EB-2014-0154

ONTARIO ENERGY BOARD

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 as 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.

WRITTEN SUBMISSIONS of
NATURAL RESOURCE GAS LTD. ("NRG")

September 12, 2014

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PART I – INTRODUCTION

1. Union Gas Limited ("Union") is a utility supplying residential and industrial customers and Natural Resource Gas Limited ("NRG") with certain natural gas-related services and products.

2. Union and NRG have entered into a "South Bundled T Gas Contract" *(Exhibit B.NRG.16)* made as of October 1, 2004 together with General Terms and Conditions dated January 2009 (the "NRG / Union Contract") under which Union supplies certain services to NRG.

3. Under the NRG / Union Contract, NRG was obliged to supply natural gas to meet "contractual balancing obligations" as at February 2014. NRG had an obligation to supply 115,000 GJ to Union on or before February 28, 2014. It supplied 90,000 GJ, but was unable to supply the remaining 25,000 GJ although doing everything reasonably possible to meet the requirement.

4. Union met NRG's obligation from its supplies in storage. Union purchased 29.8 PJ of spot gas between December 12, 2013 to February 21, 2014 period to ensure adequate supplies were available to meet demands on the Union system from March 31, 2014 and to ensure adequate storage balances at March 31, 2014 for design day requirements at prices which ranged from \$4.94 per GJ to \$12.31 per GJ with an average price of \$7.12 per GJ *(Exhibit B.Staff.1, page 3)*.

5. The Ontario Energy Board (the "Board") fixed a penalty rate in its decision in RP-2001-0029 using a formula being "… the higher of the daily spot cost at Dawn in the month of or the month following the month in which gas is sold but not less than Union's approved weighted average cost of gas …" (otherwise known as the Ontario landed reference price). This formula will hereinafter be called the "Penalty Formula".

6. Union sold gas to NRG pursuant to the Penalty Formula. The penalty rate was \$78.73 per GJ. The Ontario landed reference price for 2014 was \$4.87 per GJ. This rate is 16 times Union's Ontario landed reference price for 2014. In all other years from 2006 to 2013 (except 2008), the February penalty rate was always identical with the Ontario landed reference price *(Exhibit B.NRG.12)*.

7. In this application, Union has asked the Board to change the penalty rate from the highest daily spot rate at Dawn to the second-highest daily spot rate at Dawn. This is a change from \$78.73 per GJ to \$50.50 per GJ.

8. Union has based its application on several principles. The first is that the four winter months from December 2013 to the end of March 2014 were the coldest four consecutive months since the winter of 1975/76 *(Exhibits B.NRG.3; B.NRG.1)*. Union has given evidence that what it characterized as "exceptional weather conditions in 2014" caused high gas prices *(Exhibit B.Kitchener.1, page 1)*. Union also states that it seeks to reduce the penalty rate based on the individual characteristics of four of the eleven direct purchase customers who failed to supply balancing gas to Union, namely that the penalty

rate would or could cause financial impairment or even bankruptcy of one or more of these four customers *(Exhibit B.Staff.1, page 2)*.

9. NRG agrees that the weather conditions were exceptional, and that they justify a change in the penalty rate. NRG agrees that the Board should consider individual characteristics of each customer affected by the change in the penalty rates when determining the appropriate change in the penalty rate.

10. NRG submits that Union's choice of $50.50 per GJ or the second-highest price for spot gas in February 2014 is arbitrary, and not founded in either fact or principle.

11. NRG submits that the Board should fix a penalty rate based on historic norms and costs incurred by Union to supply the natural gas to NRG. The historic norms are one indication of what NRG's reasonable expectations were in February 2014, namely that the penalty rate was never greater than the Ontario Landed Reference Price and never more than $12.45 per GJ *(Exhibit B.NRG.12, Table 1)*. The costs incurred by Union reflected in its Ontario Landed Reference Price for February 2014 or reflected in its own spot purchases during the winter of 2013/2014 are another measure of reasonable expectation for NRG, namely that the penalty rate would not be above Union's average weight cost of spot purchase gas, $7.12 per GJ *(Exhibit B.TCE.2, Table 1)*.

