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September 12, 2014

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27 Floor
Toronto, ON M4P 1E4

Filed electronically

**Attention: Ms. Kirsten Walli
Board Secretary**

Dear Ms. Walli:

**Subject: Union Gas Limited (Union). – Reduce Certain Penalty Charges Applied to its
Direct Purchase Customers
OEB File No. EB-2014-0154
TransCanada Energy Ltd. (TCE) Written Submission**

In accordance with the requirements in Procedural Order No. 3 dated July 29, 2014, please find attached TCE's written submissions.

Yours truly,
TransCanada Energy Ltd.

Original signed by

Nadine Berge
Senior Legal Counsel
Energy Law

Attachment

**ONTARIO ENERGY BOARD
EB-2014-0154**

IN THE MATTER OF the *Ontario Energy Board Act, 1998*,
S.O. c. 15, Schedule B (the “OEB Act”);

AND IN THE MATTER OF an Application by Union Gas
Limited for an order or orders approving a one-time exemption
from Union Gas Limited’s approved rate schedules to reduce
certain penalty charges applied to direct purchase customers who
did not meet their contractual obligations.

**TRANSCANADA ENERGY LTD.
ARGUMENT**

September 12, 2014

INTRODUCTION

1. This proceeding is, at its heart, about just and reasonable rates. The Board has correctly considered the April 3, 2014 letter from Union Gas Limited (“Union”) as an application under section 36 of the OEB Act (i.e., a rate application).
2. The Board’s authority under section 36 of the OEB Act is to ensure that charges for the distribution and storage of gas are just and reasonable. Consequently, the Board must determine whether the reduced penalty charges proposed by Union on April 3, 2014 (the “Application”) are just and reasonable.
3. As a result of exceptional winter weather conditions, a number of Union’s direct purchase customers failed to deliver sufficient gas to meet their contractual requirements in February and March 2014. As a result, Union applied penalty charges (at a rate of \$78.73/GJ) to these direct purchase customers, calculated based on methodologies in Union’s tariff.
4. TCE was one of those customers, and has paid approximately \$4.3 million in penalty charges to Union.¹ TCE is a T2 customer and its contract with Union is to provide gas for its Halton Hills Generating Station (“HHGS”). As a dispatchable generator, HHGS is subject to daily dispatch instructions issued by the Independent Electricity System Operator (“IESO”). Those IESO instructions determine when HHGS will run, which ultimately dictates how much gas TCE must purchase on any given day.
5. Union’s proposal in this proceeding to reduce the penalty rate from \$78.73/GJ to \$52.04/GJ would still result in TCE paying almost \$3 million in penalty charges.
6. TCE does not deny that its gas storage levels fell below zero on March 16 and 17, 2014, nor does it suggest that it should not be assessed a penalty for failing to meet its delivery obligations.

¹ TCE Evidence, page 1 of 5.

7. However, TCE believes that the both the initial penalty rate (of \$78.73/GJ) and Union's proposed reduced rate (of \$52.04/GJ) are unreasonable.

8. As a result of the extraordinary weather conditions of this past winter, TCE is proposing an alternative methodology for calculating the penalty charge applicable to T2 customers only that:
 - fully respects the underlying rationale for the penalty charge (i.e., to encourage customers to comply with their contractual commitments);
 - is principled from a rate-making perspective, because it reflects the spot price of gas on the day that the customer exceeded its volumes, thereby strengthening the link between the violation and cost consequences;
 - has been utilized by the Board elsewhere; and,
 - results in a penalty charge that is reasonable in magnitude.

9. Before elaborating on our substantive arguments noted above, TCE would like to address three procedural aspects in this proceeding:
 - First, as stated in TCE's evidence,² TCE's alternative Supplementary Inventory Charge proposal for T2 customers is limited to the anomalous weather circumstances that gave rise to this proceeding.
 - Second, to this point in the proceeding, no party (including Union) has taken issue with TCE's alternative methodology for T2 customers. Union had the opportunity to file interrogatories on TCE's evidence and did not. Union filed its Argument-in-Chief without contesting TCE's evidence, and indeed without even mentioning it. TCE can only assume that Union accepts TCE's proposal, since any attempt to take issue with it solely in reply argument would be unfair to TCE because it would prejudice TCE's ability to address any argument by Union.
 - Third, there can be no argument here that any proposal (including TCE's) to establish an alternative penalty charge in the circumstances amounts to retroactive rate-making. As explained below, the OEB never approved a penalty charge of

² TCE Evidence, Section 2, para. 2, p.1.

