December 23, 2011

Sent by E-mail and Courier

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
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Dear Ms. Walli:

Natural Resource Gas Limited ("NRG")
2010 Distribution Rates Application (Phase 2)(EB-2010-0018)
Argument-in-Chief

Enclosed please find NRG's argument-in-chief regarding the issue of gas purchases from NRG Corp., as required under Procedural Order No. 10 (issued by the Board on December 8, 2011).

Yours very truly,

"*SIGNED"*

Richard King

RK/mnm

cc: All intervenors and interested parties

EB-2010-0018

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF Phase 2 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.

NATURAL RESOURCE GAS LIMITED
ARGUMENT-IN-CHIEF (Phase 2)

December 23, 2011

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A. INTRODUCTION

1. This document sets out the Argument-in-Chief of Natural Resource Gas Limited ("NRG") in respect of the last outstanding matter in NRG's application for fiscal 2011 gas distribution rates – namely the appropriate pricing of gas purchased by NRG from its related company, NRG Corp.

B. OVERVIEW OF THE ISSUE

2. NRG has purchased natural gas from NRG Corp., a related company, for over thirty years.

3. During that time, NRG's system has expanded significantly, from what was essentially a gathering system for local production (that also served a small number of customers) to a modern gas utility serving more than 7,000 customers today.

4. Over the years, the two companies (NRG and NRG Corp.) have been closely aligned both corporately (with, at varying times, common officers and employees) and operationally (with NRG Corp. drilling and developing wells in areas where NRG needed gas).

5. Throughout this time, NRG's ratepayers have benefited from the close relationship between the two companies in several respects:

   - local, dispersed natural gas supply points which contribute to system reliability;
   - reduced charges from Union Gas Limited (as a consequence of less gas being required by NRG at its interconnection points with Union Gas Limited);
   - lower gas distribution rates resulting from the avoidance of costly capital additions to supply NRG's southern service area; and,

- for most years, lower system gas costs (as compared to gas from third parties) as a result of not having to pay transportation charges on NRG Corp. gas.

Each of these points will be elaborated upon below, but this last benefit is significant. Throughout the course of this proceeding, the discussion has focused on comparing the price of gas from NRG Corp. to a "market price" based on published market indices. NRG submits that a more appropriate comparison would be one made against the price that NRG's customers are paying to get gas to NRG's franchise area (which includes transportation). This comparison is made in section H(b) below.

6. The availability and pricing for the natural gas sold by NRG Corp. to NRG had never been a contentious issue until the fall of 2009, when the market price of natural gas dropped to very low levels. Up until that point, the methodology established by the Board to govern commodity pricing between NRG and NRG Corp. had: (a) been satisfactory to NRG Corp. (i.e., allowed them to operate and continue to explore/develop wells); and (b) allowed NRG to demand and secure as much supply from NRG Corp. as NRG needed.

7. On September 1, 2009, NRG Corp. indicated that it was no longer in NRG Corp.'s interest to supply NRG with gas at the Board-established pricing methodology (market-based), which would have dropped the price from $8.486 per mcf to $6.40 per mcf. NRG Corp., like other gas producers, can choose to shut in its wells in times of low commodity prices, and wait for the price of natural gas to rebound.

8. However, given the significant growth in NRG's distribution system over the past several years, it became apparent in the fall of 2009 that NRG required a certain amount of gas from NRG Corp.'s wells in order to maintain a minimum system pressure and safe levels of odorant in the system. In other words, the "system integrity" issue came to light.

9. On September 30, 2009, NRG Corp. agreed to supply NRG with gas at the then-existing pricing of $8.486 per mcf. NRG determined at the time that this would be the most sensible way of dealing with the system integrity issue, and by far the cheapest for ratepayers.

10. Since then, NRG has been able to purchase gas from NRG Corp. at the $8.486 per mcf price, which has resolved the system integrity issue. This is the current status quo.

11. Because the pricing of NRG Corp. gas is tied to the system integrity issue, the evidentiary record on this issue has expanded beyond merely the appropriate price to be paid for gas from NRG Corp. to include an inquiry into whether there are other options for resolving the system integrity issue (i.e., other than requiring NRG to purchase gas from NRG Corp.). These other potential options are both physical and non-physical, and include:

- constructing additional pipeline capacity to NRG's southern service area;
- flowing additional gas through the interconnection stations between Union Gas Limited and NRG;
- utilizing the system shut-off valves in incidences of possibly inadequate system pressure in NRG's southern service area;
- considering the potential for demand-response/interruptible customers to alleviate low pressure issues in NRG's southern service area; and,
- considering whether there are alternate suppliers of natural gas in NRG's service area.