12. Union does not provide any evidence of what other compliant customers paid for their natural gas to meet their balancing obligations on or before February 28, 2014 *(Exhibit B.NRG.14)*. The only evidence of cost to Union is what it paid for natural gas as indicated either by its Ontario landed reference price or its purchases in the spot market from December 2013 to March 2014.

13. The range of prices for winter 2013/2014 spot purchases of gas paid by Union from December 2013 to March 2014 were $4.94 per GJ to $12.31 per GJ for an average cost of $7.12 *(Exhibits B.NRG.15 page 2; B.Staff.1 page 3; B.TCE.2, Table 1)*.

14. NRG submits that the Board should be guided by the principles set out in its own prior reasons in RP-2001-0029 and RP-2003-0063 and, in the exceptional weather conditions of the Winter of 2013/2014, fix a penalty rate based on Union's actual costs, individual characteristics of NRG (namely that it is a utility purchasing gas for its own residential and industrial customers where the gas costs will be normally paid by those customers) and an analysis of NRG's good faith attempts to meet its contractual obligations to supply the winter balancing gas on or before February 28, 2014.

15. As will hereinafter be set out, NRG asks the Board to consider a penalty rate for NRG in a range between $4.87 per GJ to $7.12 per GJ.

PART II – RELEVANT PRIOR BOARD DECISIONS

16. Union's application is for a one-time change in the penalty rate which is derived from a formula originally fixed by the Ontario Energy Board (the "Board") in RP-2001-0029 dated September 20, 2002. The Board said at page 31 of its Reasons for Decision in regard to the penalty provision that is in issue in this proceeding as follows:

> The Board accepts the premise that is important to encourage compliance with contractual obligations to balance in a system such as Union's, where a wide variety of users are dependent on such balancing to ensure the integrity, security and efficient operation of the system. The failure to balance can place **compliant system participants at risk,** and may result in **additional costs.**

The Board further stated:

> In the Board's view, the penalty must be **sufficiently costly** to defaulters to strongly discourage **strategic non-compliance** of contractual obligations which are not reasonably achievable. The Board is concerned that parties wishing to engage the market, either directly or through agents, must be appropriately encouraged to **manage their obligations responsibly**. The system as a whole requires that. [*emphasis added*]

17. The Board explained the system-wide benefits of Union's then proposed load balancing mechanism in its decision RP-2003-0063 where it noted as follows:

> Under the current practice, Union accounts for and provides for shortfalls and surpluses in the gas accounts of direct purchase customers. All of the costs associated with procuring spot gas for direct purchase customers overusing in the winter period and the costs associated with shedding the surplus gas in the Fall, have previously been allocated to the rate class to which the imbalanced direct purchase customers belong. This has the effect of burdening all members of the class with increased costs, whether or not they had operated within their contractual obligations and forecasts. **This violates the principle that those who cause costs ought to bear them.** [*emphasis added*]

18. Based on the above quotations, NRG respectfully submits that it should fix a new one-time penalty rate on the principles that:

    (a) "... those who cause costs ought to bear them ...";

    (b) the Board should also have regard to ensuring that the penalty is sufficiently costly to defaulters to "... strongly discourage strategic non-compliance of contractual obligations ..."; and

    (c) fix a penalty rate which encourages NRG to "... manage its obligations responsibly.

PART III – OTHER CONSIDERATIONS RELEVANT TO THE BOARD'S DECISION

19. Union itself has testified that its request for a "... one-time exemption from the Board approved rate schedule was based on feedback from customers most impacted by the penalty charge. Specifically, the impact is significant for the four customers that were facing a charge in excess of $800,000 as indicated in Exhibit B.CME.2, Attachment 1.

