



ONTARIO ENERGY BOARD

BOARD STAFF SUBMISSION

**INTEGRATED GRAIN PROCESSORS CO-OPERATIVE INC.
AND
Natural Resource Gas Limited**

**Board File Nos.
EB-2013-0081/EB-2012-0406**

November 6, 2013

Introduction

On October 11, 2012, Integrated Grain Processors Co-operative Inc. ("IGPC") filed an application requesting the Board to order Natural Resource Gas Ltd. ("NRG") to provide gas distribution and sales services to meet its facility expansion and upgrading plans. The Application also sought to determine the reasonably incurred capital costs for constructing a dedicated pipeline that serves the IGPC ethanol facility in NRG's franchise area. IGPC also brought forward other issues in this application including seeking an adjustment to the letter of credit posted by IGPC and a determination that invoices sent to IGPC in relation to a request for expansion be declared null and void.

On February 11, 2013, the Board issued a Notice of Application and Written Hearing with respect to the above noted application. The Board determined that it would only address one of the issues, namely, the request by IGPC pursuant to Section 42(3) of the Act requiring NRG to provide gas distribution services and gas sales as requested by IGPC to meet its facility expansion and upgrading plans. The Board assigned File number EB-2012-0406 to the application.

The issue of the capital cost of the pipeline is a long standing dispute between NRG and IGPC that arose during the construction of the pipeline. The matter was first brought forward by IGPC in NRG's cost of service proceeding (EB-2010-0018) in 2010. The Board in that proceeding determined that it would only address those issues that impact rate base.

On October 4, 2012, the Board, on its own motion, issued a notice of motion to review the EB-2010-0018 decision, in particular with regard to the capital cost of the IGPC pipeline including capital contribution amounts. The Board in that decision (EB-2012-0396) determined that a capital contribution is a rate and the Board therefore had jurisdiction to determine the entire amount of the capital costs including any capital contribution.

The Board further issued a Notice of Application on April 2, 2013, pursuant to the Board's Decision in EB-2012-0396 advising parties that the Board had initiated a new proceeding (Board file No. EB-2013-0081) to review the capital contribution costs paid

by IGPC to NRG. The Board also determined that it would combine the Section 42 (EB-2012-0406) and the determination of capital costs (EB-2013-0081) proceedings.

The Board issued a Decision on Motion and Procedural Order No. 4 on August 29, 2013, ordering NRG to respond fully to certain interrogatories and also ordered a settlement conference to be held on September 18, 2013, with the objective of reaching a settlement among the parties on the issues before the Board. No settlement was reached between the parties.

In Procedural Order No. 5, the Board ordered a second round of interrogatories with written submissions on all issues. However, the Board provided for separate submissions on the Section 42 issue (EB-2012-0406) and the determination of the capital costs of the pipeline (EB-2013-0081).

The submissions below reflect observations and concerns of Board staff on issues that are in dispute regarding the capital cost of the IGPC pipeline, namely issues 2 to 5 in the Board approved Issues List. The following issues are addressed in the submission:

- Legal costs
- Contingency costs
- NRG Staff Costs – Mr. Bristoll’s salary costs
- Insurance costs
- Interest charges
- Letter of credit
- Remedial measures

At a high level, NRG has argued that the pipeline was built under budget. The IGPC pipeline was estimated to cost \$9.1 million but was built for \$8.65 million. NRG has argued that a cost under budget is a sufficient test to determine reasonableness. However, Section 3.13 of the Pipeline Cost Recovery Agreement (“PCRA”) clearly notes that once the pipeline was built, there would be a reconciliation to actual costs. Board staff notes that there is nothing in the PCRA that exempts both parties from reconciliation if the cost is under budget. In Board staff’s view, the fact that the pipeline

was built at a cost lower than the initial estimate does not imply that the costs are reasonable and no further action is required to true up costs.

The PCRA is an agreement entered into between NRG and IGPC. It is not formally binding on the Board with respect to what determines a just and reasonable total cost to IGPC for the pipeline. However, it does reflect the intention of the parties, and was before the Board in the original leave to construct proceeding. In Board staff's view, the Board should use the terms of the PCRA to guide it in determining the appropriate capital cost of the pipeline, and the amounts (if any) owing from NRG to IGPC.

As per the detailed pipeline cost schedule filed by NRG and summarized in the table below, the total disputed amount between NRG and IGPC is \$877,938¹. However IGPC disagrees with this amount² noting that NRG appears to have re-cast certain legal invoices and now disputes Mr. Bristoll's entire salary allocation. The revised disputed amount as per IGPC (i.e. the amount IGPC argues it is owed by NRG), which is reproduced in the table below, is \$948,462.

