NRG
Natural Resource Gas Limited

March 27, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli:

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

Natural Resource Gas Limited ("NRG") respectfully replies to the submissions of Board Staff contained in a letter dated March 24, 2014.

The Facts

NRG has answered or has given responses to Board Staff questions. The answers to those questions are relevant to the Board Staff response. Copies of the responses are attached to this reply submission as Schedule "A".

Position Taken by NRG to Board Staff Submissions

(a) Full Prudence Review Board Recommendation

Board Staff recommends a "full prudence review" of NRG's incremental gas purchases in a second phase of the above-captioned proceeding. NRG submits that a full prudence review is not required.

Prudence:

NRG accepts the criteria set out by Board Staff regarding the analysis of prudence as previously enunciated by the Board in EB-2001-0032. NRG emphasizes that decisions made by NRG's management are to be presumed prudent unless challenged on reasonable grounds. It is respectfully submitted that there is no reasonable challenge to NRG's management decisions in this case. The Board should therefore conclude that NRG's decisions and the "outcome of those decisions" cannot be found to overcome the presumption of prudence.

When considering the issue of prudence in this case before the Board, the circumstances that were extant at the time of the decision are so unusual and unprecedented that they answer any concerns about the outcome of NRG's decisions and do not overcome the presumption of prudence.

The Board has already felt the impact of the unusual nature of the weather conditions that prevailed in Ontario in the last winter. They were colder and longer than at any point in recent memory.

When considering a review of prudence, the Board must consider the nature, sophistication and intentions of the decisions of the person who made them. In this case, the Board must analyze these matters in respect of NRG. It is respectfully submitted that NRG is not a highly sophisticated purchaser of gas by itself, but relies upon its market purchasers and suppliers. The size of NRG's customer group militates against a department of analysts and buyers who can deal with all exigencies of gas purchases in the same way that a utility the size of Union can do. The issue of "size" also carries through to the quantity of gas required to be purchased by NRG. In normal circumstances the amount of gas would not require a "layered approach", whereas this would be a necessity for Union given the sheer volume of their purchases and even Union's layered approach and level of sophistication they had to purchase up to February 12, 2014. Secondly, NRG is purchasing gas for its customers in the public interest. The gas purchase price is normally a pass through to the consumer. There is no benefit for NRG if decisions are made that might have led to a different and better result. The nature of NRG's sophistication and the motivation of the public interest militate in favour of a finding of prudence.

In addition, in these extraordinary circumstances, NRG took another approach and appealed to Union in its letter of February 21, 2014, in the hope that Union could assist NRG. This was a prudent move on NRG's part, although Union chose not to intervene in this matter which resulted in NRG having to purchase gas at $27.27/GJ and not the amount that Union paid of $12.31/GJ.

The Board Staff have raised two risk issues.

The first risk regards gas costs, and the second involves gas availability on a particular day. These are different risk components which must be analyzed differently.

Price of Gas:

The price of gas at the end of February was not reasonably foreseeable by NRG having regard to its past experience and its reasonable estimates; this was clearly shown in the graph supplied by NRG in its first reply submission. NRG was watching both commodity and transportation, but historically we have not ever seen fluctuations like this in transportation costs and few predictors exist since buyers typically do not know when pipeline capacity is met. NRG was therefore not imprudent in purchasing gas at that price in late February, having regard to all the conditions.

Availability of Gas:
The prudence of this decision cannot seriously be challenged on reasonable grounds. It was wholly unprecedented that gas could not be purchased by NRG on February 28, 2014. The number of large players, in particular Union, that held extremely large volume contracts with a delivery date of February 28, would have had a hand in creating the transportation cost and availability issue – i.e. lack of capacity in the TCPL leading up to that particular date. NRG would not have been privy to this and Union did not advise us that this could occur. It is therefore submitted that the general presumption of prudence in this regard cannot be challenged on any grounds.

Arising out of this analysis, it is therefore submitted that a prudence analysis would not find NRG to be lacking.

Surplus Sale over Consumer Premium Charge:

The Board has the jurisdiction and power to reduce the size of the "Surplus Sale over Consumer Premium Charge" as part of the solution to avoid lengthy and complex Board hearings, to ensure that NRG's incremental gas purchase costs be minimized in the public interest and to direct that Union not receive a windfall arising out of the $78.728 per GJ penalty cost.