12. For the reasons set out below, it is NRG's submission that all of these potential options are far less desirable (for both NRG and its ratepayers) than continuing to enable NRG to purchase gas from NRG Corp., as it has for decades.

13. The only material change that NRG is requesting in this proceeding is that the Board-approved pricing methodology established for NRG Corp. gas sales incorporate a floor price of $8.486 per mcf.

14. A recap of NRG's proposed pricing methodology to govern gas purchases by NRG from NRG Corp. is set out in detail at the end of this Argument-in-Chief. What follows immediately below is NRG's submissions with respect to these "other" potential options for resolving the system integrity issue, followed by NRG's submissions in support of its floor price proposal.

C. ADDITIONAL PIPELINE CAPACITY TO SOUTHERN SERVICE AREA

15. As part of its Phase 1 Decision in this proceeding, the Board directed NRG to have an independent engineering study prepared to determine whether there was a "cost effective permanent solution" to the system integrity issue (EB-2010-0018 Decision, p.22). This study was completed by Aecon Utility Engineering ("Aecon") in accordance with terms of reference approved by the Board.

16. The purpose of the independent study by Aecon was to asses the existing NRG distribution system and identify viable alternatives to maintain adequate system pressures if the supply from NRG Corp. wells was zero (see Aecon System Integrity Study, July 15, 2011, section 1.1).

17. In order to accomplish this, the Aecon study ran the NRG system simulation model using a -28°C day, with grain dryers operating. In the absence of NRG Corp. wells supplying NRG's system, system pressures in the Town of Aylmer and south of Aylmer were inadequate (see Aecon System Integrity Study, July 15, 2011, section 4).

18. In response to an interrogatory from Board Staff (IR#13(f)), the simulation was re-run by Aecon with interruptible grain dryer customers shut off. Aecon concluded that there were still not acceptable pressures in the affected area (i.e., in the Town of Aylmer and south of Aylmer).

19. In NRG's view, the bases for the Aecon simulation are reasonable, and not extreme. A temperature of -28°C is cold, but not exceptional, in NRG's service area. In addition, there are a variety of factors that account for significant system demand (e.g., quantity and moisture content of grain, tobacco curing loads, early frosts, wind chill, etc.). In short, a scenario with -28°C temperatures and non-interruptible grain dryers operating is not an unreasonable system simulation from a temperature/demand perspective.

20. The conclusion reached by Aecon's simulations confirm NRG's observations from the fall of 2009 – that there is in fact a system integrity issue that requires some supply of NRG Corp. gas to the NRG system.

21. In order to resolve the system integrity issue, Aecon proposed three different alternatives for bringing additional gas supply to the affected area.

22. All three proposed alternatives involved significant capital costs and correspondingly significant rate increases to customers:

	Description	Capital Cost*	Delivery Bill Impact
Alternative 1	New gas supply from UGL HP facility east of NRG franchise area	$7.6 million	27.4% (Rate 1) 54.3% (Rate 2) 65.4% (Rate 3) 42.2% (Rate 4) 63.5% (Rate 5)
Alternative 2	New gas supply from UGL HP facility near Highway 401	$8.1 million	29.4% (Rate 1) 57.3% (Rate 2) 70.8% (Rate 3) 45.1% (Rate 4) 68.7% (Rate 5)
Alternative 3	New gas feed from UGL interconnection station near Highway 401	$22.9 million	N/A

*capital costs are exclusive of land acquisition, regulatory and environmental costs (which NRG has estimated could add 25 to 35% to the numbers above)

23. In dollar terms per customer, the costs to build a pipeline would be approximately $175 to $200 annually per residential customer versus a $25 to $50 "premium" for purchasing gas from NRG Corp. (with "premium" meaning above the current published index price).

24. It is NRG's submission that none of the physical supply alternatives proposed by Aecon make sense. For NRG's ratepayers, the distribution rate impacts associated with the Aecon alternatives are too great, and much greater than obtaining supply from NRG Corp. For NRG, it would be imprudent to make a capital investment in the order of $8 million with no new customers to support such investment.