Item	Disputed Costs as per NRG's Pipeline Cost Schedule	Disputed Costs as per IGPC ³
Legal Costs	\$319,897	\$271,785 ⁴
Contingency Costs	\$132,000	\$132,000
NRG Staff Costs	\$271,905	\$394,405
Interest	\$88,272	\$88,272
Insurance Costs	\$62,000	\$62,000
TOTAL	\$877,398	\$948,462

The following is the Board's Issue #2 which is addressed in detailed below in this submission.

Issue #2: With respect to the cost items listed below, what is the appropriate amount to be included in determining the capital cost of the IGPC pipeline facilities?

¹ Response to IGPC interrogatory #5, June 28, 2013

² Response to Board staff interrogatory #1, October 28, 2013.

³ Response by IGPC to Board staff interrogatory #1, October 28, 2013

⁴ From IGPC response to Board staff interrogatory #1, 258,135+7,369+6,281=271,785

- 2.1 Legal costs*
- 2.2 Contingency costs*
- 2.3 NRG staff costs (Mr. Bristoll)*
- 2.4 Interest during construction*
- 2.5 Insurance costs and other service costs (e.g. auditing)*
- 2.6 Administrative penalty; and*
- 2.7 Costs arising from this proceeding*

2.1 Legal costs

The revised disputed legal costs as per IGPC are \$271,785⁵. This amount excludes contingency costs of \$132,000. The majority of the disputed costs are related to motions filed during the Leave-to-Construct proceeding (EB-2006-0243). As noted in NRG's evidence, the cost of the 2007 emergency motion and the appeal totals \$94,800 while the costs of the 2008 motion related to the letter of Credit are \$82,554⁶. NRG is seeking to recover from IGPC those legal costs as part of the capital cost of the pipeline. In response to a second round of interrogatories, IGPC revised the disputed amount related to the two issues noted above from \$177,354 to \$199,709⁷. Since IGPC has not provided a breakdown for the individual proceedings, Board staff has used the number provided by NRG in the argument.

The emergency motion was filed by IGPC on June 28, 2007 in response to NRG's refusal to sign the Assignment Agreement and the Bundled T-Service Agreement. In the motion proceeding, IGPC indicated that the motion was urgent because if NRG did not sign the agreements, the funds that were held in escrow by Canada Trust would have to be returned to equity investors. IGPC further noted that if the deal did not close by July 5, 2007, IGPC would lose \$11.9 million in funding under the Federal Government's ethanol expansion program.

NRG in response submitted that at the motion's proceeding, it did not receive any documents related to the escrow arrangement and the Board had to rely on unsworn

⁵ Response to Board staff interrogatory #1 by IGPC, October 28, 2013 (\$258,135+\$7,369+\$6,281). The previous disputed legal costs as per Detailed Pipeline Cost Schedule was \$319,897.

⁶ NRG Evidence, Page 14, June 3, 2013

⁷ Response to Board staff interrogatory #3 by IGPC, October 28, 2013

evidence of IGPC. NRG also objected to the motion proceeding on the basis that the Board did not have jurisdiction to compel a corporation to sign an agreement.

NRG submitted that although it signed the agreements one week later, the lenders proceeded to close the financial transaction and all documents related to the financing were executed. NRG submitted in subsequent proceedings before the Board that the alleged urgency that IGPC relied upon in bringing the emergency motion to the Board did not exist⁸.

Board staff is of the view that it is not clear from the record to-date whether NRG was at fault for not signing the agreements on the date required by IGPC. In addition, the actions of NRG did not terminate the deal as claimed by IGPC. Board staff therefore submits that NRG's costs related to the emergency motion should be shared equally between NRG and IGPC (\$47,400 owed to IGPC).

The second motion related to the Letter of Credit that was to be provided by IGPC to NRG. NRG has indicated that IGPC failed to pay certain invoices and also did not deliver the Letter of Credit as agreed to in the PCRA. In a letter dated, January 31, 2008, NRG asked for a Letter of Credit in the amount of \$31.92 million versus the \$5.3 million estimated by IGPC as per the terms of the PCRA. IGPC therefore filed a motion which was heard by the Board on February 28, 2008.

The understanding of IGPC was that the Letter of Credit as defined in the PCRA was to account for the difference in the revised estimated capital cost and the revised estimated aid to construct. However, at the motions hearing, NRG sought to include other costs including decommissioning costs, tax liability, loan breakage fee and loss of delivery revenue. The Board in its Decision rejected the arguments put forth by NRG and determined that a Letter of Credit in the amount of \$5.3 million was appropriate.