Union did not pay $78.728 per GJ for the 25,496 GJ which NRG could not purchase in the marketplace in order to deliver to Union by February 28, 2014. Union paid $12.31 per GJ for the gas. It is a fact that they did not need any of the 115,523 GJs from NRG and could have mitigated NRG's gas costs and reduced the impact on NRG's ratepayers. Union had the gas on hand and suffered no detriment to its physical operating system or to its other customers. The circumstances which gave rise to NRG's purchase deficit were highly unusual weather conditions and equally unusual consistently high prices in the month of February, compounded by the extremely rare inability to purchase gas in the marketplace. It is submitted that these conditions can be ameliorated in the public interest without any consumers or any company suffering a loss or a deficit by a Board ordered change in the penalty rate.

It is respectfully submitted that such a change will not be a precedent for future requests, in that the confluence of circumstances are unlikely to ever occur in the future. Additionally, the Board is being asked to lower the penalty rate for another utility (namely, NRG) which itself is supplying services to the public as opposed to a for profit private enterprise. Board regulates NRG in the public interest, giving a cost of service and gas to individual consumers of NRG. The cost of service and gas is a pass through cost. The reduction of the penalty rate to Union will have no impact on Union's customers or its shareholders except the possible loss of a windfall benefit.

Finally, the Board's action in reducing the Surplus Sale over Consumer Premium Charge will avoid both a prudence hearing before the Board and an arbitration between Union and NRG. By avoiding these legal proceedings, the Board is proceeding with efficiency and reduces legal costs of both utilities. These results are much to be desired.

(b) Rates

The Board recommends approval of the rates arising from NRG's April 1, 2014 QRAM Application as filed with two exceptions.

The first exception is that NRG's ratepayers not be burdened **at this time** with the cost consequences of the Surplus Sale over Consumer Premium Charge. The Board further recommends that the cost of gas in rates for the 25,496 GJ of gas should be reduced to $27.276 per GJ. NRG submits that the Board should deal with these issues without a further hearing. For reasons set out above and in its earlier responses to Board Staff, NRG asks that the Board simplify the entire matter by making a one-time reduction in the premium rate to Union's actual cost of gas needed to make up the non-delivered 25,496 GJ of gas. The actual rate is $12.31.

If the Board adopts this policy, then a prudence hearing is not required at all and arbitration is avoided.

If the Board is not willing to use the $12.31 rate per GJ, NRG requests that the charge of $27.276 per GJ should be applied immediately.

Rate Mitigation:

With respect to the suggestion by Board Staff that the rate recovery period be extended, NRG are acceptable to whatever the Board decides.

Conclusion

NRG respectfully submits that a prudence inquiry would not lead to a result that NRG was imprudent. As a result, the NRG requests made above and its responses to Board Staff should be granted in one of two ways:

a) Reduce the penalty rate from $78.72805/GJ to Unions' actual cost of gas fixed at $12.31/GJ, on a one time basis, and calculate NRG's actual cost of gas to be added to the commodity variance account as follows: $12.31/GJ x 25,496 GJ = $313,856 plus $27.276/GJ x 90,027 GJ = $2,455,576 for a total of $2,769,432.

b) Calculate NRG's actual gas cost as follows: $78.72805/GJ x 25,496 GJ = $2,007,250 plus $27.276/GJ x 90,027 GJ = $2,455,576 for a grand total of $4,462,826.

The first solution is preferable as it avoids a prudence hearing before the Board, avoids a private arbitration between Union and NRG, and is based on sound public policy and the protection of the public interest in unusual circumstances so that it can be identified as a one-time only reduction.

If the Board is not moved to amend the penalty rate, the Board declare that NRG was prudent in its' gas purchasing for the period in question and permit the actual cost of gas be added to NRG's commodity variance account for the calculation of rates.

Yours very truly,

B. Lippold

RESPONSES TO BOARD STAFF

EB-2014-0053

QUESTION:

1. **Ref: Schedule 1/Page 2: NRG provided a brief description of its delivery obligations under its direct purchase bundled transportation contract with Union.**

   (i) Please provide a more detailed description of NRG's delivery obligations and balancing requirements under its direct purchase bundled transportation contract with Union.