For these four customers, the impacts include the potential of financial impairment or even bankruptcy, the proposed reduction is consistent with the intent of the penalty mechanism, while providing some financial relief for those customers impacted for failure to meet their contractual obligations".

20. Union is asking the Board to consider customer-specific factors in fixing the one-time penalty rate in the exceptional weather conditions set out above.

21. NRG agrees that the Board should consider customer-specific factors in fixing the one-time penalty rate.

22. As will hereinafter be set out, NRG asks that the Board consider that NRG is the only direct purchase customer which is required to pay the penalty rate which is a utility *(Exhibit B.CME.2, Attachment 1)*. NRG was asked to pay $2,007,250 under the highest spot price and is asked to pay $1,287,655 under the second-highest spot price. Of the eleven customers involved only three are asked to pay over $30,000 and NRG is asked to pay the largest amount *(Exhibit B.CME.2, Attachment 1)*. NRG's customers will be required to pay this penalty rate which is 16 times greater than the Ontario Landed Reference Price ("Union's Reference Price").

23. NRG will ask the Board to consider that on the facts presented in evidence, NRG acted responsibly in supplying 90,000 GJ of the required 115,000 GJ and made all reasonable efforts to purchase the remaining 25,000 GJ during the month of February 2014, but was unable to obtain a supply. NRG acted responsibly in seeking the assistance of Union which did not avail NRG of any assistance.

24. Based on this evidence, NRG has shown that it was not engaging in strategic non-compliance, that it was managing its obligations responsibly and that it did not cause any costs for other Union customers to bear.

PART IV – THE FACTS

NRG Described

25. Mr. Brian Lippold, General Manager for NRG, has given testimony in this matter which has not been made the subject of cross-examination or questions by Union or any Intervenor. The Board should therefore accept his testimony. (*NRG Evidence: Lippold Affidavit – para. 1)*

26. Mr. Lippold was involved in the issues and gas purchases of NRG to meet its Winter Checkpoint Quantity under its contract with Union Gas Limited ("Union") leading up to February 28, 2014. (*NRG Evidence: Lippold Affidavit – para. 1)*

27. NRG is an Ontario corporation that carries on the business of distributing and selling natural gas in the southern Ontario. NRG is regulated by the Ontario Energy Board (the "Board") under the Ontario Energy Board Act (the "Act"). (*NRG Evidence: Lippold Affidavit – para. 2)*

28. NRG is a customer of Union. NRG receives gas from Union pursuant to a southern bundled T contract, the terms and conditions of which are attached to NRG's evidence filed with its Request to Intervene (subject to Schedule 2, which Union attached to its evidence. *(NRG Evidence: Lippold Affidavit – para. 3)*

Union Application: Penalty Rate Change

29. Union first made this Application by letter dated April 3, 2014. In that letter, M. Richard Birmingham, CPA, CA, Vice President, Regulatory, Lands and Public Affairs, writing on behalf of Union, requested that the Board change the penalty provision in its contracts affecting NRG and other customers be reduced from $78.73/GJ to $50.50/GJ. Mr. Birmingham, on behalf of Union, stated that it was prepared to make the change in the penalty charge "… in recognition of the exceptional weather conditions in 2014 …" *(NRG Evidence: Lippold Affidavit – para. 5)*

Unprecedented Severe Cold Weather: 2013/2014

30. NRG accepts Union's characterization that the weather conditions for the five-month winter period of November 2013 to March 2014 were the coldest in Union's records for Union South. In Exhibit B.NRG.1, in answer to an interrogatory from NRG, Union filed a chart indicating that the 2013/2014 five-month winter period had more cold days below 18 Centigrade than any other year from 1970 forward. *(NRG Evidence: Lippold Affidavit – para. 6)*

