Ontario Energy Board

Commission de l'énergie de l'Ontario

EB-2008-0273

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 Union Gas Limited for an Order pursuant to Section 36 of the *Ontario Energy Board Act, 1998,* seeking changes to reduce its financial exposure in regard to a Bundled T Gas Contract and an M9 Delivery Contract with Natural Resource Gas Limited.

BEFORE: Gordon Kaiser
Presiding Member and Vice-Chair

Cathy Spoel
Member

DECISION AND ORDER

On August 1, 2008 Union Gas Limited ('Union") filed an Application pursuant to Section 42(1) of the *Ontario Energy Board Act, 1998* seeking the Board's approval to discontinue service to Natural Resource Gas Limited ("NRG"). The Application was amended on October 9th and Union requested alternative relief under Sections 23 and 36 of the *Act*.

The Board has granted intervenor status to two parties, Integrated Grain Processors Co-operative ("IGPC") and the Town of Aylmer.

NRG sells and distributes natural gas in southern Ontario in a service territory that stretches south from highway 401 to the shores of Lake Erie. NRG has approximately 6,500 customers located in and around the Town of Aylmer. The largest customer is IGPC, an ethanol plant in the Town of Aylmer owned by a 650 member Co-operative of southern Ontario corn producers.

Background

NRG delivers gas to Union in firm, daily, even quantities pursuant to a Bundled T Gas contract ("BT Contract") first made as of October, 2004. Union delivers gas as a gas transmitter to NRG pursuant to an M9 Delivery contract ("Delivery Contract") first made as of October, 2006. Both contracts have now come to an end and Union is currently supplying NRG on a month-to-month basis without a contract.

Section 5.04 of the General Terms and Conditions of both the BT Contract and the Delivery Contract provide as follows:

> *"**5.04 Financial Assurance***
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> *If at any time during the Term of this contract, Union has reasonable grounds to believe that Customer's creditworthiness under the Contract has become unsatisfactory, then Union may by written Notice request financial assurances from Customer in an amount determined by Union in a commercially reasonable manner. Upon receipt of such Notice, customer shall have fourteen days to provide such financial assurances."*

Union states that it has reasonable grounds to believe that NRG's creditworthiness has become unsatisfactory and seeks certain financial assurances from NRG which NRG to date has refused to grant.

Union advised the Board that its maximum exposure from NRG is currently in the range of $1.9 million and that it is only prepared to grant an unsecured facility of $600,000 leaving a balance of $1.3 million to be satisfied by certain security arrangements.

Union proposes two alternatives to NRG. First, NRG can provide assurances in the form of a cash security deposit or a letter of credit in the amount of $1.3 million. Alternatively, NRG can make arrangements to change the renewal date of its BT Contract to an annual anniversary date of April 1st. The result of the date change would be to limit the credit issues arising from NRG's Banked Gas Account on a going forward basis.[1]

NRG's response is that its creditworthiness has not deteriorated and it has never failed to pay its bills to Union. NRG indicated in its letters of July 2 and September 5, 2008 that it would not post additional security nor change the date of the Bundled T Contract.

Union cites two developments as legitimate reasons for believing that NRG's creditworthiness has deteriorated. First, Union notes that its 2007 credit review of NRG was based on NRG's 2006 audited financial statements which contain a qualified auditor's opinion. The reason for the auditor's qualified opinion was that NRG had Class "C" retractable shares outstanding with a redemption value of about $13.5 million and under Canadian General Accepted Accounting Principles ("GAAP") rules these shares must be presented on the balance sheet as a liability.

NRG's Financial Status

The Class "C" retractable shares have been in existence since 2003 but in previous audited statements these shares were classified as equity as opposed to liabilities. Mr. David Pallett of the firm Neal, Pallett and Townsend, the NRG auditors, testified in this proceeding. He indicated that he was aware that retractable preference shares under GAAP were to be treated as a liability but believed that there was an exemption for regulated utilities. Ultimately, he was able to clarify that matter and accordingly, the audited Financial Statements for the year ended September 30, 2006 stated that the shares were to be treated as liabilities. According to Union, decreasing NRG's equity by $13.5 million and increasing NRG's liabilities by the same amount meant NRG had negative shareholders equity which "provides no protection for creditors".

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[1] Currently, the renewal date of the Bundled T Contract is September 30th each year. NRG supplies gas to Union in firm, daily, even quantities throughout the year. However, NRG takes gas from Union according to daily and monthly demand. That demand is greatest during the winter heating season. That means that by the end of the heating season on March 31st, NRG owes Union Gas in an amount valued at approximately $1.9 million dollars. Changing the renewal date to March 31st would mean that the balance would have to be zero at that date. This would reduce Union's liability and would impose a one time gas cost on NRG.

Union's second reason for believing that NRG's credit worthiness had become unsatisfactory is that NRG pledged all of its assets to the Bank of Nova Scotia ("BNS") pursuant to a demand loan with that institution. The BNS loan replaced a previous loan agreement with Imperial Life Assurance of Canada which had been in existence for approximately 12 years. NRG had also pledged all of its assets to Imperial Life under the terms of that loan.

Union states however that there are significant differences between the two loans. First, the BNS loan is for some $6.4 million compared to $2 million in the case of the Imperial loan. Secondly, the BNS loan is a demand loan whereas the original loan was long term debt. NRG's current assets Union claims are not even sufficient to cover the Bank's secured debt much less Union's unsecured commodity-related debt of $1.9 million as of March 31st.