   (ii) Please explain whether NRG could have requested authorization from Union to deliver incremental gas to Union in advance of the Winter Checkpoint in order to reduce banked gas account imbalances. Did NRG make such requests to Union? If so, please document the responses. If not, why not?

RESPONSE:

1.

   (i) Refer to attached contract for more detail on NRG's delivery obligations. Schedule I.

   (ii) Yes, NRG could have requested authorization from Union to deliver incremental gas to Union in advance of the Winter Checkpoint. But, this was not a reasonable or prudent thing to do having regard to past experience. NRG did not make a request from Union. There was no recent history (2010 to 2013) that would indicate that the cost of gas would be so consistently high in February. NRG reasonably expected that the cost of gas would decline during the month of February for purchases were necessary to meet the Winter Checkpoint. NRG was acting prudently having regard to past experience and its obligation to avoid price increases to its customers if at all possible. The extraordinary event that led to the penalty price was the wholly unpredictable inability to purchase gas at all and to deliver it to Union before 5:00 pm on February 28, 2014.

QUESTION:

2. Ref: Schedule 1/Page 3: NRG stated 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 GJ in order to meet the Winter Checkpoint Quantity at the end of February 2014. NRG further noted that pursuant to its contract with Union, NRG was required to purchase the above noted volume by February 28, 2014.

- **(i) Please provide the Direct Purchase Status Reports for each month from December 2013 to February 2014.**
- **(ii) Please discuss the systems that NRG has in place to monitor imbalances in its banked gas account with Union.**
- **(iii) Please discuss how often NRG monitors imbalances in its banked gas account.**
- **(iv) Please discuss when NRG first became aware that there was an existing imbalance in its banked gas account.**
- **(v) Please describe the systems that NRG has in place to monitor gas prices.**
- **(vi) Please discuss how often NRG monitors gas prices when imbalances exist in its banked gas account.**
- **(vii) Please provide natural gas prices at Dawn for each day (December 1, 2013 to February 28, 2014) on both a forward market and cash market basis.**

RESPONSE:

2.

(i) The report is attached as Schedule 2.

(ii) PURCHASING PROCEDURE AND SEQUENCE OF EVENTS:

Standard Practice:

It is standard that at the winter checkpoint every February there will be some imbalance and NRG will be required to purchase or shed gas. If gas is required to be purchased NRG is emailed on a daily basis, commencing February 1. The General Manager monitors the price and when the price looks reasonable then a purchase is made. In the past, there has never been an issue with the gas not being available for purchase or a consistently high price during the month of February with wholly unpredictable price variations during the month.

January 2014:

Gas pricing is monitored daily by NRG because spot gas purchases are completed monthly. In January, spot gas pricing escalated to as high as $8/GJ at Parkway. Since they are typically in the $4 /GJ range, this was viewed as exceptionally high. Prior to transacting January's spot purchase, NRG requested and received from Union a table, outlining transportation costs at various points of entry into Union's system. The intention was to analyze if introducing gas at another point in Union's system could reduce the overall purchase price. It was determined that any savings gained by purchasing gas at points other than Parkway, were negated by the transportation costs.

February 2014:
This past February the same practice was followed and when the price of gas rose drastically at the beginning of February, an emergency meeting was called and the executives discussed what course of action to take. The consensus was that the high price was an anomaly and if NRG bought at $10.00/GJ and the price reduced back down to the normal price of around $5.00GJ, NRG would be held accountable as acting imprudently. There was nothing in the industry at this point that was speculating the price would continue to climb to the levels it did in February. By February 21, it was clear to NRG that prices may not self-correct by the end of the month.

Assistance Sought/High price of gas now a certainty:
On February 21, 2014, a letter was sent to Union Gas requesting that Union waive any rights it may have to require NRG to purchase the required gas before February 28. If the gas was not required by Union or had already been purchased by Union for system integrity, NRG believed that Union should assist in relieving NRG (and therefore its customers) of its contractual obligations in the public interest on the condition that NRG pay Union's cost of gas purchase plus any reasonable mark-up. Union denied NRG's request. It is now clear from Union's QRAM that the required amount of gas for system integrity had been purchased by February 12, 2014. Unions failure to provide gas to NRG in these exceptional circumstances at its cost price was unreasonable, imprudent, unnecessary for physical integrity of the pipeline and system and not in the public interest.