31. The extreme cold weather conditions in the winter period of November 2013 to February 2014 were the subject of an article and a separate editorial written in the Financial Times on Thursday, June 26. Referring to North America as a whole, and the U.S. economy in particular, the article noted that the U.S. economy suffered serious economic damage due to, inter alia, the "country's worst winters on record". It was reported that the extreme winter conditions helped "push first-quarter domestic product figures down an annualized three percentage points more than estimated". The article quotes Paul Dales, Senior U.S. Economist at Capital Economics in London, England, saying: "…the larger contraction in GDP [USA] in the first quarter is not a sign that the U.S. is suffering from a fundamental slow-down, it is largely due to extreme weather". The article further stated as follows: "The first-quarter figures confirm the previous picture of a terrible winter, as arctic conditions closed factories, shut transportation units, kept customers away from the shops and deterred homebuyers. There was also a huge run-down in inventories which knocked 1.7 percentage points off growth." In an editorial in the same newspaper and on the same day, an editorial writer, James MacKintosh, opined that "The U.S. economy shrank far more in the first-quarter than anyone imagined, dropping 2.9% on an annualized basis according to the latest revision yesterday. As this plunge took place in a single quarter, it does not meet the standard definition of a recession, which requires two quarterly successive drops." *(NRG Evidence: Lippold Affidavit – para. 7)*

32. Based on Mr. Lippold's uncontradicted evidence, North America generally, and southern Ontario in particular, endured the coldest and most damaging extreme winter weather conditions from November 2013 to February 2014 on record. *(NRG Evidence: Lippold Affidavit – para. 8)*

Cold Weather Impact on Natural Gas Consumers

33. Mr. Lippold's evidence is that the weather conditions during the period November 2013 to March 2014 in southern Ontario were sufficiently unpredictable and unpredicted that the Board should consider the impact on consumers and customers of Union and grant a reduction in the penalty rate in the amount hereinafter set out by NRG. *(NRG Evidence: Lippold Affidavit – para. 9)*

Reasonable Penalty: Historic Norms and Exceptional Weather

34. The impact on the public consumer in the Province of Ontario is paramount. NRG is a utility which supplies natural gas to 8,000 residential and industrial consumers in a predominantly rural and small town area of the province. The reasonable penalty rate per GJ should be as small as possible, related to historic norms and/or sufficient to pay Union's cost of gas. *(NRG Evidence: Lippold Affidavit – para. 11)*

35. Mr. Lippold, on behalf of NRG, recognized that Union's application for a reduction in the penalty rate is a one-time event and a one-time relief from the penalty rate presently fixed by the Board. *(NRG Evidence: Lippold Affidavit – para. 12)*

36. Union itself has testified that the exceptional weather conditions caused the high gas prices in February 2014 *(Exhibit B.Kitchener.1, page 1)*.

37. The \$78.73/GJ spot rate for natural gas in February 2014 contrasts with February penalty rates for the years 2006 to 2013. Historically, penalty rates derived from the Penalty Formula for the years 2006 to 2013 were Union's Reference Price, except for 2008 when the penalty rate was \$1.69 above Union's Reference Price. The penalty rates in the years 2006 to 2013 ranged from \$5.37 per GJ to \$12.45 per GJ *(Exhibit B.NRG.12, Table 1)*. *(NRG Evidence: Lippold Affidavit – para. 13)*

38. Union itself recognizes that \$78.73 is not reasonable in these circumstances. With little explanation, Union has requested a reduction to \$50.50. On the historical spot gas price evidence above, \$50.50/GJ is not a reasonable penalty rate in the extreme circumstances experienced in November 2013 to March 2014. The historical norms are a market-based substitute for fixing a reasonable spot price for natural gas in the circumstances. *(NRG Evidence: Lippold Affidavit – para. 16)*

39. As hereinafter submitted, NRG therefore submits that the penalty rate for February 2014 should be fixed by the Board based on historic norms, Union's actual costs and facts specific to NRG.

