevant in assessing the value of the insurance given that most service line

interruptions can typically be repaired within a few hours. The level of loss due to the interruption would, under those conditions, be small. There is no evidence suggesting that business interruption insurance is a typical expense incurred by regulated gas utilities, or that the OEB has allowed such a cost for recovery through rates by any other utility.

- ii. Appropriateness for Recovery from Ratepayers: It appears that the intent of the insurance is to pay NRG if service to customer(s) is interrupted under conditions where the customer(s) have no obligation to pay. In IGPC's opinion, such a business interruption (caused, for example, by damage to NRG's system) is a business risk, and shareholders are compensated for business risks through the return on equity. If a business risk is mitigated by an insurance that pays the company, and thereby protects the shareholders, then either the cost of the premium should be paid by the shareholders, (i.e. not by customers) or the rate of return should be reduced to reflect the reduced level of business risk.
- iii. Appropriateness for recovery from IGPC alone: It appears that the intent of the insurance is to pay NRG if service to customer(s) is interrupted under conditions where the customer(s) have no obligation to pay. There is no evidence on which to conclude that the insurance addresses a risk specific to IGPC. It has not been shown that the intent of the insurance is to protect IGPC, as would be the case if proceeds were to be paid to IGPC if IGPC's business is interrupted, nor has IGPC ever requested or required NRG to obtain such insurance. There is also no evidence that the coverage is restricted to interruption of service to IGPC.

IGPC concludes that NRG has not substantiated that the cost of the Business Interruption Insurance is prudently incurred, and even if it were prudently incurred, the nature of the coverage is such that the costs should be paid by shareholders rather than by customers. IGPC therefore requests that the Board disallow the cost of the Business Interruption

Insurance for recovery in rates. However, it is clear IGPC should not bear this cost as NRG's witness testified that NRG's shareholder and their ratepayers benefited from the policy. Mr. Todd did not indicate that IGPC received any benefit from such policy.

*MR. TODD: Well, the purpose of the business interruption insurance is that its coverage kicks in if the business operations are interrupted and revenue stream is blocked.*

*MR. STOLL: Right, and that is to the benefit of the **shareholder**; correct? And the **other ratepayers** that NRG is able to continue on? [Emphasis added]*

*MR. TODD: Yes.<sup>27</sup>*

- b. **General Liability, Umbrella, and “Additional Umbrella”** - In support of its proposed allocation, NRG has merely stated in general terms that the addition of IGPC to the system occasioned NRG's upgrading of its coverages. In IGPC's view, this is not sufficient evidence that IGPC is the causal factor in the incurrence of the premium costs. There is no evidence that the umbrella and additional umbrella policies insure against risks that are different from those insured under the general liability policy, and no evidence that either umbrella policy specifically addresses risks imposed on NRG by IGPC (rather than simply providing a higher level of liability coverage across the system). On this basis, IGPC takes the position that it is inappropriate for the cost of \$10 million of additional umbrella liability to be assigned directly to IGPC. Rather, it is IGPC's position that 40% of the total cost of general liability and both umbrella policies should be allocated to IGPC.
- c. **Transfer Station Insurance** – NRG proposes that the insurance cost of the transfer station be directly allocated 100% to IGPC. It does not seem unreasonable that the costs of insuring a transfer station for the sole use of IGPC should be allocated to IGPC. Despite the request for additional information, NRG failed to provide any additional information that would permit IGPC to understand the expenditure of

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<sup>27</sup> Transcript, Vol. II, September 9, 2010, page 63, lines 2 thru 9.

\$35,387 to insure a station that cost \$884,003 for an amount of \$1,785,000. In addition IGPC questions what treatment is being given to the costs of insuring the station(s) that serve NRG's other classes of customers. For fair allocation treatment, those costs should be isolated and deducted from IGPC's allocation of insurance costs. IGPC suggests that the something less than the proposed annual premium of \$35,387 be approved on this basis.

- d. **Property Plant and Equipment Insurance** – Maintenance of the IGPC pipeline will be subcontracted out entirely to MIG and the equipment and fleet assets owned by NRG will not be utilized in the service of the IGPC pipeline. Therefore it is IGPC's position that no equipment floater and fleet insurance costs should be allocated to IGPC. While it is IGPC's position that a reasonable allocation would be 22.5% of the property insurance cost of \$2,828 (reference Undertaking J 2.6, Schedule – Insurance Allocation), or \$637. IGPC has taken a conservative approach and used the 40% allocator.

