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June 27, 2012

Filed on RESS
Sent By Email

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Your reference
EB-2010-0018

Our reference
01012724-0011

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Dear Ms. Walli:

Natural Resource Gas Limited – Aylmer Franchise Renewal (EB-2012-0072)

We are counsel to Natural Resource Gas Limited ("NRG"). in the above-noted proceeding. This letter is written in response to the proposed issues lists filed by the Town of Aylmer (the "Town") and Integrated Grain Processors Co-operative Inc. ("IGPC") on June 20, 2012.

Before addressing the specifics of the submissions of the Town and IGPC, as a general comment NRG submits that all but two of the issues being proposed by the Town and IGPC are beyond the Board's jurisdiction in this case (i.e., are outside the scope of NRG's application). NRG submits that in assessing the costs of this proceeding, the Board should take into account not only the ultimate outcome of the proceeding but the conduct of parties to the proceeding, and their contribution to the costs of the proceeding.

The matter before the Board is an application by NRG pursuant to section 10 of the *Municipal Franchises Act* (Ontario) ("MFA") to renew its franchise agreement with one of the municipalities served by NRG (i.e., the Town of Aylmer). The Board's jurisdiction in MFA applications such as this one is to determine whether the "public convenience and necessity" require the renewal of NRG's franchise agreement with the Town (and if so, on what terms). There are a number of OEB and judicial decisions that have clarified: (a) the jurisdiction of the Board under section 10 of the MFA (see NRG's response to the Town's proposed issue 1 below); and (b) the "public convenience and necessity" test (see, for example *Union Gas v. Township of Dawn* (1977) 76 DLR 613 (Div. Ct.)). The majority of the Town's and IGPC's proposed issues are answered by this existing jurisprudence.

Each of the issues being proposed by the Town and IGPC are considered in turn below.

Town of Aylmer's Proposed Issues List

1 ***The Board's Decision and Order dated May 5, 2009 in EB-2008-0413 (the "2009 Franchise Decision") at page 12 refers to the Board's 1986 Report in acknowledging the legitimacy of "municipalities seeking alternative supply in the appropriate circumstances".***

a. What is the process for municipalities seeking alternative supply to follow?

b. What are the "appropriate circumstances" in which the Board would order that municipalities be permitted to not renew their Franchise Agreement(s) in order to seek alternative supply?

NRG Response: This proposed issue is beyond the scope of this proceeding. This issue of competing gas providers and attempts to remove incumbent gas providers has been dealt with by the Board since the 1986 Board Report noted in the question. In EBLO 232 (*Horseshoe Valley* case, September 6, 1989) and EBLO 225 (*Hope and Hamilton*, July 22, 1988) the Board considered competing applications by utilities who both wanted to service the same franchise area. In both cases, the Board held that an existing franchise holder has a priority right to serve that area. The Board's decisions are consistent with the American jurisprudence which states that a competing utility provider should only be allowed to "invade the field" when it has been demonstrated that the existing utility provider is unable to property serve the public (*State of North Carolina Utilities Commission v. Carolina Telephone and Telegraph Company* (1966), 64 P.U.R. (3d) 243). More recently, the issue was dealt with in the case of *Re Centra and City of Kingston*, EBA 825 (June 22, 2000) where the Board denied Kingston's attempts to replace Union Gas Limited as the distributor in the Town of Pittsburgh portion of Kingston.

Only NRG owns and operates gas distribution facilities in the Town of Aylmer. The Board has no authority to transfer ownership of NRG's system or appoint someone else to operate NRG's system (EBA 825, and *Sudbury (City) v. Union Gas Ltd.* (2000), 47 OR (3d) 654 (SCJ)). If the Town wants an alternative supplier, it must construct (or have an alternative supplier construct) a gas distribution system in Aylmer. In such a scenario, the Board would be required to determine if it is in the public interest to approve the construction of works for a second franchise in an already franchised municipality, and it is clearly not in the public interest to do so.