Purchase:
In the circumstances, NRG was left in a position that it had to purchase the gas by February 28. On a daily basis, NRG monitored the price of gas from the following sources: Shell, Enersource, Blackstone (recommended by Union) and Go Energy. NRG's reasonable expectation based on historical prices and normalized weather conditions was that prices for gas would fall before the end of the month of February. Unpredictably, prices did not fall. Prices rose as high as $37.00/GJ by February 26 (this is an unprecedented increase). On February 26, NRG understood that Union absolutely needed the physical gas for its system integrity. As it turns out, Union did not need the gas and had purchased sufficient gas and held it available in storage or otherwise to meet the system needs such that it did not require NRG's gas. On February 26, NRG was able to purchase 90,027 of its 115,523 requirement for an average price of $27.276GJ. NRG advised Union on February 28, that there was insufficient volumes available to purchase on the market. Union passed along our

name to one of their in-franchise customers who might be willing to sell us the gas (they had an excess). However, this led to no further opportunity to purchase.

Subsequent to February 28:
On March 2, NRG notified Union that there was now gas available to purchase on the market and NRG could make up our shortfall at a cost of approx. $27/GJ. Union refused NRG permission to deliver any gas to Union's system. On March 4, a letter was sent to Union Gas advising them of NRG's position that the penalty was not enforceable. NRG gave notice of arbitration.

(iii) Refer to the answer in 2 (ii).
(iv) Refer to the answer in 2 (ii).
(v) Refer to the answer in 2 (ii).
(vi) Attached Schedule 3.

QUESTION:

3. Ref: Schedule 1 / Page 4: NRG noted that on February 21, 2014, it asked Union to waive any rights it might have to require NRG to purchase natural gas before February 28, 2014. NRG noted that Union refused to waive NRG's contractual obligation.

(i) Please discuss why NRG waited until only 1 week before it was required to meet its winter checkpoint quantity, to ask Union to waive its contractual rights.

RESPONSE:

Refer to 2(ii).

QUESTION:

4. Ref: Schedule 1 / Page 4 – 5 & Schedule 3: NRG noted that it purchased 90,027 GJ of gas after February 21, 2014 at a cost of $2,455,576 ($27.276/GJ). NRG noted that it was unable to purchase the remaining shortfall of 25,496 GJ in February as there was no gas available to be purchased and delivered to Union's system. NRG noted that it was informed by Union that the shortfall of 25,496 GJ would be the subject of the "Surplus Sale over Consumer Premium." NRG noted that it received an invoice from Union charging its customers for the 25,496 GJ at a cost of $2,007,250 ($78.728/GJ).

(i) Please describe the protocols that NRG has in place for the execution of transactions required to reduce or alleviate balances in its banked gas account.

(ii) Please advise whether NRG has ever been subject to a Surplus Sale over Consumer Premium charge in the past.

(iii) Please provide the date(s) on which NRG executed the transaction(s) to purchase 90,027GJs of gas.

(iv) Please explain why NRG decided that it was prudent to execute the transaction(s) to purchase 90,027GJs of gas on the date(s) that it was purchased.

(v) Please advise where the authority resides to proceed with the execution of the noted transaction(s) of 90,027GJs.

(vi) Please provide any gas market price analysis, emails, and memos that support the execution of the above noted transaction(s).

(vii) Please discuss whether NRG considered making any incremental gas purchases earlier in the winter which could have helped to reduce or alleviate imbalances in its banked gas account prior to the Winter Checkpoint. If so, please discuss why those options were not executed. If not, please explain why.

(viii) Please discuss whether incremental gas purchases, made earlier in the winter period (as opposed to immediately before the Winter Checkpoint), could have reduced NRG's costs of procuring gas supplies for its customers.

(ix) Please discuss whether NRG considered any non-Dawn spot gas purchases. Please discuss whether spot gas purchases at locations other than Dawn could have reduced NRG's costs of procuring gas supplies for its customers.

RESPONSE:

4.

(i) Refer to 1 b.

(ii) We reviewed our files over the last 6 years and at the September 2010 checkpoint we were charged a premium charge. Based on the August 2010 Direct Purchase Status report, NRG purchased the required amount of gas for $4.42/GJ. The final September consumption figure per the September 2010 Direct Purchase Status report was far greater than the amount forecast in August resulting in a shortfall of gas purchased. Union Gas charged us for the shortfall less the 4% allowance at a price of $6.121/GJ.