NRG Acted Responsibly and did not Engage in Strategic Non-Compliance

40. While it does not bear directly upon the penalty rate that the Board may consider appropriate for all relevant customers, the individual actions of customers may bear some analysis in order to ensure the Board and the Ontario public that the customers in question who failed to supply all of their required Winter Checkpoint Quantity (in particular NRG for my evidence) did not simply ignore their obligations and thereby stand accused of ignoring the penalty rate fixed by the Board and their bundled T service contract obligations. *(NRG Evidence: Lippold Affidavit – para. 19)*

41. NRG recognized its difficulty in purchasing natural gas to meet its Winter Checkpoint Quantity, first for a reasonable price, and then at all. NRG sought Union's assistance. While Union was polite, it gave NRG no meaningful assistance in purchasing natural gas to meet its Winter Checkpoint Quantity and refused (at that time) to grant NRG any relief from the penalty rate. Any suggestions for gas purchases made by Union did not lead to the ability of NRG to purchase sufficient natural gas to meet its Winter Checkpoint Quantity *(see Exhibit B.NRG.17, attachments 1 and 2)*. *(NRG Evidence: Lippold Affidavit – para. 21)*

42. NRG acted reasonably and in the public interest, having regard to the needs of its own customers and having regard to the emergency conditions that were extant during the winter season of November 2013 to March 2014. NRG did buy a substantial amount of gas at very high market rates and delivered that gas prior to February 28, 2014 in an attempt to meet all of its Winter Checkpoint Quantity. NRG could not purchase sufficient gas such that it could be delivered by February 28, 2014. The price for spot gas fell from as high as $78.73 on February 28, 2014 to a low of approximately $17.00/GJ on the next trading day, namely March 3, 2014. Within the first week of March, the market prices dropped considerably and began to stabilize. On March 10, 2014 the trading value for gas at Dawn ranged from approximately $7.50 to $11.50/GJ (CAD). Pricing continued to fall and further stabilize in the weeks following. NRG acted reasonably in withholding its purchases during February 2014 with the reasonable expectation that prices would return to normal values prior to February 28, 2014. The exceptional conditions conspired against that reasonable expectation. The fact that price dropped substantially on the next trading day after February 28, 2014 indicates that NRG was acting reasonably. *(NRG Evidence: Lippold Affidavit – para. 22)*

43. It is Mr. Lippold's uncontradicted evidence that NRG did everything reasonably possible to meet its contractual obligations to provide the Winter Checkpoint Quantity and did nothing unreasonable in the circumstances in failing to meet 25,000 GJ of its outstanding 115,000 GJ obligation. *(NRG Evidence: Lippold Affidavit – para. 23)*

44. NRG and its management team were diligent and watched market conditions and pricing daily. NRG also purchased gas monthly without exception. Although NRG was fully aware of the flow through cost recovery model, it was always acting to protect its customers by choosing to look for the lowest possible price available in February in keeping with past experience. By asking Union to grant a modest, short-term deadline extension into March, NRG was confident that even that small window of time would be

enough to alleviate pricing pressures and bring the spot price down to historic levels. *(NRG Evidence: Lippold Affidavit – para. 24)*

45. When NRG was advised by Union that there was no assistance for NRG, they were forced to purchase gas at existing spot rates. NRG was able to purchase, in six transactions, the majority of its shortfall from Shell Energy at an average price of $26.81/GJ. *(NRG Evidence: Lippold Affidavit – para. 25)*

46. On the days of February 26-28, NRG Managers spent their time focussed on purchasing gas in quantities sufficient to meet its' contractual requirements. NRG contacted secondary suppliers such as GoEnergy and Blackstone in attempts to purchase the remaining gas to satisfy the requirement. In addition, NRG invited match-making assistance from Union whereby Union supplied a potential contact for an in-franchise gas purchase. In spite of pursuing all avenues, NRG was unable to purchase ample gas required to completely meet its contractual obligations. NRG was advised that any further purchases of gas could not be delivered to the Dawn Hub after February 28. *(NRG Evidence: Lippold Affidavit – para. 26)*