Board staff is of the opinion that IGPC was not at fault for filing the motion before the Board in response to an unreasonable request from NRG. NRG essentially sought financial assurance that was 3.5 times the estimated value of constructing the pipeline. Accordingly, Board staff submits that IGPC should not bear the legal costs of NRG related to the 2008 motion.

⁸ Response to IGPC interrogatory 8(d) and (f)

The other two items in NRG's schedule of legal costs includes Shareholder Advice (\$26,426) and Project Management (\$15,000). In response to an interrogatory⁹, NRG indicated that the categorization has been done by IGPC. NRG has claimed that IGPC has reviewed the legal invoices and made conclusions that the legal work involved "project management" and should not have been performed by NRG's legal counsel. NRG disputed this categorization and submitted that it was IGPC's legal counsel that was unnecessarily involved in some of the steps including equipment purchase order extensions, quote review and pipeline delivery coordination¹⁰.

Board staff is of the view that it is not clear from the evidence whether IGPC's legal counsel was too involved in day-to-day coordination or the disputed costs were as a result of certain actions on part of NRG. Accordingly, Board staff takes no position on costs related to Project Management.

With respect to Shareholder Advice, NRG has confirmed in an interrogatory response that the legal expenses do not include any costs related to providing advice to the shareholder of NRG or any of its affiliates¹¹. Board staff believes that IGPC may have mischaracterized certain legal costs. However, it is not clear whether IGPC's reduction of the disputed costs in response to the second round of interrogatories¹² reflected an adjustment to costs that were initially characterised as Shareholder Advice. IGPC's notes to the interrogatory response reveal that the reduction is related to categorization of certain legal costs into contingency costs. Board staff therefore submits that NRG should be permitted to recover costs that have been categorized as Shareholder Advice as there is no evidence to support that legal costs were incurred for the shareholder.

⁹ Response to Board staff interrogatory #1, June 28, 2013

¹⁰ Response to Board staff interrogatory #1, June 28, 2013

¹¹ Response to IGPC interrogatory #7, June 28, 2013

¹² Response to Board staff interrogatory #1 by IGPC, October 28, 2013. IGPC has revised the legal costs downwards, from \$312,787 to \$258,135 as a result of NRG re-casting certain legal invoices to contingency costs.

2.2 Contingency Costs

Contingency costs are costs that might occur but are not planned. NRG has recovered \$132,000 in contingencies from IGPC. IGPC's position is that these costs were not actually incurred at the time of construction and therefore should be disallowed.

At the oral hearing related to the motion filed by IGPC for full and adequate responses to certain interrogatories, NRG noted the contentious relationship between itself and IGPC during the leave to construct application. NRG therefore expected a litigious relationship and wanted some protection against unanticipated legal fees¹³.

NRG in its evidence has indicated that the pipeline came into service five years ago and it is still incurring significant costs¹⁴. NRG dismissed IGPC's position that since the pipeline has been completed, there should be no contingency costs.

Board staff agrees with NRG's position. The fact that there were several motions filed prior to the construction of the pipeline may have prompted NRG to reserve additional monies for future legal costs. NRG has confirmed that the costs have already been incurred and in fact exceeded the contingency¹⁵. Board staff submits that the contingency costs should be allowed.

2.3 NRG Staff Costs (Mr. Bristoll's Salary)

IGPC originally disputed a portion of Mr. Bristoll's salary that has been allocated to the capital cost of the pipeline. The disputed amount as noted in the cost schedule (response to IGPC IR #5) is \$271,905 which represents a portion of Mr. Bristoll's salary allocated to the capital cost of the pipeline.

NRG in response to an interrogatory noted that Mr. Bristoll's salary was capitalized against 2008 Salaries and Wages in the audited financial statements¹⁶. However, a review of NRG's evidence in the 2011 rates proceeding (EB-2010-0018) shows no such

¹³ Transcript, Motion Hearing, Page 45, July 29, 2013

¹⁴ NRG Evidence, Page 20, June 3, 2013

¹⁵ NRG Evidence, Page 20, June 3, 2013

¹⁶ Response to IGPC Interrogatory 16, October 28, 2013

capitalization in 2008¹⁷. NRG has itself agreed in an interrogatory response that the rate application did not reflect actual management fees or the reduction to Salary and Wages¹⁸. Board staff observes that the 2007 forecasted number for salaries was used to set rates for 2007 to 2010 and there is no evidence of capitalization of Mr. Bristoll's salary. Board staff further note that actual Operating and Maintenance expenses for 2007 and 2008 as filed by NRG do not indicate capitalization of Mr. Bristoll's salary¹⁹.

