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Ontario

BY EMAIL

March 24, 2014

Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: Natural Resource Gas Limited
April 1, 2014 QRAM Application
Board File No. EB-2014-0053

Board staff has set out its comments in regards to Natural Resource Gas Limited's ("NRG") April 1, 2014 QRAM Application below.

As part of its application, NRG noted that it is a direct purchase customer of Union Gas Limited ("Union"). As part of its contract with Union, NRG is required to rectify imbalances in its banked gas account prior to the Winter Checkpoint. NRG noted that, based on the Direct Purchase Status Report received from Union for the month ending January 31, 2014, it was notified that it was required to purchase 115,523 Gigajoules ("GJ") of gas in order to meet the Winter Checkpoint Quantity at the end of February 2014.

NRG wrote to Union on February 21, 2014 asking Union to waive any rights it may have to require NRG to purchase natural gas before February 28, 2014. Union refused to waive NRG's contractual requirement to purchase natural gas for its Winter Checkpoint Quantity. On this basis, NRG attempted to purchase the gas required to meet the Winter Checkpoint Quantity in late February 2014. NRG managed to purchase 90,027 GJ of natural gas prior to the winter checkpoint but was unable to purchase the remaining shortfall of 25,496 GJ in February. NRG noted that there was no gas available to be purchased and delivered to Union's system prior to the Winter Checkpoint. Union bought the remaining shortfall quantity on NRG's behalf. As a result, Union applied the Surplus Sale over Consumer Premium charge to the 25,496 GJ of natural gas that NRG was short at the time of the Winter Checkpoint.

NRG requested that the Board approve the recovery of costs from its ratepayers in regards to the following:

(1) The purchase of 90,027 GJs of natural gas at a total cost of $2,455,576 ($27.276 per GJ).

(2) The Surplus Sale over Consumer Premium charge applied to NRG by Union of $2,007,250 for the 25,496 GJ of natural gas that NRG was short at the time of the Winter Checkpoint ($78.728 per GJ).

NRG indicated that in regard to the Surplus Sale over Consumer Premium charge, it has served notice on Union that the $78.728 per GJ cost is a penalty provision and unenforceable under its contract. Further, NRG has served notice on Union asking for arbitration to declare the Surplus Sale over Consumer Premium amount to be unenforceable. NRG also intervened in Union's April 2014 QRAM proceeding (EB-2014-0050) asking that the Board grant it an exception to the Surplus Sale over Consumer Premium charge. In the EB-2014-0050 Decision, the Board stated:

> With respect to NRG's request that the Board grant it an exception to the Surplus Sale over Consumer Premium charge, the Board will examine this issue in NRG's April 2014 QRAM proceeding.[1]

Board staff asked NRG a number of questions regarding its purchasing procedure and the sequence of events that led to the incremental gas purchases that it made in February to meet the Winter Checkpoint requirements.

Board staff submits that the prudence of NRG's purchasing decisions over the past winter is at issue in this proceeding. NRG argues that it was appropriate to make its purchases to meet the Winter Checkpoint requirements at the end of February as this is its normal practice. NRG noted that every February (at the Winter Checkpoint) there will be some imbalance in its banked gas account with Union and NRG will be required to purchase or shed gas. NRG stated that its General Manager monitors the price of gas and when the price looks reasonable, a purchase is made.

[1] Decision and Order, EB-2014-0050, March 21. 2014 at p. 5.

NRG provided the sequence of events that led to its late February gas purchase. NRG noted that in January 2014 it monitored gas prices daily. NRG considered gas prices during the month of January to be exceptionally high and therefore made no purchases. NRG continued to monitor gas prices in February and when the price rose drastically at the beginning of the month, an emergency meeting was called. The consensus arising from that meeting was that the price of natural gas was abnormally high and if NRG had purchased gas at $10 per GJ, and the price reduced significantly, NRG would be held accountable for acting imprudently. NRG stated that there was no information, at the time that the meeting was held, that indicated that the natural gas price would continue to rise.

On February 21, 2014, NRG determined that a high spot price for natural gas for the remainder of the month was certain. On that basis, NRG sent a letter to Union requesting that Union waive its rights to require NRG to purchase gas prior to February 28, 2014 to meet the winter checkpoint. Union denied NRG's request.

As Union denied NRG's request to waive its Winter Checkpoint requirement, NRG was required to purchase 115,523 GJs of natural gas prior to February 28, 2014. NRG managed to purchase 90,027 GJs prior to the winter checkpoint at an average price of $27.276 per GJ but was unable to purchase the remaining quantity of 25,496 GJs. As such, Union applied the Surplus Sale over Consumer Premium charge of $78.728 per GJ to the above noted quantity of gas.

Board staff submits that NRG, as a monopoly utility operator, has the responsibility to manage the purchases of gas for its customers in a reliable, prudent and cost-effective manner. Board staff is of the view that NRG did not adequately meet its duty to its customers over the past winter.

Board staff notes that every month, NRG receives a Direct Purchase Status Report ("DPSR") from Union, which sets out the expected balance in its banked gas account with Union at the time of next balancing point (in this case, the Winter Checkpoint). Each month throughout the winter period, the DPSR was indicating that NRG was going to be short gas come the time of the Winter Checkpoint. In fact, the DPSRs indicate, that each month throughout the winter period, NRG's expected shortfall, at the time of the Winter Checkpoint, was growing larger. Board staff notes that at no point during the 2013 – 2014 winter period did NRG take any preemptive action to mitigate its balancing shortfall.