25. Finally on this point, as NRG Corp. indicated at the November 30 hearing, it anticipates being able to supply NRG's gas needs for the foreseeable future. Further, NRG does not believe that the system integrity issue will materially change in scope in the short- to medium-term in such a way as to make the construction of a pipeline to the affected area a sensible option.

D. FLOWING MORE GAS THROUGH UNION'S INTERCONNECTING STATIONS

26. During cross-examination of Mr. Anthony Chan (Senior Engineer at Aecon) and Mr. Graat, the option of resolving the system integrity issue by increasing the amount of gas taken by NRG from NRG's connection points with Union Gas Limited was raised.

27. Both Mr. Chan and Mr. Graat indicated that maximizing the pressure at NRG's supply points from Union Gas Limited would not assist in resolving the system integrity issue because the issue was one of the ability of NRG's distribution system to move gas into the affected area (i.e., the Town of Aylmer and area south of Aylmer). In other words, the issue is one that is internal to NRG's distribution system (see Hearing Transcript from p. 89, line 15 through p. 91, line 1). As Mr. Graat stated at p. 50, line 3 of the November 30 hearing transcript:

> [W]e don't have a problem getting gas from Union into our franchise area. It's distributing it in the franchise area. So anything that's out of the franchise area is of very little help to us.

28. In Undertaking J1.2, Mr. Chan was specifically asked to run the model with maximized output at the Union supply points, and the response to this undertaking was as follows (at p.8):

> The Union Gas interconnections were reflected in all simulation model runs as having maximum outputs given current facility piping and equipment configuration. Additional capacities may be possible for some of these Union Gas facilities but not without substantial upsizing of facility piping and equipment.
>
> Additionally, to get the increased available capacities or volumes, a new pipeline and pressure regulating station will be required to bring gas to the problem-prone region of the NRG Limited distribution system.

29. Consequently, this alternative cannot resolve the system integrity issue.

E. UTILITIZING SYSTEM SHUT OFF VALVES IN LOW PRESSURE AREAS

30. Mr. Chan and the NRG witnesses were also cross-examined about the possibility of utilizing the system shut-off valves to manage the system integrity issue. Essentially, the idea is that when low pressure issues arise in certain areas on NRG's system, NRG could isolate the affected area (i.e., cut gas supply to the area) through the use of system shut-off valves until the conditions creating the low system pressure have passed. NRG could then return gas to the affected area.

31. NRG views this as an entirely unacceptable solution for several reasons.

32. First, NRG's system shut-off valves are for emergency purposes and not to be used as a routine tool for managing system pressure.

33. Second, the process of isolating a portion of the gas distribution system is not a simple undertaking – as Mr. Chan and Mr. Graat stated, bringing a portion of the system back from an outage would require a period of time for the system to re-adjust, and would involve re-lighting gas service to each customer (probably at a rate of 100 per day) (see Hearing Transcript, p. 95 starting at line 13; and Undertaking No. J1.3). As noted in Mr. Chan's response to undertakings given at

the hearing, the estimated number of customers impacted in the event of a system integrity issue would be 300 to 3,000 (Undertaking No. J1.3, December 16, 2011, p.11). These are significant numbers, which would make re-lighting the affected area a large undertaking, and potentially a costly one as well.

34. Third, there are other risks and costs associated with widespread outage in an area (particularly in very cold weather conditions). These include the potential for significant property damage, temporary replacement heating costs, and personal injury/death suffered by at-risk residents. (see Undertaking No. J1.3). These are not acceptable risks and costs, particularly when an ample, available local supply exists.

35. Finally, and perhaps most importantly, NRG regards its first and foremost job as supplying natural gas to its customers. The supply of a reliable fuel source has enabled NRG to significantly grow its business. In the case of rural customers, this growth has come through conversion of many customers who had previously utilized propane. All customers have energy options, and if it is perceived that NRG will start interrupting large numbers of customers, NRG believes these customers will exercise these alternative energy options.

36. For these reasons, NRG submits that managing the system integrity issue via the use of its shut-off valves is an unacceptable option.

F. POTENTIAL FOR DEMAND RESPONSE VIA INTERRUPTIBLE CUSTOMERS

37. Toward the end of the oral hearing on November 30, the Board Panel asked Mr. Chan to consider whether, at a high level, there was any demand response measure that could be utilized to alleviate the system integrity issue, given that NRG has interruptible customers.