\$78.73/GJ. The OEB approved a methodology for calculating penalty charges that was dependent upon external factors (i.e., factors beyond the Board’s or Union’s control). Those external factors resulted in a penalty charge being calculated in March 2014 that was unreasonable in magnitude.

ESTABLISHING A REASONABLE PENALTY CHARGE

10. As a preliminary matter, TCE notes that it is in agreement with Union on most of the matters in this proceeding. First, Union cites the extreme winter conditions in 2014 and refers to them as “exceptional”³. TCE agrees with Union that the winter of 2014 was extraordinary. Union states that, due to these exceptional weather conditions, it is appropriate to make two changes to its Supplementary Inventory Charge to Rate T1 and T2 customers, and its Unauthorized Overrun Charge to Rate 25 customers.⁴ TCE also agrees that due to the extreme conditions a reduction in the Supplementary Inventory Charge is warranted⁵. The only place where Union and TCE have a difference of opinion is regarding the appropriate charge to be assessed in the circumstances.

11. The anomalous nature of the penalty charges levied by Union relative to other years is illustrated in Figure 1 below.⁶

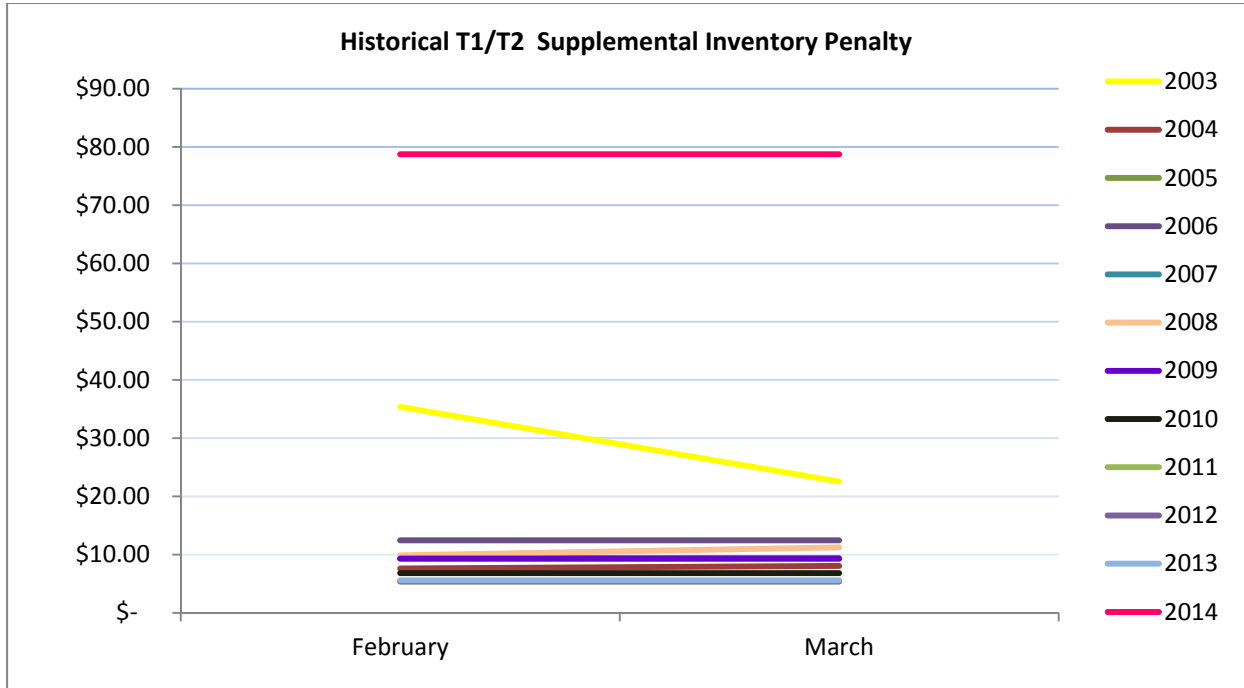
³ Union Application, April 3, 2014.