47. The evidence is clear that NRG took all reasonable steps to fulfill its contractual obligations, paying an average price of $26.81 per GJ to fulfill its obligations to supply natural gas for balancing under the Union/NRG Contract. NRG was unsuccessful in being able to purchase gas to meet its residual balancing obligations at the end of February 2014. NRG unsuccessfully looked for assistance from Union to purchase the gas and pursued all avenues to purchase the remaining 25,000 GJ to complete its contractual obligations.

48. On the basis of the facts set above, NRG was neither careless, incompetent nor seeking to strategically fail to comply with its contractual obligations. NRG acted reasonably and responsibly and only failed to meet its residual obligations to supply natural gas due to exceptional weather conditions, unprecedented costs and actual lack of supply of natural gas.

Uniqueness of NRG

49. NRG is itself a utility whose costs for gas are a "flow-through cost". On this basis, NRG submits that special consideration should be given to NRG in fixing a penalty rate. The penalty rate should reflect Union's out-of-pocket costs being in arrange as set out below.

50. NRG submits that the Board should take into account that NRG does not make any profit from its natural gas purchases and that the purchases are made for its customers not NRG itself.

51. The Board should avoid any artificial detriment to NRG's customers based on a penalty rate which is not fixed based on sound rate making principles.

Storage at Union

52. Union has admitted that it sold gas to NRG under the NRG / Union Contract at the penalty rate of $78.73 per GJ on February 28, 2014. The gas was supplied from Union's storage to NRG's banked gas account. *(Exhibit B.Staff.1 page 1(d), second paragraph).* Union's average cost of gas for this supply was its Ontario landed reference price of $4.87 per GJ or $7.12 per GJ, being Union's average cost of gas for its spot purchases.

53. Union has a unique asset in its storage capacity. Union made a presentation to a stakeholder conference in October 2010 regarding the Dawn Hub and its storage facilities. *(NRG Evidence: Lippold Affidavit – para. 28)*

54. The Dawn storage facility was upgraded over the last several years. Union has stated that the Dawn storage was ample at capacity to supply gas to 1.9 million homes for the entire year. Union has given evidence that it has sufficient gas inventory in its "integrity space" in its storage facilities for late season weather variations *(Exhibit B.1, Attachment 1, page 3)*. *(NRG Evidence: Lippold Affidavit – para. 29)*

Windfall Benefits to Union

55. Union has given evidence that it did not purchase any natural gas for NRG in order to meet NRG's contractual obligations *(Exhibit B.NRG.15)*.

56. Union has given evidence that the monies received from the penalty charge are or will be "…credited to Union North and Union South sales service customers to ensure that the cost consequences of the NP customers failing to balance are not borne by these customers." *(Exhibit B.NRG.15, second page)*.

57. The evidence has already shown that Union's actual costs ranged from $4.87, being its Ontario Landed Reference Price to $7.12 being its average weighted cost of gas for Winter 2012/2013 spot purchases *(Exhibits B.NRG.12 and B.TCE.2)*.

58. At a penalty rate of $78.73 per GJ, Union's customers are receiving a windfall benefit from NRG of $71.62 per GJ for 25,000 GJ being $1,790,250. At a penalty rate of $50.50 per GJ Union customers are receiving a windfall benefit from NRG of $1,082,250.

59. NRG is a utility supplying residential and small industrial customers. Natural gas purchases are made by NRG for these customers. Normally they lead to a flow-through so that NRG's customers pay for the cost of gas and in particular the penalty rates in effect NRG's customers are paying a special penalty rate to Union's sales service customers even though the circumstances were unprecedented, not within any historic norms and not based on Union's actual costs paid for the gas actually supplied to NRG.