In response to the second round of interrogatories, IGPC has revised its position and now claims the entire salary of Mr. Bristoll as disputed costs²⁰. IGPC added \$122,500 to the disputed costs noting that NRG did not capitalize any wages related to Mr. Bristoll and his wages were being recovered through existing rates.

Board staff agree with IGPC that Mr. Bristoll's salary as president of NRG was recovered through distribution rates. Although Mr. Bristoll spent a significant amount of his time dealing with the requirements of IGPC, NRG did not need to hire additional employees or pay Mr. Bristoll overtime for his services²¹. The rationale that Mr. Bristoll spent a majority of his time negotiating with IGPC does not justify recovery of amounts that are already embedded in rates.

Board staff submit that any additional recovery from IGPC amounts to double recovery from ratepayers. NRG has recovered the entire salary of Mr. Bristoll in 2007 and 2008 through rates and there is no basis for recovering the same amount from IGPC. Additionally, NRG has argued that Mr. Graat spent a significant amount of his time during the negotiation process and NRG got the benefit of his time for free²². Board staff submits that this is irrelevant to the issue in consideration which relates to recovery of costs related to a specific NRG employee.

As per NRG's confidential filing in response to IGPC interrogatory number 12, 25% of Mr. Bristoll's salary was allocated to a related company in 2006. As per response to Board staff interrogatory number 4 filed on October 28, 2013 by NRG, Mr. Bristoll spent 241 hours on IGPC related activities in 2006. The number of hours spent on IGPC in

¹⁷ EB-2010-0018, Exhibit D5, Tab 3, Schedule 1

¹⁸ Response to IGPC Interrogatory 16, October 28, 2013

¹⁹ EB-2010-0018, Exhibit D5, Tab 3, Schedule 1

²⁰ Response to Board staff interrogatory #1 by IGPC, October 28, 2013

²¹ Response to Board staff interrogatory #2h and 2i, June 28, 2013

²² NRG Evidence, Page 12, June 3, 2013

2006 constitutes 12.6% of the total hours worked²³ and are under the 75% allocation factor for NRG. Accordingly, there is no basis for NRG to recover any amount from IGPC on behalf of the related company.

Board staff therefore submits that the entire salary of Mr. Bristoll was recovered through rates in 2006, 2007 and 2008 and NRG has no basis for recovering a portion of the salary from IGPC.

2.4 Interest During Construction

The interest charges claimed by NRG are calculated on the basis of the agreement between IGPC and NRG in the PCRA. They do not represent interest charges incurred by NRG. IGPC claimed that NRG submitted some invoices after the due date resulting in late payment interest charges.

In an interrogatory response²⁴, NRG indicated that although it does have the invoices, it did not have a record of the dates that each invoice was sent and it would be cumbersome to review each invoice and determine the date it was sent to IGPC.

IGPC in an interrogatory inquired about Mr. Bristoll being named as a consultant in the interest charges schedule and corresponding interest charges to this entry. NRG in reply²⁵ confirmed that this was an error and the corresponding interest charge of \$7,099 should be removed.

Board staff is of the view that NRG should not be permitted to recover interest charges for invoices that were sent to IGPC after the due date. This is because in such cases IGPC would not have been able to prevent incurring the interest charges.

Considering the lack of information and the effort required to determine whether IGPC could have avoided interest charges on specific invoices, Board staff submit that only \$7,099 should be disallowed from the disputed costs of \$88,272.

²³ The total hours worked by Mr. Bristoll in 2006 is 1,920

²⁴ Response to Board Staff Interrogatory #3, October 28, 2013

²⁵ Response to IGPC Interrogatory #17, October 28, 2013

2.5 Insurance Costs and Other Service Costs

NRG has allocated \$62,000 in insurance costs to the IGPC pipeline representing coverage during development and construction of the pipeline. NRG confirmed in response to IGPC interrogatory #14 that it did not incur additional costs; it was simply a re-allocation of insurance costs that NRG recovered through rates.