47. As summary of IGPC position regarding the allocation of insurance costs is provided in Tables 4 and 5.

**Table 4 - Allocation of Insurance Costs to IGPC**

Insurance Component	Coverage \$ million	NRG Application Test Year 2011 Premium	IGPC Allocation			
			NRG Proposal Undertaking J 2.6		IGPC Proposal	
General Liability / Umbrella	\$ 15.0	165,452	40%	66,181	40%	66,181
Additional Umbrella Liability	\$ 10.0	42,262	100%	42,262	40%	16,905
Business Interruption	?	25,580	100%	25,580	0%	-
Transfer Station		35,387	100%	35,387	40%	14,155
Property		2,828	22.5%	637	40%	1,131
Equipment Floater		1,355	22.5%	305	40%	542
Fleet		12,062	22.5%	2,715	40%	4,825
<b>Total</b>		<b>284,926</b>		<b>173,067</b>		<b>103,738</b>

**Table 5: Allocation of Insurance Costs: Rate 1 thru 5**

Insurance Component	Coverage \$ million	NRG Application Test Year 2011 Premium	Rate Classes 1 to 5	
			IGPC Proposal	
General Liability / Umbrella	\$ 15.0	165,452	60%	99,271
Additional Umbrella Liability	\$ 10.0	42,262	60%	25,357
Business Interruption	?	25,580	0%	-
Transfer Station		35,387	60%	21,232
Property		2,828	60%	1,697
Equipment Floater		1,355	60%	813
Fleet		12,062	60%	7,237
<b>Total</b>		<b>284,926</b>		<b>155,608</b>

48. Under the IGPC proposal, existing rate payers in customer classes 1 to 5 benefit with both increased insurance coverage and a reduction in the cost of the insurance subsequent to the addition of IGPC as a customer of NRG. IGPC submits its approach is reasonable and that it has been conservative in allocating costs to Rate 6 as it has not reduced the insurance cost associated with property plant and equipment and has not suggested eliminating premiums associated with the potential over-insurance of the transfer stations. The insurance costs for rate classes 1 to 5 under the IGPC proposal is \$155,608 which represents a 14% reduction compared to the insurance costs prior to IGPC of \$180,651 in the year 2008. IGPC would request the Board exclude the cost of Business Interruption insurance from rates.

**(c) Maintenance Expenses**

49. NRG is seeking to recover \$112,109 for third party O&M for the pipeline, plus \$43,050 for the Customer Station. In the Leave to Construct Application<sup>28</sup> prepared by AECON, approximately \$38,000 – an amount that included \$18,200 for additional insurance and maintenance of the customer station – was included as incremental O&M. The requested amount contained in the Application, sole sourced to 2 service providers, is almost 5 times the amount predicted. This is the equivalent of two additional employees for an entire year. IGPC submits the costs are unreasonably high and are not caused by IGPC but rather NRG is using IGPC as an excuse to impose such costs.
50. IGPC requested the specific regulatory and code references that mandated such work to be undertaken, and the required frequency, be provided. NRG did not provide such information and relied upon a general response from MIG Engineering, a company with no demonstrated pipeline maintenance experience that benefitted from the sole source arrangement. IGPC would note that if the work was to be carried out on an annual basis to comply with a regulatory or code requirement, the task should have been performed twice already and an underlying historical cost should have existed. However, no detailed justification and no historical costs were provided by NRG. Further, no attempt was made to ensure the practice was consistent with other gas utilities in the province.
51. Specifically, IGPC disputes the following:
- a. **Pipeline Markers** – NRG is sending out this work to a third party when its own employees are capable of carrying out such work. The leave to construct application<sup>29</sup> assumed NRG employees would carry out such work. The inclusion of this cost is symptomatic of NRG's lack of rigour to cost control.
  - b. **Weekly Observations** – NRG is contemplating a weekly inspection of the pipeline for a cost of \$12,350. While IGPC expects periodic inspections are appropriate, NRG has not provided express justification for the frequency or a solid rationale for

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<sup>28</sup> EB-2006-0243 Board Staff, IR 2(b).

<sup>29</sup> EB-2006-0243, TC-2 expressly included such cost.

requiring this service to be provided by a third party. Why were weekly as opposed to bi-weekly (a savings of \$6,175) or monthly inspections not appropriate given the limited amount of development in the Aylmer area.