⁴ Ibid.

⁵ Union Application, April 3, 2014; Letter from Union to OEB, April 10, 2014, Q&A 2; and Exhibit B.Kitchener 1(b)

⁶ TCE Evidence, page 3 of 5.

Figure 1: Union’s Historical T1/T2 Supplemental Inventory Penalty



(a) Basis for the Application

12. Union did not frame its rate proposal as a section 36 rate application. Instead, Union sought to reduce its penalty charges because:

- Union recognized that penalty charges calculated based on the methodology were extremely high due to the exceptional weather conditions. Simply put, the \$78.73/GJ was not a just and reasonable penalty charge.
- Union recognized that for some of its customers, the penalty charges were so significant that they had the potential for financial impairment or even bankruptcy for some customers.⁷

13. Notwithstanding the fact that Union initiated this proceeding, no deference should be given to Union’s penalty charge proposal on the basis that the Application is a goodwill

⁷ Union Argument-in-Chief, section 11 and Union IR Response to Board Staff 1.

gesture on the part of Union, and had Union not initiated this proceeding, customers would have been left without any recourse.

14. The fact is that had Union not brought its Application, Union's penalized customers would have pursued redress from the penalty charges either via arbitration (as NRG did) or via a customer-led section 36 application (which is permitted by section 36 of the OEB Act).

15. Regardless of how the matter came to the Board, the role of the Board now is to ensure that the penalty charge be established at a level that is just and reasonable.

(b) Union's Alternative Penalty Charge Proposal

16. In lieu of the \$78.73/GJ penalty charge (which was calculated using the highest spot price at Dawn in the two-month period of February-March 2014), Union is proposing to simply tweak the calculation by using the second highest spot at Dawn in those two months (i.e., \$50.50/GJ or \$52.04/GJ).

17. In TCE's view, simply moving to the second highest spot price at Dawn does not address the issue of determining what a reasonable penalty charge would be in light of the anomalous external factors. It is TCE's position that arbitrarily picking the second highest price at Dawn during such an extreme winter results in a charge that is no better, and that remains unreasonably high.

18. Penalty rates are unique in that the intent of a penalty charge is not to recover the costs of providing a service, but rather to encourage compliance with certain rules or requirements. In the case of the penalty rates at issue in this proceeding, the intent is to discourage Union customers from strategic non-compliance with their contractual obligations to supply Union with gas.⁸

⁸ Page 31 of Decision, as cited in Union's Argument-in-Chief, para. 13.

19. In the case of the Supplementary Inventory Charge levied against T2 customers such as TCE, means that the penalty rate must be high enough to ensure that TCE is worse off if it fails to deliver gas to Union to keep its storage inventory above zero. In other words, on any given day, the Supplementary Inventory Charge penalty should be greater than TCE's cost to purchase spot gas. On this point, TCE agrees with Union that “[a] customer should not be in a position of making an economic decision to pay a penalty rather than paying a higher market-based price, thus putting the integrity of the utility system at risk.”⁹

20. Thus, one factor to determine the reasonableness of a penalty charge such as the Supplementary Inventory Charge is that it must be high enough to encourage customer compliance with their contractual obligations. However, that is not the only relevant factor to determining the reasonableness of a penalty rate – if it were, \$78.73/GJ would be reasonable, as would any number higher than that.

21. As the Board noted in RP-2001-0029, the penalty charge must also not be of unreasonable magnitude. This is the second factor that the Board must consider in establishing a just and reasonable penalty charge.

22. The Board's determination of a just and reasonable penalty charge in this case depends on a proper balancing of these two factors, as the Board noted in RP-2001-0029:

In the Board's view, the penalties must be sufficient to ensure that there is no economic incentive for a customer to operate outside of the stated parameters for the service, and sufficient to dissuade such operation. Union must be able to plan and operate its system with the knowledge that its customers will generally operate within the set parameters. The penalties at the same time must not be of unreasonable magnitude.¹⁰

23. In seeking to justify its proposed reduced penalty charge of \$50.50/GJ and \$52.04/GJ, Union focuses on the first of these two factors, arguing that:

[a]ny price below the proposed February \$50.50/GJ and March \$52.04/GJ does not meet the intent of the penalty charge as contemplated in RP-2001-0029. The 3rd, 4th and 5th lowest prices noted in

⁹ Exhibit B.NRG.29.