Finally, NRG submits that the Town overstates both the Board's determination in EB-2008-0413 and the importance of the Board's 1986 Report. The generic proceeding that resulted in the 1986 Report was convened by the Board "in order to provide a forum for the discussion of a number of general and specific concerns which have arisen over the last few years regarding municipal franchise agreements for the distribution of gas in Ontario." The major recommendation of the 1986 Report was to establish a Municipal Franchise Agreement Committee ("MFA Committee") to probe the issues canvassed at the generic proceeding more deeply. The Board findings in the generic proceeding were explicitly stated to be not legally binding on its future deliberations." With respect to the provision cited in the Town's proposed issue #1 above (section 7.39 of the 1986 Report), that provision is found in the portion of the 1986 Report that dealt with the appropriate duration of franchise agreements and is not found in the section that deals with franchise exclusivity and the approval of a second supplier in an area already being served. This is dealt with earlier in the 1986 Report (section 7.13). Further, section 7.39 of the 1986 Report (had it been fully quoted in EB-2008-0413) indicates that the issue of a uniform expiry date for a utility's franchise arrangements should (in the Board's opinion) be dealt with by the MFA Committee. The ultimate Model Franchise Agreement developed by the MFA Committee did not see fit to include any mention of uniform expiry dates.

None of EB-2008-0413, the 1986 Report or the work of the MFA endorsed any "process" to replace existing gas distributors. The case law governs, and the issue being proposed by the Town would re-visit a generic issue that has been settled by the Board and the courts. There is no place for this issue in this proceeding.

2 ***Subsection 10(2) of the Municipal Franchises Act clearly gives the Board jurisdiction to make an order refusing a renewal or extension of the rights contained in a Franchise Agreement. Section 2.2 of the OEB Act requires that the Board in exercising such power have regard to, among other things, the interests of consumers with respect to the reliability of gas service.***

a. What powers does the Board have to ensure the reliability of gas service in period of transition between the making of an order refusing the renewal or extension of a Franchise Agreement and the commencement of service by a new supplier under a new Franchise Agreement.

b. What is the appropriate process for municipalities seeking alternative supply to request the exercise of those powers?

NRG Response: See NRG's response to Town's Proposed Issue #1.

3 ***The 2009 Franchise Decision, at page 12, acknowledges the legitimacy of municipalities in the NRG service area seeking to align the expiration dates of all of their respective Franchise Agreements.***

a. What is the process for municipalities to follow in order to seek orders of the Board aligning the expiration dates of their respective Franchise Agreements?

b. Should this proceeding be adjourned, with the Interim Order herein dated February 27, 2012 remaining in effect, until such time as similar applications have been commenced in respect of each of the Franchise Agreements of the other municipalities in the NRG service area, so that the issue of the alignment of the renewal and expiry dates can be addressed in a consolidated hearing?

NRG Response: See NRG's response to Town's Proposed Issue #1. As noted above, the Town's reading of both EB-2008-0413 and the 1986 Board Report overstate the Board's interest in expiry date alignment. Section 7.39 of the 1986 Report (had it been fully quoted in EB-2008-0413) indicates that the issue of a uniform expiry date for a utility's franchise arrangements should (in the Board's opinion) be dealt with by the MFA Committee. The ultimate Model Franchise Agreement developed by the MFA Committee did not see fit to include any mention of uniform expiry dates. Moreover, NRG is not aware of the Board making any concerted effort to align franchise expiry dates.

4 ***Whether the Board should reconsider the 2009 Franchise Decision in light of its February 11, 2011 Decision and Order in EB-2010-0374?***

NRG Response: NRG is not seeking a "reconsideration" of the 2009 Aylmer franchise decision. In EB-2010-0374, the Board decided to vacate the administrative penalty issued against NRG in its entirety, together with the finding of non-compliance giving rise to it. The administrative penalty, in NRG's reading of the 2009 franchise decision, was one reason for the shorter than normal (i.e., 20 year) franchise term. This matter is currently before the Divisional Court.