38. This issue was addressed by Mr. Chan as an addition to Undertaking J1.1 (see p.4 of the Undertakings report prepared by Aecon). Mr. Chan did a model simulation run of the NRG distribution system with NRG Corp. gas wells off, as

well as all gas to interruptible customers shut off (Scenario #3). He then compared this to Scenario #2, which was a simulation run with all NRG Corp. gas wells off but all customer loads running (including interruptible customers). As Mr. Chan states:

> The idea is to examine if there are ways to alleviate possible low system pressure issues on cold winter days by making adjustments to system demands. For example, shutting off gas flows to customers on contracts with interruptible rates.

39. The conclusion was that system pressures under Scenario #3 improved somewhat over Scenario #2 "but the overall impact to the distribution network is such that wide-spread low system pressure would be experienced."

40. Consequently, utilizing the interruptible customers to provide demand response would not appear to be a mechanism capable of resolving the system integrity issue.

G. POTENTIAL FOR SUPPLY FROM OTHER LOCAL PRODUCERS

41. One other potential option to alleviate the need for NRG to rely on supply from NRG Corp. that was explored during the course of this proceeding was to determine whether other suppliers might be able to supply NRG, on demand, for a price below $8.46 per mcf.

42. It is the position of NRG, based on the evidence of Mr. Graat, that this is not a viable option for several reasons:

- although there are hundreds of wells in the area, these wells are not connected to the NRG system and owners of those wells are not prepared to make the capital investment to connect to NRG's system (which is even more true during periods of depressed gas prices);

- the owners of other wells in the service are mostly farmers that are unfamiliar with the gas business (i.e., they are not in the business of developing wells in order to transact the commodity);

- NRG views many other producers or potential producers they have dealt with as unreliable, particularly because the wells would have to be maintained and prepared to flow on demand; and,

- further, NRG's experience is that other parties that do not have the same interest in NRG as NRG Corp. will want some sort of regular payment (whether gas is provided or not) – i.e., some sort of standby charge for being able to supply if NRG requires gas for system integrity purposes.

(see Hearing Transcript, p. 46 starting at line 6, through p. 53, line 27)

43. Mr. Graat has significant knowledge on this topic. Through NRG Corp., Mr. Graat has been drilling gas wells in the Aylmer region for the purposes of serving NRG for over thirty years (see Hearing Transcript, p.45, starting at line 23, and p.46, starting at line 22).

44. Even if there were other viable producers, in times of depressed natural gas commodity prices, other producers (who are not in the business of selling gas and have no interest in the viability of NRG) will leave the gas in the ground and wait for prices to rise. That only makes sense.

45. In contrast, NRG Corp.'s business is closely tied with NRG. NRG Corp. has drilled its wells and brought wells to production for the sole purpose of supplying NRG. NRG Corp. has an interest in ensuring NRG has gas to supply its customers. Other suppliers do not have such an interest in supplying NRG.

46. For the above reasons, NRG submits that obtaining supply from other suppliers is not a viable option for dealing with the system integrity issue.

H. SETTING AN APPROPRIATE PRICE FOR NRG CORP. GAS

(a) Overview

47. It is NRG's position that the best option for addressing the system integrity issue is continued supply from NRG Corp., and that a floor price of $8.486 per mcf would enable this to occur. Since 2009, this $8.486 price has exceeded the market price for gas, but has been below the price that NRG pays for third party gas (as discussed below).

48. NRG does not dispute that the issue of pricing for gas transacted between NRG and NRG Corp. is a legitimate issue for Board consideration and determination. Because NRG and NRG Corp. are not at arm's length, the Board will want to ensure that NRG Corp. does not unduly benefit (through its gas sales to NRG) at the expense of NRG ratepayers.

49. In a transaction between a gas utility and an affiliate where a competitive market for the good exists, the Board's *Affiliate Relationships Code for Gas Utilities* ("ARC") dictates that the utility pay no more than the "market price" when acquiring that product from its affiliate. The "market price" can be determined via a competitive bidding process, or via benchmarking where evidence of a market price is available.

50. NRG and NRG Corp. are not affiliates, but given the relationship between the companies, NRG understands that the Board (for the purposes of setting rates) will want to ensure that if the price to be paid by NRG for gas from NRG Corp. is greater than the market price, there are reasons to support such pricing (see ARC, sections 2.3.4 through 2.3.6).

51. For the purposes of this Argument-in-Chief, there are two issues:

- What is the "market price" that should be used as a benchmark for the purposes of pricing gas purchased by NRG from NRG Corp.?