¹⁰ RP-2001-0029, para.6.93.

[February/March 2014] are near to, if not below, prices that compliant customers were paying in the market place to meet their balancing obligation.¹¹

24. Firstly, there simply is no evidence on the record to support Union's bald statement that setting the penalty below \$52.04/GJ would not meet the intent of the penalty. Union, like anyone else, could look at published prices at Dawn during the time period, but would not know who was purchasing that gas (i.e., whether they were Union customers) and for what purposes.

25. Secondly, as noted in TCE's response to Board Staff IR 1(b), generators that receive service under T2 operate under real-time dispatch instructions from the IESO. Consequently, the relevant gas price for the purposes of a penalty charge is the maximum price in the market on the day when gas was required in order to meet the IESO's dispatch instructions. Those are the days when T2 generators would have to buy additional gas or draw down on their storage inventories to meet their IESO commitments. It is the differential between the maximum gas price on that day and the magnitude of the penalty charge that influences customer behaviour. In that context, Union's proposal of \$52.04/GJ is completely arbitrary.

(c) TCE's Proposed Penalty Charge

26. TCE is proposing an alternative methodology for calculating the penalty charge applicable to T2 customers only that: (a) fully respects the underlying rationale for the penalty charge (i.e., to encourage customers to comply with their contractual commitments); (b) is principled from a rate-making perspective, because it reflects the spot price of gas on the day that the customer exceeded its volumes, thereby strengthening the link between the violation and cost consequences; (c) has been utilized by the Board elsewhere; and (d) results in a penalty charge that is reasonable in magnitude.

¹¹ Union Argument-in-Chief, para. 14.

27. In RP-2001-0029, the Board noted that

Union has also proposed to change the unauthorized storage space overrun charge applicable to T1 [now also T2] and T3 customers when their storage balances fall below zero. Union has proposed that the charge be changed to be consistent with the proposed charge to bundled direct purchase customers...¹²

28. The proposed penalty charges to bundled direct purchase customers were designed to address the fact that there was insufficient incentive for direct purchase customers to balance, because Union's imbalance penalties at the time did not reflect market prices for gas at the time of default.¹³ The Board noted Union's argument that:

its proposal, by levying the penalty at the time of imbalance – thus strengthening the link “between the violation and the cost consequences” – and by reflecting market prices at the time of the choice not to balance, would provide sufficient incentive to ensure that the cost consequences arising from direct purchasers strategically choosing not to balance would not be visited on system gas customers.¹⁴

29. The methodology approved in RP-2001-0029 was intended to address situations in which a shipper was better off incurring a penalty than securing gas in the spot market to meet its daily obligations. The purpose of the new methodology was to eliminate the potential benefit of taking such an approach relative to the other alternative, i.e. paying the prevailing market price on that day.

30. Therefore, it is logical that a penalty that reflects market prices on the day of the imbalance would result in a reasonable alternative penalty in the circumstances, and indeed, would address the underlying rationale for the change to the current penalty methodology in the first place.

31. A methodology that incorporates the highest spot price on the date of the overrun has already been approved by the OEB in Enbridge Gas Distribution's Rate 125 for Unauthorized Supply Overrun.¹⁵

¹² RP-2001-0029, para. 6.89

¹³ RP-2001-0029, para. 2.63.