5 ***If the Franchise Agreement with NRG is to be renewed, should the Board make it a condition of renewal that:***

a. NRG be required to commit to conduct and adopt a new cost-allocation study to ensure that all cost and revenues are properly allocated between rate classes prior to its next rate hearing;

b. Either,

i. NRG's shareholder be required to remove the "retractable" feature of NRG's Class "C" shares; or

ii. NRG be required to provide to the municipalities a Postponement Agreement in favour of NRG's security deposit holders relating to the redemption of the Class "C" retractable shares in a form substantially similar to the Postponement Agreement that NRG provided to the BNS on August 26, 2008 and that it provided to Union Gas pursuant to the Board's Decision and Order dated November 27, 2008 in EB-2008-0273; and

c. NRG be required to implement a complete separation of its utility gas distribution business from its non-utility ancillary businesses such as hot water heater rentals?

NRG Response: With respect to item (a), the proposed issue is a rate issue. NRG recently completed a lengthy cost-of-service proceeding at which cost allocation issues were considered and dealt with by the Board. If this issue were important to the Town, it had ample opportunity to raise this issue over the past two years. Rate considerations are irrelevant in a franchise proceeding. If it were otherwise, then the logical extension is that the ability of an electricity distributor to continue to operate in its service area should be contingent on its rates in comparison to rates of other neighbouring utilities. NRG's rates are, and have always been, just and reasonable.

With respect to item (b) (i), the Board has no jurisdiction over NRG's shareholder so cannot order the removal of the retractable feature of NRG's Class C shares.

With respect to item (b) (ii), the retractable share issue continues to be a red herring in NRG's view. First, the holder's ability to call for the shares to be redeemed is nil – it has postponed the retractability of the shares in favour of: (a) NRG's lender for so long as NRG is indebted to the lender; and (b) Union Gas Limited for so long as NRG is in a position of owing Union Gas money. With respect to (a), NRG will not be without a lender, so this postponement commitment is basically permanent. With respect to (b), because NRG drafts the Union Gas Limited system (i.e., NRG's contract year with Union commences late fall, meaning that NRG's usage at the beginning of the contract year is greater than its consumption later in the contract year, yet its contractual commitment is straight-lined over the contract year), it is essentially always in the position of owing Union Gas Limited money. So again, this postponement is effectively permanent. Moreover, the Board routinely monitors the actual debt-to-equity ratio at every utility rate proceeding (including NRG's) to determine whether a utility is (in the view of the Board) too highly leveraged. When all of this is taken together, the issue of the retractable nature of NRG's Class C shares is non-issue.

With respect to item (c), the separation of NRG's non-utility and utility businesses is an issue long familiar to the Board, and one which has been carefully overseen by the Board in past rate applications (i.e., it is ultimately a rate issue and not one of proper gas distribution service). At the time that the Board required larger gas utilities in Ontario to separate their utility and non-utility businesses, the Board agreed to address the issue for NRG (a much smaller utility), as follows:

- In EBRO 496 (August 1998), NRG agreed to change to a fully allocated cost ("FAC") methodology for the purposes of allocating the costs of its ancillary programs, and to provide sufficient information to achieve the application of such methodology at its next rate application (see p. 7 of the ADR Agreement in EBRO 496).

- The resulting FAC study and costing allocations were presented at NRG's next rate application (RP-1999-0031, March 2000) and accepted by the Board (see paras. 91-95 of RP-1999-0031 decision).

- In EB-2002-0446, the Board approved the results of a further study which outlined the segregation of costs relating to non-utility business activities.

The Board remains content with the present arrangement. Indeed, the Board affirmed in EB-2010-0018 that it is "satisfied that the current cost allocation methodology appropriately separates the costs and assets of the regulated and ancillary business", and it did not find sufficient justification to unbundle NRG's businesses.