- What other factors should the Board consider in determining whether NRG's proposed floor price of $8.486 per mcf for gas purchased from NRG Corp. is a "just and reasonable" rate?

52. Briefly, on these two points, it is NRG's submission that:

- The average price that NRG pays to third parties to get gas to its franchise area is an appropriate and relevant benchmark for pricing gas purchased from NRG Corp.

- In light of the number of significant benefits accruing to ratepayers as a result of having NRG Corp. provide NRG with local supply of natural gas, the $8.486 per mcf floor price is just and reasonable.

Each of these is discussed below.

(b) Benchmarking NRG's Proposed Floor Price of $8.486 per mcf

53. In EB-2005-0544, the Board approved a methodology for establishing the price for gas purchased from NRG Corp. The methodology set an annual contract price based on the average forward price of the one-year forward strip price over the last ten business days in September (for each new contract year commencing October 1st). The methodology also approved the "Source Report" prepared by Energy Source Canada Inc. as the publication to be used as the reference for the one-year forward strip price.

54. The published strip price did not contain a transportation component to move that gas to NRG's franchise area. However, the price for third-party gas (i.e., not NRG Corp. gas) sold to NRG's system gas customers will contain both a commodity component and a transportation component.

55. Consequently, while one benchmark of pricing for gas purchased from NRG Corp. is a published market price at a liquid trading hub, NRG submits that an

equally valid benchmark would be the actual cost of third party gas to NRG's ratepayers (i.e., commodity, plus cost to get it to NRG's system).

56. As Ms. O'Meara indicated under cross-examination on November 30, in the past five years, the average cost of third-party natural gas (commodity plus transportation) purchased by NRG is significantly higher than the $8.486 per mcf paid to NRG Corp. Indeed, as Ms. O'Meara testified, if NRG had paid NRG Corp. the same price that NRG paid to get third-party gas into NRG's system, NRG would have had to pay NRG Corp. approximately $2 million more over those five years. In other words, in the last five years, if NRG had not had local supply from NRG Corp. at $8.486 per mcf, NRG's system gas customers would have collectively paid an extra $2 million for gas. Ms. O'Meara, as indicated under cross-examination, calculated these amounts from the January 2010 filed evidence at Tab 3 of the Book of Authorities filed as Exhibit K1.1 on November 30 (see Hearing Transcript, page 35, line 2 to 23).

57. The calculations based on the evidence (which includes actual and forecast) for the five years from fiscal 2007 through 2011 are set out in the table below:

	Fiscal 2007	**Fiscal 2008**	**Fiscal 2009**	**Fiscal 2010**	**Fiscal 2011**
Gas purchased from NRG Corp. (in m^3)	8,654,796	6,679,010	6,679,010	2,206,453	3,424,818
Price paid to NRG Corp.	0.301200	0.301200	0.301200	0.301200	0.301200
Actual price paid to third party	0.378893	0.409864	0.439948	0.349323	0.378097
NRG Corp. Less (More) than third party supply	$672,421	$725,767	$926,702	$106,180	$264,357
Cumulative Total	$672,421	$1,398,188	$2,324,890	$2,431,071	$2,694,428

* The "Gas purchased from NRG Corp." and "Price paid to NRG Corp." are taken directly from the "Cost of Gas" Schedules in the evidence.
** The "Actual price paid to third party" is a calculation based on the amounts and cost of purchases at Parkway and Western plus transportation (to establish an average cost). E.g., for Fiscal 2007, NRG purchased 9,440,656 m^3 of gas (sum of 3,125,250 + 6,315,406) at a cost of

$3,622,491 (sum of $1,046,155 + $2,136,707 + $394,141), for an average unit price of $0.378893 per m^3.

58. The table above is based on the January 2010 filed evidence (which contained actual and forecast information). Ms. O'Meara's testimony on November 30 was based on her calculations using updated actual gas purchased from NRG Corp. for the full five years, which drops the amount of the benefit to ratepayers (since NRG purchased less than forecast from NRG Corp. in the past couple of years). However, the benefit to ratepayers, when compared to third party gas purchased by NRG, is still in the $2 million range over the five year period.