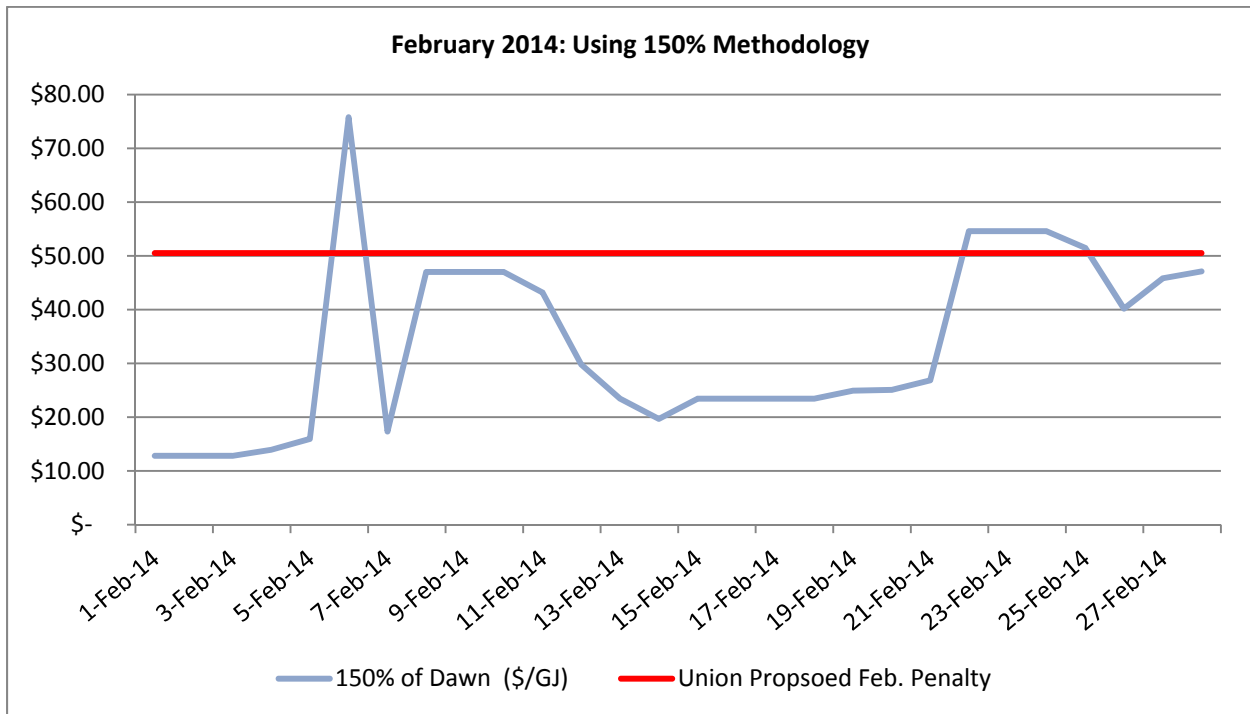
¹⁴ RP-2001-0029, para. 2.64. See also para. 2.85.

¹⁵ A copy of Enbridge's Rate 125 is attached to TCE's evidence as Appendix A.

32. Enbridge’s Rate 125 penalty for Unauthorized Overrun connects the level of the penalty charge to actual prices on the day that the penalty is incurred. Effectively, for any gas deemed to have been Unauthorized Overrun, the customer would be charged 150% of the highest price in effect for that day (the “150% methodology”).

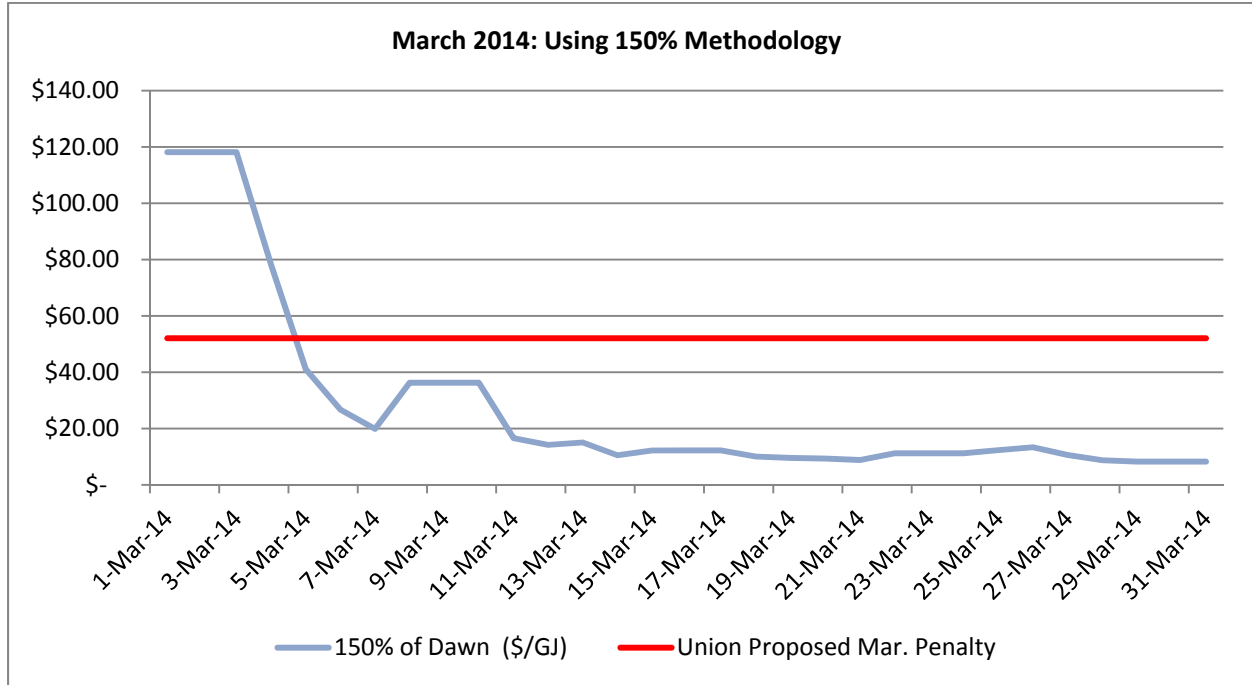
33. In its evidence, TCE provided figures showing the daily penalty charges that would result if the 150% methodology were used in lieu of the Union methodology. Figures 2 and 3 are reproduced below. The underlying values on a daily basis were provided in TCE’s response to Board Staff IR.1(a).