Although the Class "C" shares are retractable, NRG is presently prohibited from retracting them pursuant to an Assignment, Postponement and Subordination Agreement dated August 26, 2008 with the BNS. Union notes that while this protects the BNS, it is of little assistance to an unsecured creditor like Union. In response, counsel for NRG states that NRG is prepared to grant a similar postponement to Union. In the Board's view, this deals with one of Union's major concerns. And this appears to be the largest concern of the two. A $13 million reduction in equity and a $13 million dollar increase in liability is significant. NRG is now in a negative equity position.

The BNS loan however, is a different matter. It is true that there was an increase from $2 million to $6 million but this was fully disclosed in 2006 and was dealt with by this Board in the 2006 rate case. (See EB-2005-0544, September 20, 2006 at pg. 20).

In the Board's view, disclosure of retractable shares as a liability significantly increases the financial risk associated with NRG. That deterioration however can be addressed by NRG providing Union with a Postponement Agreement in substantially the same form as NRG provided to BNS. The Board notes that there is no evidence that NRG has failed to make any payments to Union in the past. While it is accepted that there is a maximum exposure of some $1.9 million dollars at March 31st each year regarding the Bank Gas Account, the situation is not new and NRG has always met its obligations.

Financial Disclosure

The Board agrees that Union's concerns are serious. Any allegation that a Utility faces financial difficulties must always be addressed carefully by the Board. In this connection, the Board is very concerned that NRG's financial reporting is invariably late. NRG's year end is September 30th. Under the Board's Rules[2], NRG is required to file its audited Financial Statements within four months of year end, i.e. by January 31st of the following year. In 2007 this filing did not occur until July 16th, almost six months late.

It is a condition of this Order that NRG file its 2008 Audited Financial Statements within the four month deadline. And the Board further orders NRG to provide Union with unaudited quarterly statements within 60 days of the end of each quarter and to provide a copy to the Board. This is to begin with the quarter ended December 31, 2008. The Board will carefully monitor NRG's financial performance on an ongoing basis.

NRG should understand that these filing requirements will form part of the contract with Union and a failure to provide these Statements to Union in the timeframe specified would constitute a breach of the Agreement in which case Union would be entitled to pursue any remedies under the Contract related to the breach including an application under Section 42 of the *Act*.

Jurisdiction

The Board recognizes that it is unusual to specify terms such as these in a contract between a utility and its customer. The Board believes however that in this case it is important to improve the degree of financial disclosure. This will allow Union to protect its interests and the Board to monitor the situation more closely.

On previous occasions, the Board has clearly stated that it has the power "to compel the provision of service by an LDC to any customer including entry into a Board specified contract. This is part of the inherent jurisdiction which the Board has as a regulator of gas monopolies"[3]. The Board has also previously stated that "rates include more than

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[2] Natural Gas Reporting and Record Keeping Requirements (RRR) Rules for Gas Utilities, December 22, 2004

[3] Re Contract Carriage Arrangements for the Consumers Gas Company Ltd., ICG Utilities Ltd. and Union Gas Limited, Ontario Distribution Systems, EBRO 410-11, March 23, 1987 at p. 23

monetary terms and do in fact include conditions of service, particularly those that are directly or indirectly rate related"[4].

THE BOARD THEREFORE ORDERS THAT:

1. Union and NRG enter into new five year Bundled T gas contracts and M9 Delivery contracts on substantially the same terms as the existing Bundled T contract first made as of October, 2004 and the existing M9 Delivery Contract first made on October, 2006 with the following additional terms:

    a. NRG shall provide Union with its audited 2008 Annual Financial Statements, with a copy to the Board, no later than January 31, 2009, and each year thereafter on the same basis;

    b. NRG shall provide Union with unaudited quarterly Financial Statements, with a copy to the Board, no later than 60 days of completion of each quarter beginning with the quarter ended December 31, 2008; and

    c. NRG shall provide Union with a Postponement Agreement 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. The Postponement Agreement shall be provided by December 31, 2008.

Costs

The intervenors participating in this hearing shall be entitled to their reasonably incurred costs which costs are to be paid by NRG. The common practice is that the applicant bears the costs. However, this situation is unique. Union's concern with the financial stability of NRG was well founded, given NRG's reclassification of the retractable shares. The Bank of Nova Scotia had a similar concern and NRG addressed it promptly by providing a Postponement Agreement.

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[4] Re Contract Carriage Arrangements for the Consumers Gas Company Ltd., Northern and Central Gas Corporation Limited and Union Gas Limited, Ontario Distribution Systems, EBRO 410-11, April 9, 1986 at p. 182

In the case of Union's request for security, NRG did not act in a timely manner. The record suggests that NRG essentially stone-walled Union. This resulted in significant costs for Union, the Board, the Town of Aylmer and the Integrated Grain Processors Co-operative. This type of brinkmanship is not helpful where 6,500 customers and a recently activated ethanol plant supported by substantial Federal and Provincial funding are involved. The Board also directs that costs being paid by NRG shall be paid by NRG's shareholder and not passed on to the NRG rate payers.

DATED at Toronto, November 27, 2008

ONTARIO ENERGY BOARD

Original signed by

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Gordon Kaiser
Vice-Chair and Presiding Member

Original signed by

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Cathy Spoel
Panel Member