- c. **Community Awareness (\$8,000)** – NRG has provided no indication that this program was solely the result of having a NPS 6 steel pipeline. Meetings with the fire department should deal with all natural gas fires. NRG's insurance company recognized the number and frequency of incidents would be higher on NRG's plastic distribution system. This cost represents approximately 75 hours of MIG time.
- d. **Emergency Response - Mock Emergency** - The \$18,000 annual cost represents approximately 175-200 hours of time. First, if there is third party damage to the IGPC Pipeline, the third party should be responsible for such costs and such costs should not be passed along to IGPC as it did not cause such costs to be incurred. Finally, there is no recognition that the effort to conduct such a mock emergency would likely decrease in subsequent years.
- e. **Manual Review/Technician Training** – IGPC submits that it is inappropriate for it to have to pay for the training of technicians hired from “companies that work for other gas utilities”. The costs of these third party service providers for the specific service being provided should include the cost of being competent to perform the task. Further, IGPC submits that allocating approximately 40hours per year to update manuals is an overstatement of reasonable costs.
- f. **Third Party Observations** – IGPC submits that the \$4,680 sought to be recovered should be recovered from the third parties that necessitate this work being done. IGPC understand that in other situations NRG would recover the costs from the party (e.g. municipality or developer) requiring such observation services. NRG confirmed that for the remainder of its distribution system that it would be appropriate to invoice the developer. IGPC does not understand, and NRG has provided no evidence, why such costs would be treated differently in so far as they apply to the IGPC Pipeline.



Finally, to charge IGPC does not accord with principle of cost causality as it is not the cause of such costs.

- g. **MIG Costs** – NRG is seeking permission to recover, through O&M, \$35,619 for “administration”, disbursements and engineering design. It is IGPC’s position since the engineering design, \$19,500 (or approximately 175 to 200 engineering hours)<sup>30</sup> is related to making the pipeline piggable, and that is a capital expenditure, the design should also be capitalized. NRG could not provide a capital forecast for any upcoming year and so the \$19,500 should be incorporated into the agreed capital expenditures. Further, the administration cost and disbursement cost will be reduced in direct proportion to any reduction in costs.

52. IGPC would suggest that the Board approve a direct allocation of \$35,000 to IGPC. IGPC would further suggest that the Board allocate approximately \$20,000 across all rate classes in respect of amounts claimed for Community Awareness and Emergency Response. IGPC would suggest the Board use rate base as the allocator. Therefore, IGPC would be allocated approximately \$4,500 in respect of these charges in addition to the \$35,000 directly allocated.

**(d) Station Maintenance**

53. In its response to IGPC IR#35, NRG indicated that the claimed expenditure for the maintenance of the station is \$43,050. This amount includes PST and inflation of 3%. IGPC would submit that the cost of maintenance on the station should not include any PST, as PST is not charged in the province of Ontario after July 1, 2010, and that the inflation is overstated. However, removing only the PST will generate an annual expense of \$39,861, or a reduction of \$3,189.

**(e) Allocated Administrative and General Expenses**

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<sup>30</sup> The number of hours is based upon the hourly rates of MIG employees found the Affidavit of Mr. Cowan, Exhibit C where hourly rates ranged from \$75 to \$138.

54. NRG's Application allocated 31.5% of the administrative and general expenses ("A&G") to IGPC. Following a review of the treatment of the Union Transportation costs for the purposes of classifying A&G costs as noted in Undertaking J 2.6, NRG excluded the Union transportation costs from the calculation which resulted in a reduction from 31.5% to 25.73%.

55. IGPC approves the approach and mechanics of the calculation as detailed in Undertaking J2.6. Given that the determination of the A&G allocation percentage to IGPC is dependent on both the costs directly assigned to IGPC as well as other revenue requirement figures, the calculation will need to be re-calculated to reflect the final costs approved by the Board.

#### **PART IV. Capital Structure & Cost of Capital**

56. NRG is requesting a deemed capital structure of 58:42 (debt:equity), and a return on equity ("ROE") of 10.35%. The proposed ROE exceeds by 50 basis points the ROE, the Board's recent *Report on the Cost of Capital for Ontario's Regulated Utilities* (EB-2009-0084, December 11, 2009) ("CoC Report"). NRG is seeking to maintain the premium of 50 basis points established for it previously when it was compared to Enbridge's ROE, which was set using a different formula than currently proposed.

57. NRG is also requesting that its cost of debt be established as its currently-existing net cost for all debt instruments, including in the mix a GIC of \$2.75 million held as a compensating balance for loans with the Bank of Nova Scotia. Under the borrowing arrangement, NRG has effectively borrowed \$2.75 million over and above the amounts needed for its business and invested the funds in a GIC, for which the rate of interest earned is significantly below the cost of borrowing the funds.