Figure 2: The 150% Methodology (February 2014)



Source: NGX

Figure 3: The 150% Methodology (March 2014)



Source: NGX

34. As noted in TCE’s evidence¹⁶, Figures 2 and 3 demonstrate that there would be days in which the penalty applicable using this methodology would be higher than the penalty charges based on Union’s existing methodology. However, TCE suggests that this is appropriate, because whether the magnitude is unreasonable can only be assessed relative to the spot price on the day that the shipper exceeded its storage volumes. If it was a high price day, then it is necessary to have a higher penalty to provide a disincentive for customers to breach their balancing obligations (by merely paying the penalty and avoiding higher gas costs).

¹⁶ TCE Evidence, page 5 of 5.

(d) Not Retroactive Rate-Making

35. Union indicates that the Supplementary Inventory Charge for Rates T1 and T2 was approved by the Board in Union’s 2002 rates proceeding (RP-2001-0029)¹⁷. That is not accurate – certainly the specific rate of \$78.73/GJ was not approved.

36. Rather, the Board merely approved a methodology for establishing the rate and in so doing, required that the magnitude of the penalties assessed using the rate not be unreasonable¹⁸.

37. It was inherent in the methodology that the rate would vary from time to time depending upon external factors. As Union acknowledges, these external factors experienced extraordinary conditions in February and March 2014¹⁹. The impact of those extraordinary conditions on the methodology was that it yielded an exorbitant Supplementary Inventory Charge that, in TCE’s submission, is not reasonable.

38. The fact that Union has come forward with an application to voluntarily reduce that Supplementary Inventory Charge amounts in principle to an admission that the \$78.73/GJ rate yielded by the approved methodology was excessive and unreasonable, and that a reasonable rate needed to be established.

CONCLUSION

39. It is imperative that the change to the penalty charges in this case result in a charge that is just and reasonable in magnitude. The charge that Union has proposed is excessive. TCE has proposed an alternative methodology for calculating the penalty charge for T2 customers that: (a) fully respects the underlying rationale for the penalty charge (i.e.,

¹⁷ Union response to TCE.1(a).

¹⁸ RP-2001-0029, para. 6.96

¹⁹ Union Application, April 3, 2014; Letter from Union to OEB, April 10, 2014, Q&A 2; and Exhibit B.Kitchener 1(b)

encouraging contractual compliance); (b) is principled from a rate-making perspective, because it reflects the spot price of gas on the day that the customer exceeded its volumes, thereby strengthening the link between the violation and cost consequences; (c) has been utilized by the Board elsewhere; and (d) results in a penalty charge that is reasonable in magnitude.

40. Use of TCE's methodology for T2 customers yields a just and reasonable result and TCE respectfully requests that the Board order Union to use it in calculating the penalty charges payable by T2 customers for February and March 2014.