Board staff submits that the inclusion of \$62,000 to the capital costs of the pipeline amounts to double recovery as the same amount has already been recovered through rates. Although NRG has argued that it has flexibility to reallocate the envelop OM&A amount that is included in rates, Board staff submits that this does not imply that it can seek additional recovery without incurring any incremental costs. NRG further argued that it was able to add the pipeline to its existing insurance policy due to its long standing relationship with its insurer. NRG is essentially arguing that it should receive some benefit because IGPC has benefitted from the good will and relationship of NRG²⁶. Board staff further submits that this is a flawed argument since every business benefits from relationships and it is not standard practise to quantify each and every intangible benefit. Rather the focus should be on actual costs incurred and that is what the PCRA intended to cover.

2.6 Administrative Penalty

The Board imposed an administrative penalty of \$140,000 with respect to NRG's refusal to sign the Assignment Agreements. The Board on its own motion later vacated the administrative penalty. IGPC submitted that NRG had included the administrative penalty as a capital cost to the pipeline.

NRG has already confirmed that it has excluded the administrative penalty and provided the calculation in response to an interrogatory in its draft Rate Order²⁷.

²⁶ Response to IGPC Interrogatory #14, June 28, 2013

²⁷ Response to interrogatory #5, EB-2010-0018, January 17, 2011

2.7 Costs Arising from this Proceeding

IGPC has indicated that it seeks to recover the costs of this proceeding from NRG²⁸. NRG in its evidence has submitted that it will be seeking to recover costs from IGPC considering that it has made significant efforts to resolve the matter with IGPC²⁹.

Both parties are seeking to recover costs. Board staff submits that it is not clear whether NRG or IGPC is at fault for not resolving the dispute. Accordingly, Board staff submits that there should be no costs awarded in this proceeding and the parties be responsible for their own costs.

The table below summarizes staff's position with respect to which costs should be disallowed.

Item	Total Costs as per NRG Pipeline Cost Schedule	Disputed Costs as per Pipeline Cost Schedule	Disputed Costs as per IGPC ³⁰	Board staff submission – disallowed costs
Legal Costs	711,633	319,897	271,785 ³¹	198,359 ³²
Contingency Costs	132,000	132,000	132,000	0
NRG Staff Costs	385,045	271,905	394,405	385,045
Interest	113,272	88,272	88,272	7,099
Insurance Costs	62,000	62,000	62,000	62,000
TOTAL	1,403,950	877,398	948,462	652,503

²⁸ IGPC Evidence, Exhibit A, Page 33

²⁹ NRG Evidence, Page 22, June 3, 2013

³⁰ Response by IGPC to Board staff interrogatory #1, October 28, 2013

³¹ From IGPC response to Board staff interrogatory #1, 258,135+7,369+6,281=271,785

³² Disputed costs as per IGPC less \$73,426 (47,000+26,426); Board staff takes no position on Project Management related costs (\$15,000)

Issue # 3: Are the capital contribution amounts and the financial assurance provided to NRG by IGPC for the existing NRG facilities serving IGPC reasonable?

Section 7.6 of the PCRA states that the “Customer is entitled to reduce the Letter of Credit on each anniversary of the commencement of deliveries under the Gas Delivery Agreement to an amount equal to the net book value of the Utility Connection Facilities allocated to the Customer at the time.”

NRG is currently holding a Letter of Credit for \$5.2 million and NRG has agreed that the letter of credit has remained unchanged since its inception in April 2008³³.

Board staff submits that once the Board determines the capital cost of the pipeline in this proceeding, NRG should adjust the Letter of Credit based upon the net book value of the pipeline in NRG’s rate base.

Issue #4: What, if any, is the appropriate amount of payment including any interest owed by NRG to IGPC?

NRG has confirmed that it has been paid the total amount in dispute³⁴. Board staff in its submission has made arguments with respect to specific cost items. Since the amounts have already been paid to NRG, Board staff submits that NRG owes IGPC some refund. The refund amounts to \$652,503 as per Board staff’s argument in this proceeding.

Issue #5: If any amounts are owing from NRG to IGPC, by what means and in accordance with what terms should IGPC be reimbursed?

Board staff notes that if the Board in its decision revises the capital cost of the pipeline, there would have to be some mechanism to return the amounts owed to IGPC. Board staff submits that one of the remedial measures to adjust the capital contribution would be through the creation of a deferral account.

³³ Response to Board staff IR# 6c, June 28, 2013

³⁴ Response by NRG to Board staff interrogatory #1, October 28, 2013

If the Board were to adopt Board staff's submission in this matter, NRG may find it difficult to refund such a large amount as a single payment. A suitable alternative would be to refund the amount over a three year period through a rate rider. Board staff submits that the established deferral account should include Board prescribed interest rates. However, Board staff submits that no interest payment be required for the additional payments made by IGPC to-date.

– All of which is respectfully submitted –