58. The unusual debt arrangements not only raise questions of interpretation as to the interest rate at which the debt should be considered to be incurred, but also creates confusion as to the debt:equity ratio that is forecast to exist in the test year.

59. IGPC will address the following questions:

- a. Is a deemed capital structure, rather than the actual capital structure, the appropriate basis to use in establishing NRG's revenue requirement, and if so, what should the deemed structure be?
- b. Should the premium of 50 basis points approved by the Board for NRG previously be continued, and if so, by reference to what standard?
- c. How should the amount of interest recoverable by NRG be determined, in view of the GIC?

**(a) Capital Structure**

60. The Board in EB-2005-0544 approved an equity ratio of 42% for NRG and in the Decision, stated that the actual ratio at the time was 41.5%. Since that time, NRG has made no equity contribution and has added over \$4.5million to rate base for the IGPC Pipeline; yet has still maintained a 42% equity component.
61. Since the decision in EB-2005-0544 NRG's auditors have begun to qualify their opinion on the financial statements, because of the provision that allows for retraction of the shares. Canadian Generally Accepted Accounting Principles ("GAAP") require such shares to be classified as a liability, rather than as equity. In IGPC's view, no evidence has been provided that the retractable shares constitute an investment by the shareholders that should be considered as equity on the same basis as ordinary, non-retractable common shares.

62. If the retractable shares are accepted as equity, there remains a significant issue as to how the actual equity ratio of NRG should be computed—i.e. should it be on the basis of “gross” debt or “net”. The “gross” computation would include in the calculation the \$2.75 million borrowed for purchase of the compensating GIC; the “net” computation excludes it. According to NRG’s evidence, and to its Argument-in-Chief at paragraph 100, NRG’s debt:equity ratio at the end of 2011 is forecast at 62:38 on a gross basis and on a net debt basis would reach 54:46. IGPC does not believe that these figures allow for reductions in capital for the IGPC pipeline that should be included in rate base.
63. NRG further argues that increases in equity ratio forecast to occur over the next five years should be considered by the Board in establishing a capital structure at the present time, because it would apply over the term of a proposed IR plan. This ignores the fact that the proposal for an IR plan has been set aside for consideration at a later date. However, the computations assume that the compensating balance arrangement would remain in place throughout the period, resulting in the continuation of the significant difference between gross and net in computing the capital structure.
64. IGPC submits that the combination of the retraction provisions of the shares and the issue of gross vs. net in computing “actual” capital structure effectively eliminate the possibility of using “actual” capital structure as a point of reference for the Board in approving a capital structure for NRG in this proceeding.

65. If the Board considered, as NRG argues that it should, NRG's five-year forecast of capital structure, the reference figures presented by NRG are an average of 53:47 (on a gross debt basis) and 43:57 (on a net debt basis). In so arguing, NRG relies on the Board's comment in EB-2005-0544 that the actual equity ratio should be used unless the actual ratio was unreasonable. IGPC submits that these ratios would in fact be unreasonable, as even the lower figure of 53:47 exceeds very significantly the equity component approved by the Board for the electricity distributors, and exceeds still more significantly the equity component approved by the Board for the other Ontario natural gas utilities. Approval by the Board of an equity ratio in this range on the basis that it is the actual ratio would effectively put NRG in a class by itself in terms of Ontario energy utilities.
66. IGPC therefore recommends that the Board deem a capital structure for NRG that is consistent with the capital structure approved for its peers in the natural gas and electricity sectors in Ontario. In approving the current deemed equity ratio of 40% for all electricity distributors, the Board explicitly rejected the prior framework that allowed a higher equity component to smaller distribution businesses. If the same approach is applied to the natural gas utilities, an equity ratio of approximately 36-37% would be applicable to NRG, consistent with the equity ratios approved for Enbridge and Union. The Board might also take the approach of using the deemed structure applicable in the electricity sector, since that sector has a large number of LDCs, some of which are in the size range, in terms of rate base and number of customers, of NRG.
67. In summary, IGPC proposes that the Board approve a deemed equity ratio for NRG of not less than 36%, and not more than 40%. IGPC also notes that if an IR plan is approved by the Board, and if the deemed equity ratio applies to the computation of earnings and over-earnings, NRG will have incentive to manage its capital structure, subject to the requirements of lenders.