59. To highlight the difference between utilizing the market-based publication versus the actual cost of gas as a benchmark, one need only look to the Board's decision in Phase 1 of this proceeding requiring NRG to refund $97,000 to its ratepayers. The Board will recall that this was the four-year cost differential (Fiscal 2007 through 2010) between: (a) the $8.486 per mcf price that NRG was paying NRG Corp.; and (b) the price that should have governed the price NRG paid had NRG utilized the EB-2005-0544 methodology (based on the published Source Report).

60. When compared to the table above (as adjusted for actuals by Ms. O'Meara), the difference based solely on the choice of benchmark is significant – had the Board methodology in EB-2005-0544 been based on the actual cost of third party gas delivered to NRG's franchise area, instead of NRG owing ratepayers $97,000, NRG would have been in a position of being owed about $2 million from ratepayers.

61. In NRG's view, the use of actual third party gas delivered to NRG's franchise area is at least as good a benchmark as a published index price at a liquid hub. Indeed, one could easily argue that the true "market price" for gas in NRG's franchise area is the actual cost of third party gas.

62. NRG is fortunate to have NRG Corp. investing in gas production in the region, taking all of the financial risk associated with drilling, and building the pipelines to

connect to the NRG system. These are all NRG Corp.'s costs that are legitimate, actual costs associated with getting the gas into NRG's system, in the same way that western gas producers, transmission companies and Union Gas Limited have legitimate costs for obtaining and delivering natural gas to NRG's service area.

63. On the basis of all of this, NRG's view is that there is more than one legitimate benchmark for establishing the pricing methodology for gas from NRG Corp. All should be considered by the Board in the context of the broader costs and benefits associated with NRG Corp. supplying NRG.

(c) Other Factors That Warrant a Floor Price of $8.486 per mcf

64. As noted in paragraph 5 above, NRG's ratepayers enjoy a number of benefits as a result of having NRG Corp. drilling wells and supplying natural gas locally to NRG (including the fact that the gas is cheaper to the NRG service area than third party gas).

65. Local supply has enabled NRG to avoid having to install additional capacity to the Aylmer/south of Aylmer region within its service territory. This is of direct benefit to ratepayers. As noted above, NRG has determined that the additional pipeline options proposed by Aecon would add approximately $175 to $200 to the average NRG residential customer's distribution bills annually (see Hearing Transcript, p. 36, starting at line 10; also see annual revenue requirement for additional pipeline approximately of $1.3 million at Exh. I, Tab 5, pp. 5 and 6).

66. This distribution rate increase is far smaller than any "premium" paid to NRG Corp. above the published market price. Indeed, as the discussion in the section immediately above indicates, it is arguable whether NRG Corp. is receiving any such "premium" if the price paid to NRG Corp. is compared to the actual costs of NRG's ratepayers for non-NRG Corp. gas. On that comparative basis, over the last five years, not only have NRG's ratepayers saved approximately $1.3 million

annually (avoidance of pipeline construction), but system gas customers have also saved a further $2 million cumulatively in natural gas costs.

67. There are, in addition, modest savings in the monthly demand charges from Union Gas Limited. At the close of the hearing, Panel Chair Quesnelle asked for a rough sense of these savings. Rough calculations would indicate that they have amounted to approximately $5,500 annually over the past few years. If NRG were able to negotiate a reduced daily peak quantity allowance with Union Gas Limited, the amount could be in the range of $21,500 annually. This is minor when compared to the savings for ratepayers as a result of avoided capital expenditures on a new pipeline and the pure commodity cost savings (even at the $8.486 per mcf price) resulting from not having to pay transportation.

68. It is NRG's submission that all of these savings are exactly the type of savings that should arise as a result of having local, dispersed sources of natural gas. In the electricity sector, the policy move towards smaller, more localized distributed generation is being promoted to address local supply needs, improve transmission and distribution reliability by reducing line losses and congestion on power lines, and to avoid the need for larger (more difficult to approve and harder to construct) infrastructure such as large power plants and transmission lines. The situation in NRG's service area is somewhat analogous – and is unique to NRG as compared to the larger two gas utilities in the province. In NRG's view, this is an opportunity, and the ability to supply NRG with local gas should be encouraged and not discouraged.