60. This is an unjustified windfall benefit arising out of extreme weather conditions and resulting high prices. Both the $78.73 per GJ and the $50.50 per GJ which is now proposed by Union in its application lead to windfall benefits and, for reasons hereinafter set out, are not justified or based on sound rate making principles.

PART V – ANSWERING UNION'S ARGUMENTS IN FAVOUR OF A PENALTY RATE OF $50.50/GJ

Introduction

61. Union's arguments made throughout its filings in answers to questions put by Board Staff, Intervenors (including NRG) in favour of a penalty rate of $50.50 are inconsistent with prior Board decisions (although Union purports to argue that the prior Board decisions are being followed), and are internally contradictory. In addition, Union's arguments regarding the importance of individual characteristics in fixing a penalty rate are not properly applied to all Intervenors. Finally, Union's arguments are conclusions made either without basis in fact or in circumstances where existing facts contradict the conclusions sought.

Compliant Customers Prices Unknown and Irrelevant

62. Union takes the position that "Any price below the proposed February $50.50 per 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 b) are near to, even not below, prices that compliant customers were paying in the marketplace to meet their balancing obligation. It would be inappropriate and inequitable for a non-compliant customer to pay a price less than a customer that met their contractual obligation" *(Exhibit B.Staff.1, page 2(c))*.

63. The $50.50 spot price in the month of February 2014 only occurred on one day in the month of February 2014 *(Exhibit B.Staff.1, page 2(b))*. A one day price in February 2014 is not a fair or reasonable price to impose upon Union customers as a penalty rate without further justification.

64. There is no evidence of what spot price "compliant customers" paid for their gas supplied to Union *(Exhibit B.NRG.14)*. Union therefore has no factual basis upon which to say that the 3rd, 4th and 5th lowest prices in February 2014, being $36.39, $34.33 or $31.41 were above the prices paid by compliant customers. Union concluded its argument set out above that it would be "inappropriate and inequitable for a non-compliant customer to pay a price less than a customer that met its contractual obligations". This statement is made without the necessary factual evidence of prices paid by compliant customers and is therefore of no assistance to Union's argument.

65. It is also submitted that the prices paid by compliant customers (which includes NRG) are not relevant to establishing the penalty rate based on the principles put forward by the Board in RP-2001-0029 and RP-2003-0063. These Board decisions indicate that Union's cost is the most significant factor. The Board has indicated that those who cause costs ought to bear them. This principle elevates the importance of Union's cost and renders irrelevant what a compliant customer has paid (even if such prices were available).

66. NRG submits that Union's proposal of $50.50 per GJ is entirely arbitrary. Further, the prices paid by compliant customers of Union are not known and, in any event, not relevant. The guiding principle in these emergency conditions ought to be Union's actual costs of gas provided to NRG to meet its contractual obligations at the end of February 2014.

Customer Specific Characteristics

67. The principle of fixing a penalty rate based on Union's actual costs should be supplemented by an analysis of customer specific characteristics. In this regard, Union has stated that it "...applied for the one-time exemption from the Board-approved rate schedule based on feedback from customers impacted by the penalty charge. Specifically, the impact is significant for four customers that were facing a charge in excess of $800,000, as indicated in B.CME.2, Attachment 1. For these four customers, impacts include the potential of financial impairment or even bankruptcy. The proposed reduction is consistent with the intent of the penalty mechanism, while providing some financial relief for those customers most impacted for failure to meet their contractual obligations". *(Exhibit B.Staff.1, page 3(c)).*

68. A number of issues arise from Union's customer specific submissions. The first is that Union purports to "... provide some financial relief..." based on its own discretion. The provision of financial relief is not a principle upon which the Board should solely fix a penalty rate. It is submitted that customer specific financial relief is one of many customer specific factors to consider when fixing a penalty rate.