**(b) Return on Equity**

68. NRG is requesting the Board to approve an equity rate of return of 10.35%, computed by applying a premium of 50 basis points to the 9.85% return approved in the Board's CoC Report. The premium was approved previously, by comparison with the rate of return for Enbridge, based on evidence that NRG's business risk exceeded that of Enbridge. However, the base upon which now seeks to add the premium is significantly different than used in the prior rate case and so NRG's argument is flawed. .
69. Neither Ms. McShane nor the company witnesses offered any evidence of the specific risks that distinguish NRG's business from the business of other Ontario electricity or gas distributors. While no party pointed to specific business conditions during the hearing as supporting a reduction in risk, evidence of the following important changes related to NRG's business risk is certainly before the Board in this proceeding:
- a. The loss of virtually all tobacco-drying loads from NRG's system has been reflecting in load forecasts for the test year, and is no longer a matter of any uncertainty.
  - b. While reliance on a small number of large industrial customers (i.e. IGPC) for the majority of throughput would normally be a risk factor, those risks are mitigated by:
    - i. contract terms that obligate IGPC to pay for the contracted throughput, whether gas is taken or not; and
    - ii. a letter of credit for the value of the IGPC Pipeline.
  - c. NRG proposes to purchase an insurance policy to protect its shareholders from the risk of business interruption.

70. Furthermore, in establishing a rate of return in the COC Report, the Board intended that the rate apply to a group of LDCs, each with slightly different business conditions and a slightly different mix of customers. The rate of 9.85% established by the COC Report is not rate of return based on the individual risk profile of Enbridge Gas<sup>31</sup>, and is therefore not appropriate as a base to which a risk premium, intended explicitly to compare risk levels between Enbridge and NRG, should apply. No evidence was provided as to how a rate of return separately determined for Enbridge might compare with a rate of 9.85%.
71. IGPC therefore submits that no evidence has been provided that NRG's level of risk is outside the range of risk levels faced by the 80 or so LDC's to which the rate of return of 9.85% is intended to apply. Therefore IGPC submits that the Board should approve a rate of return on equity for NRG of 9.85%.

**(c) Recovery of Interest**

72. NRG has applied to recover the full amount of interest paid on debt, less interest earned on the compensating Guaranteed Investment Certificate ("GIC"). As a rate applied to the full amount of debt, it is 6.69%; however when applied to the total borrowing net of the GIC, the rate of interest is 8.26%.

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<sup>31</sup> In responding to Board Staff IR 26, NRG acknowledged that "the Board's standardized approach to cost of capital for the electricity distributors ... does not recognize differences in cost of capital which result from differences in size and fundamental business risk factors".



73. In IGPC's submission, the Board should not approve the costs related to the compensating balance for recovery from customers. No evidence was provided to show that the compensating balance was a specific condition of the Bank of Nova Scotia loan obtained in 2008. No evidence was provided to show that NRG would breach its loan covenants with the bank if it ceased to renew any of the GICs during the test year or during the next several years. However, evidence was provided that NRG expects to reduce its outstanding debt and decrease the ratio of debt in its capital structure during the test year and beyond. NRG said in that on the next annual review with the Bank, it would endeavour to have the requirement for the GIC dropped.<sup>32</sup>In IGPC's view, the need to continue to hold the compensating balance for the foreseeable future has not been well established.
74. IGPC therefore submits that the Board should approve an interest rate applicable to NRG's "net" debt, thereby assuming the GIC is redeemed and the funds applied to reduce debt. In IGPC's view, the most logical assumption is that the amounts are applied to reduce the amount of a fixed rate loan to replace the fixed rate loan which is due March, 2011. IGPC accepts the interest rate forecasts offered by Ms. McShane as reasonable.

#### **PART V. Cost Allocation**

75. According to the evidence, the cost allocation study was developed **almost 20 years** ago.<sup>33</sup> The modifications for this proceeding are described briefly in NRG's revised main filing<sup>34</sup>, and consist primarily of incorporating new data, allocating 15% of marketing expenses to ancillary services, and overlaying the direct assignment of costs to Rate 6 (IGPC).
76. In IGPC's opinion, allocation of costs to IGPC represents a significant change to the methodology that warrants careful review. With only one customer, a direct purchase customer, in the new Rate 6, using dedicated facilities and with different requirements from other customers, NRG has correctly adopted an approach involving direct assignment of costs whenever possible. However, when direct assignment of some costs is accompanied by

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<sup>32</sup> Response to IGPC IR 60.

<sup>33</sup> Undertaking No. J2.5.

<sup>34</sup> EB-2010-0018, Exhibit G1 Tab 1 Schedule 1 Page 1 of 3 Updated.