The issue is ultimately a rate issue in part because it is a cost allocation question, but also because it is likely that the separation of NRG's utility and non-utility businesses would likely result in adverse cost consequences for NRG ratepayers. In 2005, when Union Gas separated its storage services business into a "non-utility asset", the result was that any profits earned from that asset could no longer be used to reduce gas distribution rates. Instead, the separation was anticipated to increase residential rates (see EB-2005-0551, p. 4). Even with the separation ordered in that case, the Board found it unnecessary for Union and Enbridge to make a full, functional separation of their utility and non-utility storage assets, as it would be costly and difficult (p. 73). In sum, the

issue is a rate issue, and not relevant to the "public convenience and necessity" determination required by the Board in a section 10 MFA application.

6 ***Whether there are continuing concerns regarding NRG's quality of service, reliability, and financial viability that affect the renewal terms sought by NRG?***

NRG Response: NRG has no objection to this issue provided the word "continuing" is removed. The issue as framed by the Town is prejudicial in that it presumes that NRG's quality of service, reliability and financial viability have been less than appropriate in recent years, and there is no evidence to support this. NRG has not been advised by the Town (as noted by the correspondence in NRG's application) of any such issues.

7 ***If the Franchise Agreement with NRG is to be renewed, is there any reason to renew it for a term greater that the 10 years, that was considered adequate for a renewal agreement in the 2009 Franchise Decision at page 5, and in the Board's 1986 and 2000 Reports?***

NRG Response: The length of term of the franchise agreement is obviously an issue to be determined by the Board. However, if the Board is going to frame this issue by reference to a "standard" or "default" renewal term, then 20 years should be the standard or default term (rather than 10 years as proposed by the Town) since that is the renewal period set out in the Model Franchise Agreement. Indeed, NRG submits that the appropriate framework for the Board's determination on the issue of term of the franchise agreement is to consider whether there are public interest reasons for a shorter than 20 year renewal period, since that renewal period is the Board's standard policy and is based on years of Board practice. The rationale for the Board making 20 years the standard renewal term is obvious – it allows for utility's the ability to plan and fund long-term capital expenditures.

8 ***Who should bear the costs of this proceeding?***

NRG Response: NRG agrees that this is a relevant issue in this proceeding, and NRG (as evidenced in the correspondence in the pre-filed evidence filed with the section 10 MFA application) has consistently raised the costs of this proceeding with the Town.

<u>IGPC's Proposed Issues List</u>

1 ***What are the elements and standards of quality of service the Board considers during a renewal of a franchise agreement? Has NRG satisfied each of the required elements and standards in providing service to the ratepayers?***

NRG Response: See NRG's response to the Town's proposed issue #6. In addition, the approach suggested by IGPC here is flawed. The Board's discretion in section 10 MFA applications is to make its determination on the basis of a broad "public interest" test (*Union Gas v. Township of Dawn* (1977) 76 DLR 613), and proceeding as IGPC suggests (by establishing an itemized checklist of service quality standards and evaluating a utility's performance against each) would risk fettering the Board's discretion in favour of a mechanical decision-making exercise. Moreover, the approach being proposed by IGPC seems to suggest that if there was less than perfect compliance with every single checklist item, the that would be sufficient reason to depart from the standard franchise renewal terms. This is impractical – imagine if the Board were to open up electricity distributor licence service areas if an LDC was late with a regulatory or rate application filing.

2 ***Has NRG complied, and is it in compliance, with the requirements of the Gas Distribution Access Rule?***

NRG Response: The issue of NRG's regulatory compliance is already covered off in the draft issues list provided by NRG on June 13, 2012.

3 ***Are there any outstanding Board orders or directives pertaining to NRG?***

NRG Response: There are almost always outstanding Board orders and directives to NRG (mostly related to rates). If IGPC is aware of an order or directive that calls into question the ability of NRG to properly serve its customers (i.e., that touches on the public interest test that comprises the Board's "public convenience and necessity" deliberations), then that would presumably be dealt with in the regulatory compliance issue proposed by NRG in its issues list.

4 ***Should NRG provide an annual certification as to its compliance with paragraphs 2 and 3 to the Board and to the municipalities in which it operates?***

NRG Response: Ongoing regulatory compliance is within the jurisdiction of the OEB, and not within the jurisdiction of the Town. NRG is not aware of any other utility that must do this, and submits that it is unnecessary.