Board staff notes that the 2013 – 2014 winter started off colder than normal and the weather forecasts throughout the winter continued to indicate that it was going to be a long, cold winter. Board staff submits that a prudent utility operator would have heeded the weather forecasts and begun to mitigate the variance in its banked gas account early in the winter by making incremental gas purchases with a view to spread spot gas purchases over the winter and thereby diversify the risk associated with these incremental purchases. Instead, NRG chose to delay its purchases such that it had to attempt to purchase its entire shortfall in a compressed time period, thereby increasing the risk borne by ratepayers.

NRG noted that it could have requested authorization from Union to deliver incremental gas to Union's system prior to the Winter Checkpoint. Therefore, at any point during the winter, NRG could have requested authorization from Union to deliver incremental gas to reduce the shortfall in its banked gas account. Board staff submits that, in order to hedge the risk of high gas costs at the end of February, a prudent utility operator would have made incremental gas purchases throughout the winter period. If NRG had done so, it would have avoided the risk of high prices (and the risk that no gas would be available for purchase) at the end of February and attained a more reasonable cost of gas to pass onto its ratepayers. A layering approach to incremental gas purchases, over the 2013 – 2014 winter months, was in Board staff's view, the lower risk option for the management of variances in the banked gas account given the unique circumstances of this past winter. In addition, if a layering approach had been followed, the risk that no gas would be available for purchase at the end of February to meet the Winter Checkpoint quantity would have been avoided.

Board staff notes that in the Decision with Reasons in EB-2001-0032, the Board set out its general approach to a review of prudence:

- Decisions made by the utility's management should be generally presumed to be prudent unless challenged on reasonable grounds.

- To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.

- Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.

- Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time the decision was made and must be based on the facts about the elements that could or did enter into the decision at the time.[2]

Board staff is of the view that the prudence of the purchasing decisions made by NRG over the 2013 – 2014 winter period is open to question on the basis that NRG was aware that every month throughout the winter the shortfall in its banked gas account was growing and that the winter was expected to continue to be colder than usual.[3] Board staff submits that incremental gas purchases should have been layered in well in advance of the Winter Checkpoint to avoid the risk of high gas prices and tight supply at the end of February.

Board staff notes that in the Decision with Reasons in E.B.R.O. 486-04, the Board made a finding to disallow certain gas costs associated with spot gas purchases. The Board, in that decision, noted:

> The Board would have expected Union to have undertaken a plan to spread its spot gas purchases more evenly over the winter period. The Board is of the view that once Union had identified the 12 Bcf shortfall, it should have taken immediate steps to purchase at least 3 Bcf of spot gas in December to accomplish a more even spreading of spot gas purchases.[4]

The Board continued:

> The Board finds that the amount of $5.140 million is most appropriately borne by the shareholder and directs that this amount be removed from the PGVA debit.[5]

For all of the above reasons, Board staff submits that the Board should make the following findings in its decision on NRG's April 1, 2014 QRAM:

1) Order that a full prudence review of NRG's incremental gas purchases be undertaken. Board staff submits that the timelines for the QRAM do not provide adequate time for parties and the Board to perform a comprehensive evaluation of NRG's purchasing decisions. As such, Board staff recommends that this review take place as a second phase to this proceeding.

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[2] Decision with Reasons, EB-2001-0032, December 13, 2002 at p. 60.

[3] In EB-2014-0050 (Union's April 2014 QRAM Application), Tab 1 at pages 14 & 15, Union filed evidence which states that it was seeing persistent colder than normal weather forecasts. Board staff expects that NRG would have sought and received the same information.

[4] Decision with Reasons, E.B.R.O. 486-04, April 12, 1996 at p. 16.

[5] Ibid at p. 17.

2) With two exceptions, grant interim approval of the rates arising from NRG's April 1, 2014 QRAM application as filed. Board staff submits that NRG's ratepayers should not be burdened, at this time, with the cost consequences of the Surplus Sale over Consumer Premium charge, considering the amounts arising from that penalty could be adjusted by the Board in the second phase of this proceeding (if Board staff's request for a prudence review is granted). Board staff submits that, for the purposes of setting rates effective April 1, 2014, the price applied to the 25,496 GJs of gas, which is subject to the Surplus Sale over Consumer Premium charge, should be reduced to $27.276 per GJ (which is the average price NRG paid for the incremental gas that it was able to purchase in February). This reduces the total cost amount recoverable from ratepayers, as part of this proceeding, associated with the quantity of gas which is subject to the Surplus Sale over Consumer Premium charge from $2,007,250 to $695,429.[6]

   Board staff also submits that, given the magnitude of the bill impacts arising from the application[7], the Board may want to consider rate mitigation by extending the prospective recovery period by an additional 6 or 12 months. Board staff invites NRG, in its reply submission, to provide the bill impacts for a typical residential customer stemming from this interim adjustment to the March purchases and for a disposition period of each of 18 and 24 months.

All of which is respectfully submitted.

Original signed by

Lawrie Gluck
Case Manager

[6] Board staff reserves its right to argue for a different treatment of the costs associated with the quantity that is subject to the Surplus Sale over Consumer Premium charge if a proposed prudence review is established by the Board. Board staff also reserves its right to argue for a different treatment of the costs associated with the 90,027 GJ spot gas purchase made by NRG in February 2014.

[7] The annualized bill impacts for a typical residential customer, based on the application as filed, are approximately $405. Board staff estimates that the reduction to the amount recoverable from ratepayers related to the quantity of gas that is subject to the Surplus Sale over Consumer Premium charge reduces the annualized bill impacts by approximately $105.

cc: Brian Lippold, Natural Resource Gas Limited
Randy Aiken, Aiken & Associates
All Intervenors in EB-2010-0018