“legacy” allocations, there is a potential result of duplicate allocations. In IGPC’s view, the treatment of insurance costs in this case, which represents an inappropriate combination of direct assignment and allocation of shared components, is a good example. A summary of NRG’s response to IGPC IR # 72 is provided below which highlights some of the reasons why IGPC is concerned with the existing cost allocation methodology.

**Table 6 – Allocation Summary**

<b>Description</b>	<b>A&amp;G</b>	<b>Allocated to IGPC<sup>35</sup></b>
Wages & Benefits	\$207,600	\$65,400
Insurance	\$74,200	\$23,400
Telephone	\$62,600	\$19,700
Regulatory	\$121,700	\$ 38,300
Bank Charges	\$16,300	\$5,100

77. The evidence shows that NRG is not using any of its staff to provide service to NRG, except for the monthly invoice, and for communicating the nomination value – tasks that would take but a few minutes each month. Further, the allocation and information regarding insurance was discussed extensively, and as identified elsewhere, IGPC has found the support and explanation for the claimed expenditures lacking sufficient information. This is also a concern for telephone costs. IGPC with a dedicated phone line for billing, is not unlike the other four (4) Rate 3 customers<sup>36</sup> whose telephone charges are \$447 each.<sup>37</sup>

**Table 7 – Example of Telephone Allocation**

<b>Item</b>	
Total Telephone Charges	\$65,000
A&G Component (96%)	\$62,600
Amount Allocated to Rate 6	\$16,107
Amount Allocated to Rate 3	\$1,789
Amount Allocated to each Rate 3 customer	\$447

<sup>35</sup> IGPC understands that these numbers will be modified by the correction identified by NRG to the allocation formula identified in J2.6 and by the Settlement Agreement.

<sup>36</sup> Exhibit C8, Tab2, Schedule 2.

<sup>37</sup> Exhibit G3, Tab 2, Schedule 1, Sheet 3.2 and Undertaking J2.6

78. Where a class is directly assigned a component of costs, the cost allocation analyst must carefully think through the directly assigned costs to ensure that the treatment is fair and appropriately reflects cost causation.
79. IGPC also questions how certain costs were classified as O&M or as A&G. This separation affects IGPC because certain costs classified as O&M were not allocated to IGPC, but IGPC is allocated a share of A&G costs. The rationale for the separation is not clearly explained. For example, there is no explanation of the nature of telephone services or bank charges, which would allow IGPC to assess the appropriateness of its allocation of these costs.
80. Beyond the areas specifically noted in this argument, IGPC is not requesting the Board to order changes in the allocation of costs for purposes of this proceeding. However, IGPC submits that having wound up a rate class and created a new one, the time is opportune for NRG to review the methodology and the computation model to ensure that both reflect patterns of cost causation in NRG's current business and organizational structure. When the model is revised, IGPC recommends that consideration be given to clarity in labeling and presentation of input data and results. IGPC also recommends that documentation describing the treatment of each cost at the stages of functionalization, categorization (classification), and allocation, be developed to accompany the tabular output.
81. IGPC submits that a proper cost allocation study is warranted and requests that the Board require NRG to prepare such a study for its next cost of service rate application.

#### **PART VI. Rate Design**

82. IGPC would suggest that any of reduction in NRG's cost of distribution service allocated to Rate 6 should be reflected in a reduced volumetric delivery charge. IGPC suggests leaving the fixed charge and the demand charge as proposed by NRG in the Application. IGPC recognizes that this will alter the fixed:variable ratio but feels a lower volumetric charge is appropriate and would be better suited to an IRM proposal as any consumption in excess of the minimum contract volume would have a muted impact and be less likely to trigger an "off-ramp".

**PART VII. Supplementary Submissions**

83. IGPC would like to make comments in respect of future steps and proceedings involving NRG and the establishment of just and reasonable rates. There have been many changes to the Application as a result of the Settlement Agreement, the correction of evidence and IGPC assumes further changes as a result of the Board's decision. IGPC requests that the Board ensure that sufficient time is provided for intervenors and Board Staff to review the draft rate order.

**(a) Cost Allocation**

84. IGPC submits the Board should, as a condition of the approval, require that NRG provide a cost allocation study in its next cost of service rate application.

**(b) Future IRM**

85. IGPC was in agreement with the parties that the IRM aspect of the Application should be deferred in order that the parties could better understand a number of factors to establish an appropriate IRM model.