69. Finally, the evidence clearly suggests that the $8.486 per mcf price is not a price that NRG Corp. is demanding in order to obtain an inordinate benefit at the expense of ratepayers. The price is tied to what NRG Corp. needs to operate as well as ensure it is sufficiently capitalized to explore for and develop new wells in the region. NRG Corp. had never before refused to supply gas to NRG because of low commodity pricing. The Board-approved market-based pricing methodology had enabled NRG Corp. to operate and continue its

exploration/development work prior to the fall of 2009. Indeed, at $8.486 per mcf, NRG Corp. during 2007, 2008 and part of 2009 received a price for its natural gas that was even lower than the published market index, but that amount was sufficient at the time. It was not until the significant drop in commodity prices in 2009 that NRG Corp. determined it could not profitably provide gas to NRG.

70. NRG Corp. takes all the risk associated with well development, and provides all the capital expenditures to bring the gas to NRG's distribution system. The floor price of $8.486 per mcf will ensure NRG Corp.'s ability to do so for the remainder of the incentive regulation term.

71. In sum, NRG's ratepayers benefit significantly from the close relationship between NRG and NRG Corp., and a floor price of $8.486 per mcf would enable ratepayers to continue to enjoy those benefits.

(d) Proposed Pricing Methodology

72. At the November 30, 2011 hearing, NRG Corp. and NRG indicated that it would prefer a floor price of $8.486 per mcf for <u>all</u> natural gas sold to NRG. This is a modest change from NRG's previous "split-pricing" methodology that would have seen: (a) a floor price of $8.486 per mcf for the first 2.4 million cubic metres of gas purchased annually, which would be deemed required for system integrity ("Integrity Gas"); and (b) amounts of gas purchased over and above this amount ("Non-Integrity Gas").

73. The new proposed pricing methodology is meant to simplify the pricing methodology, and avoid debates about whether gas was or was not "Integrity Gas". NRG, in the course of the proceeding, had estimated annual Integrity Gas at 2.4 million cubic metres, but this was merely an estimate. As evident from the testimony on November 30, 2011, it is difficult if not impossible to truly determine whether gas is Integrity Gas or Non-Integrity Gas. As noted, wells are not switched on and off like light switches – they need to be prepared, tested, kept

free of water, etc., which depending on the well, may mean running a well weeks before needed for system integrity issues. Further, as Mr. Chan noted in his response to Undertaking No. J1.2: "NRG Corp.'s wells will cycle in and out at different times during the course of the day. The wells with the highest wellhead pressures will likely feeding [sic] into the system in a more consistent basis."

74. Consequently, NRG's proposal is that gas purchased from NRG Corp. be priced as follows:

- $8.486 per mcf whenever the "market price" for natural gas is $9.999 per mcf or less; and,

- "market price" for natural gas when gas is $10.00 per mcf or more.

75. As stated in NRG's Phase 1 argument, to the extent that NRG ratepayers would be paying more than published market commodity prices (although, as noted, usually still less than third party gas) when those market prices are below $8.486 per mcf, NRG is proposing to mitigate that risk by providing for an "upside" for NRG ratepayers when the market price for natural gas is between $8.486 and $10.00 per mcf. In that case, NRG's ratepayers would continue to pay $8.486 per mcf. If the price of natural gas went to $10.00 per mcf or higher, then the price paid by NRG would be market price.

76. NRG would propose that this methodology be left in place through the incentive regulation term, at which point the methodology can be revisited.

77. With respect to establishing "market price", NRG is proposing that market price be established in a manner different from that set out in EB-2005-0541.

78. In NRG's view, there were a couple of problems with the previous methodology. First, the Source Report is not reported on a regular or consistent manner as publications from larger companies (e.g., Shell Report). Consequently, NRG proposes that the Board methodology allow for NRG to base the price on any one of a few specific indexes selected by the Board (including the Shell Report).

Second, utilizing the last 10 days of September to set an annual contract price carries risks of being "out of the market" for both NRG and its ratepayers. For example, had NRG used the September monthly average in 2006 instead of the last ten days of September, the $71,897 underpayment by NRG to NRG Corp. would have been a $329,000 underpayment. In other words, the price drop in natural gas over the course of September 2006 alone was enough to more than quadruple the differential over the three year period. This risk can be reduced by adjusting the contract price with NRG Corp. quarterly (coinciding with NRG's QRAM). The contract price would be based on a similar average of the one-year forward strip prices over the last ten business days of the second month preceding the month for which a price would be established (e.g., last ten business days of August for pricing effective October 1).

All of which is respectfully submitted this 23rd day of December, 2011.

NATURAL RESOURCE GAS LIMITED

"SIGNED"

By its Counsel, Norton Rose OR LLP
Per: Richard J. King