(iii) Refer to attached Schedule 4.

(iv) As set out above, Union advised NRG that the physical gas was absolutely required for system integrity. NRG bought natural gas accordingly.

(v) The manager arranges day-to-day unexceptional purchases of natural gas but in February, the President of NRG authorized the purchase volumes at the high spot prices which were available on the open market because Union had said that it physically required the gas.

(vi) Enclosed is the invoice from Shell that supports the purchase.

(vii) As noted in 2(ii), it is not NRG's normal practice to buy gas prior to the month of February to meet its Winter Checkpoint obligations. Having regard to normal expectations of weather conditions, gas availability and supply obligations NRG's practice of purchasing gas in February has always been a prudent practice.

(viii) Looking retrospectively, gas purchases could have been made earlier but this NRG's experience and in the experience of many other utilities was not a prudent or necessary practice having regard to historical norms. NRG was not alone in being exceptionally affected by this unprecedented and unpredictable rise in the price of natural gas and the unavailability of gas supply. It is respectfully submitted that NRG's practices were prudent and in the public interest.

(ix) Yes alternative sources were considered as noted in 2(ii).

QUESTION:

5. **Ref: Schedule 1 / Page 5: NRG states that it has served notice on Union in writing that the $78.728 per GJ cost is a penalty provision and unenforceable under the contract, and disputes under the contact are subject to arbitration under Article 8 of the contract. Board staff notes that the penalty provision is included in Union's R1 Rate schedule. Please discuss why NRG believes that this is a contractual matter rather than a rate matter.**

RESPONSE:

5. The penalty provision in Union's R1 Rate schedule is both a Board rate matter and a contractual matter. The Board fixed the penalty rate as part of Union's rate hearing. The Board therefore has the power to alleviate from the harsh reality of the penalty rate. In considering this issue, it is respectfully submitted that the Board should consider the public interest and in this case the interests of the NRG customers. The conditions which led to the exceptional Winter Checkpoint requirements, the high prices and the unavailability of gas were highly exceptional. The public record is replete with reports that the winter of 2013 and 2014 was exceptionally cold for unprecedented number of days. It is respectfully submitted that the Board should in these circumstances relieve NRG from the penalty provision which the Board fixed for Union. It certainly has the jurisdiction and authority to do so. If the Board does not relieve NRG and its customers from the penalty rate, they will have an undeserved and unavoidable high cost imposed upon them. Union or its customers will have a windfall in that they suffered no actual detriment justifying the penalty rate of $78.728/GJ. In conclusion, this is a rate matter if the Board changes the rate for these circumstances then it is acting in the public interest based on the unusual circumstances set out above.

QUESTION:

6. **Given the timelines for issuing a decision in this proceeding and the "non-mechanistic" nature of the application, please provide NRG's view were the Board to consider the following:**

   (i) Approve, on an interim basis, the establishment of a new gas supply charge effective April 1, 2014 that excludes the costs of the transactions associated with the February checkpoint (i.e. $2,455,576 + $2,007,250) pending a more comprehensive review by the Board.

   (ii) Approve, on an interim basis, the proposed gas supply charge effective April 1, 2014 pending a more comprehensive review by the Board.

RESPONSE:

With respect, NRG asks the Board to expand its options to include more than the 2 options set out above. NRG asks the Board to make its decision on the basis of limiting windfall benefits to Union and diminishing the cost of natural gas to NRG's customers without a concomitant detriment to Union.

NRG respectfully requests that the Board approve its costs in rates beginning April 1, 2014 for natural gas purchases on the basis of the following principles:

(a) include in NRG's actual cost to purchase gas the amount of $2,445,576.00, being the actual costs of NRG;

(b) include in NRG's rate as at April 1 the cost of Union's purchase of gas in order to balance its system but no more;

(c) change the penalty rate for Union in the exceptional circumstances to the cost of Union's purchase of gas to balance its system for this year only.

If NRG's primary solution is not acceptable to the Board, then NRG asks that its cost of gas purchases including the $2,455,576 and the penalty amount of $2,007,250 in NRG rates as at April 1, 2014. If the penalty rate is subsequently changed then it can be given as a rate reduction to NRG's customers.