5 ***Should NRG and Aylmer be obligated to participate in regular meetings (i.e. quarterly, on a pre-scheduled basis) to discuss and resolve any issues that may arise? Should Board Staff be present at such meetings and in what roles? Should these meeting include other municipalities or result in a public report to ensure ratepayers are kept informed?***

NRG Response: This is not an issue related to the Board's determination of a section 10 MFA application, but rather appears to be a proposed condition in the franchise agreement between NRG and the Town. The Board will ultimately determine whether any abnormal conditions not currently in the Model Franchise Agreement should be included, on the basis of the evidence in this proceeding and the submissions of the parties. NRG notes that the Town has not asked for this condition. Any issues of concern the Town has should be brought to NRG by the Town as they arise.

6 ***Does a Franchise Agreement have to be renewed for the entire geographic territory of the municipality? If not, in what circumstances would the Board consider splitting a franchise and what process would be used for such?***

NRG Response: See NRG's response to the Town's proposed issue #1.

7 ***Should the Board consider the events that preceded the 2009 Franchise Decision which renewed the franchise agreement for a term of 3 years in light of its February 11, 2011 Decision and Order in EB-2010-0374?***

NRG Response: See NRG's response to the Town's proposed issue #4 and IGPC's proposed issue #1.

8 ***Has NRG had any discussions with its lenders regarding this proceeding and will the outcome potentially impact its ability to carry on operations?***

NRG Response: This issue is beyond the scope of this proceeding.

9 ***If there are concerns regarding service qualities or other factors to be considered by the Board in the renewal of a franchise agreement, should the Board deal with such concerns by the way of: (i) order; (ii) the franchise agreement; or (iii) both mechanisms?***

NRG Response: This is a non-issue. The Board will issue an order and a franchise agreement at the end of this proceeding as it sees fit.

10 ***Is NRG involved in any significant lawsuits, claims, actions or applications or similar proceedings? If so, could or do any of the proceedings(s) create a risk of an adverse impact to NRG or ratepayers?***

NRG Response: NRG is not involved in any suits, claims, actions or applications of this type.

11 ***Are all other franchise agreements to which NRG is a party in effect and in good standing?***

NRG Response: NRG's other franchise agreements are known to NRG, the Board and the applicable municipalities. They are unrelated to this section 10 MFA. Moreover, the Board had no jurisdiction over those other franchise agreements until an application is made to the Board by either NRG or the applicable municipality, which application cannot be made until (at the earliest) one year prior to the franchise agreement expiry.

12 ***Excluding general industry reliability issues, are there any circumstances which pose a risk to the reliability of gas service within the franchise area? if so, what are the risks and what is being done to mitigate such risks?***

NRG Response: See NRG's response to the Town's proposed issue #6.

13 ***In previous proceedings, NRG has indicated that it was discussing the potential to sell the utility, Given such statements by NRG, is there any sale (in whole or in part) or change of control of NRG being contemplated? If so, on what timelines should such a process be completed and are further Board approvals required?***

NRG Response: There is no plan to sell the utility. If there were, the Board has jurisdiction to deal with the matter under section 43 of the *Ontario Energy Board Act, 1998*.

14 ***NRG has indicated that its ownership structure is unique, being a trust, and so it is unlike other utilities in the province. IGPC understood from prior proceedings that the health of the trustees may be an issue. Is there a succession plan for the trustees that administer the trust that owns NRG to ensure ratepayers are not exposed to any significant risk? If not, should there be an obligation to develop such a plan? Is there any obligation for the trust to be wound up during the requested term of the franchise agreement?***

NRG Response: This is beyond the scope of the proceeding and frivolous.

Should you have any questions, please contact me.

Yours very truly,

[original signed]

Richard King

RK/mnm

Copy to: B. Cowan (NRG)
L. O'Meara (NRG)
All Intervenors
K. Viraney (OEB)
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