86. As part of the settlement agreement, it was agreed that the depreciation on the pipeline would be 5% per year or approximately, \$237,231 per year. The annual depreciation amount included in NRG's rate related to IGPC is significant. During the course of the four years, there would be a 20% reduction, or approximately \$948,924, in the rate base of Rate 6. During the course of the IRM there will be a large reduction in the Rate 6 rate base and the relative portion such represents of the total rate base. IGPC expects that this unique situation will be reflected in any proposed IRM model.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED.**

October 5, 2010

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## Appendix A

### Undertaking J.2.2

## UNDERTAKING NO. J2.2: TO PROVIDE BREAKDOWN OF NUMBERS.

IGPC is providing the basis for the development of the table and the determination of the numbers. A general description of the columns used to organize the concerns is provided below. IGPC tried to determine an appropriate amount based upon the experience possessed, information that has been provided by NRG and costs from third parties.

**Inappropriate Direct Costs** – These costs are not appropriate for inclusion in the reconciliation of actually incurred capital costs – this would include contingency costs or operating and maintenance costs.

**Inappropriate InDirect Costs** – These are costs that should not have been necessary for the construction pipeline such as the administrative penalty, legal fees related to motions, appeal, the demand for \$32million in financial assurance and overlawying.

**Costs without documentation** – Self-explanatory really, this includes costs claimed but where there has been no documentation provided.

**Unreasonable Costs** – Costs claimed that we do not feel are reasonable in the circumstances such as paying \$295/hour for Mr. Bristoll.

As a result of the additional information provided by NRG has recalculated the amount of the dispute. IGPC has summarized the disputed amounts as follows:

<u>Description</u>	<u>Disputed Amount</u>
Administrative Penalty	\$140,000.00
Legal Costs	\$362,782.65
Project Management	\$349,609.50
Interest	\$140,605.07
EB-2006-0243 (see J2.1)	<u>\$6,281.09</u>
Miscellaneous	<u>\$81,041.00</u>
<b>Total</b>	<b>\$1,080,319.31</b>

### (i) Administrative Penalty

The \$140,000 penalty was thought to be inappropriate as IGPC felt that including such a charge is contrary to regulatory principles. IGPC requested from NRG whether such a charge had been permitted



in similar circumstances and NRG was not aware of any regulator approving such a charge to be recovered from a ratepayer.

**(ii) Legal Costs**

The disputed legal costs related to contingency costs, costs related to the motions, the appeal of the Board's decision, the police investigation, the libel claim and the gas nomination issue. In addition,

IGPC has disputed being responsible for any of the contingent legal fees. This amount has varied from \$86,088 to \$132,000. IGPC understands from the oral hearing the contingency fees are \$132,000 which are disputed because the fees were not incurred as part of the construction of the pipeline and there is no identified task for the expenditure of money related to the construction of the pipeline.

In response to IGPC IR #17 , NRG had acknowledged \$ 135,279.38 being spent on the two motions.

Description of Disputed Claim	Ogilvey Renault	Lenczner Slaght	Harrison Pensa	Notes
2007 Emergency Motion	\$10,000.00	\$23,003.25		(IGPC IR #17 ) \$52,725.54 Assume some includes reference to Appeal.
Appeal of Emergency Motion	\$13,850.00	\$47,949.79		July/August/September 2007 time related to appeal.
2008 Motion for \$32million demand (includes libel claim)	\$10,000.00	\$72,553.84		<u>IGPC #17, \$82,553.84</u>  Lenczner Invoice73976 \$21,007.93 @25% motion =\$10,500.00  Lenczner Invoice74245 total \$72,793.57; so assumed \$62,053.84 related to Motion.  Ogilvey invoice for Feb/March total approx. \$12,000.
Franchise Negotiations		\$4,000.00		Invoice 77360 – estimate of

				6 hours at \$675/hour
Police Investigation into Security Deposits		\$4,000.00		Invoice 77360 – estimate of 6 hours at \$675/hour
Over –lawyering, providing shareholder advice  Leave to Construct and Contract Negotiation	\$20,000.00		\$6,425.77	LTC and negotiation of agreements was in excess of \$175,000 for Ogilvey Renault and exceeded \$25,609.21 for Harrison Pensa. Based upon a review of invoices and .
Contingency	\$132,000.00			Per revision during oral hearing.
Gas Nomination		\$2,000.00		
Project Management		\$15,000.00		Paying L. Thacker for Project Management services but at rate of \$675/hour. Estimate based upon fraction of claimed by communicating directly with IGPC (G. Alkalay).
Post July 2008 Costs	\$2,000.00			J. Beauchamp time related to Union Gas Hearing
<b>Sub-total</b>	\$187,850.00	\$168,506.88	\$6,425.77	
<b>Total</b>	<b>\$362,782.65</b>			

### (iii) Project Management

With respect to Mr. Bristoll, IGPC understands the claim is for \$397,945 (Affidavit of Mr. Cowan, Exhibit E) at an hourly rate of \$295.00. This results in a total of 1,349hours. IGPC had indicated the claim was for \$388,585 or 1,317 hours. The original budget used for the leave to construct had \$100,000 which would be approximately 340 hours if the rate of \$295/hour is used.

#### Rate

Because the PCRA was based upon an actual cost, IGPC used a rate of \$100.00. This rate was estimated by using a \$75.00 per hour charge (\$150,000 annual salary) with a 33% loading factor.

IGPC estimated that approximately 1290 hours would be more appropriately charged at the \$100 hour rate. This left approximately 60 hours at \$295/hour for items beyond project managing such as negotiating the financing. This led to the majority of the disputed amount of \$251,439.50.

Hours Claimed

In reviewing the information provided, IGPC estimated that approximately 133 hours were not appropriate. NRG has indicated and remove 12 hours related to double counting. We estimated a further 121 hours were not related to the pipeline or were related to the motions and appeals.

**(Inappropriate Indirect Cost \$13,300 = 133 hours x \$100/hour, see Table below)**

**Disputed Hour Determination**

Time frame	Hours	Reasons
December 2006	23 hours	Admitted double entry + mismatch of times
June 2007	20 hours	Emergency Motion
July 2007	20 hours	Emergency Motion/Appeal
August 2007	10 hours	Appeal
February 2008	30 hours	2008 Motion (30 of 73 for month)
March 2008	30 hours	2008 Motion (30 of 118 for month)
<b>Total</b>	<b>133 hours</b>	

For time after December 2007, IGPC received only spreadsheets which indicated only time was spent on the file but provided no detail as to the activity. A copy of a sample timesheet is provided below. Also, given that hours after the completion of the financing and the commencement of full deliveries. IGPC disputed that sufficient documentation had been provided to substantiate the 850 hours claimed since December 2007. Some hours would be legitimate but without detail it was difficult to determine which hours. **(Costs without Documentation \$84,870.00 = 848.7 hours at \$100/hour)**

For example, IGPC was concerned that certain hours during June 2008 related to the Franchise issue with the Town of Aylmer as there was a dramatic increase in hours as compared to May 2008. Similarly, it appeared NRG was claiming hours in respect of the Union Gas proceeding, EB-2008-0273. Also, hours related to: (i) the police investigation into the security deposits; or (ii) solving the issue of the gas nomination should not be recoverable from IGPC.

**(iv) Interest**

IGPC made a number of conservative assumptions to determine that it would agree to \$50,000 in interest related costs.

<b>Description</b>		<b>Notes</b>
Claimed Amount by NRG		\$190,605.07
<b>Less:</b>		
Interest Claimed After Commencement of 100% Distribution Charges	\$89,206.18	= \$190,605.07 - \$101,398.89 The amount on July 15, 2008
Overstatement of Interest Rate by 1%	\$10,000.00	Estimate based upon percentage of claimed interest. The 1% would represent from 12% to 18% of the charged rate during the period. An estimate of a 10% reduction was taken.
Acknowledgement of Steel Purchase	\$22,783.45	\$911,388 for 6 months @ 5% (low estimate of Prime during 6 month period). If use 6% - then it would be \$27,341.64.
Incorrect Period for Claiming Interest	\$10,000.00	Start date too early – June 22, 2007 letter shows no interest claimed amount was \$6,886.02 plus estimate of interest on other invoices to final payment of final installment of aid-to-construct.
Elimination of Costs that relate to the Motion	\$10,000.00	Remove interest on legal costs related to the Motion
<b>Sub-total Expense</b>		\$141,989.63
<b>Agreed to Costs</b>		\$ 48,615.44
		Rounded to \$50,000.00 for purposes of the table and discussions with NRG.

**(v) Miscellaneous (Disputing - \$81,041)**

IGPC has disputed \$9,360 in claimed costs from Ayerswood Development, a related company to NRG, and IGPC is unclear what service was provided to substantiate such a claim.

IGPC has disputed \$9,681 for Neal, Pallett & Townsend who are NRG's auditors. It is unclear why the company needed an auditor as it appears some of the advice related to shareholder issues.

IGPC disputes the inclusion of \$62,000 related to insurance costs. This was an allocated O&M expenditure. No insurance was purchased for the construction project.

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