69. NRG agrees that individual characteristics and individual customer conduct are relevant in fixing a penalty rate. NRG has already pointed out that it is a utility which purchases gas and contracts with Union as an intermediary between NRG's customers and the natural gas vendors and transmission companies such as Union. This is a factor that weighs in favour of looking to Union's cost of gas as a fair penalty rate in the extreme and unprecedented conditions experienced during the Winter of 2013/2014.

70. NRG submits that the Board should also consider NRG's conduct and conclude that NRG did not engage in strategic non-compliance with its contractual obligations and that NRG did manage its contractual obligations responsibly.

71. In its argument, Union argued that "...Other customers paid the prevailing market prices to meet their obligations. There is no reason why NRG could have done the same". This argument is immediately rendered specious when Union says in the next sentence "...the price each customer paid will be different depending on their gas supply strategy" *(Exhibit B.Staff.1, pages 3 and 4).* NRG agrees with the last sentence but notes that there is no evidence about any other customers gas supply strategies or prices paid. Secondly, the most persuasive surrogate gas supply strategy and indication of fair prices upon which to fix a penalty rate are drawn from Union's own evidence as to what Union paid in the Winter 2013/2014 spot market for natural gas, namely $4.94 per GJ to $12.31 per GJ with an average price of $7.12 per GJ *(Exhibit B.Staff.1, page 3).*

Union's Sophisticated Gas Purchasing

72. Union gave testimony that it was able to avoid the highest price in the 2013/2014 Winter seasons for the purchase of gas by "...frequent monitoring and layering in approach to spot gas purchases...". It can be assumed that, if the Board is considering a penalty rate based on a reasonable pricing strategy, that strategy, would avoid any one-day high prices which occurred during the month of February. A reasonable pricing strategy would have

achieved the \$7.12 average weighted cost of gas of Union, being \$7.12 per GJ *(Exhibit B.Staff.1, page 3(d), first paragraph)*.

73. It is important to note that Union is a major utility in the Province of Ontario which has sophisticated gas purchasing professionals assisting it in the major purchases about which it has testified in part. This level of gas purchasing sophistication is not available to NRG although NRG has done extremely well with the resources it did have. It is therefore submitted that a reasonable penalty rate to impose on NRG is one based upon Union's costs.

Conclusion and NRG's Proposed Rate

74. On the basis of the above, it is respectfully submitted that Union's proposal of \$50.50 per GJ for the NRG penalty rate has no basis in logic or in fact. It is submitted that the \$50.50 per GJ price is a windfall for Union's customers and a concomitant severe detriment for NRG's customers. The \$50.50 per GJ is not consistent with historic norms which would lead to a penalty rate at Union's Reference Price of \$4.87 per GJ. Union's proposed penalty rate is not remotely related to Union's actual cost. The \$50.50 per GJ penalty rate takes no account of the fact that NRG did supply 90,000 GJ of the required 115,000 GJ and was not able to purchase the final 25,000 GJ for delivery to Union in spite of trying. Union's proposal does not take into account the fact that NRG acted reasonably on the facts set out above.

75. It is respectfully submitted that the Board should reject Union's proposal in favour of the range proposed by NRG.

76. In support of NRG's proposed penalty rate of \$4.37 per GJ to \$7.12 per GJ, it is important to emphasize the fact that all of this was caused by extreme weather conditions and unprecedented high prices and is only a one-time adjustment.

77. The Board is asked to exercise its jurisdiction in a unique set of circumstances. The Board's usual rate fixing jurisdiction is exercised by fixing rates in the future. Unusually, this application requires that the Board fix an historic penalty rate. This allows the Board to consider all relevant historical evidence and equitable factors. NRG asks that the Board apply an analysis based on all of the evidence and reject Union's proposal of \$50.50 per GJ based on an arbitrary selection of the second highest spot rate in February 2014.

PART VI – NRG'S PROPOSAL FOR A PENALTY RATE OF \$4.37 TO \$7.12/GJ

78. NRG has explained its proposed penalty rate in the above submissions.

79. NRG submits that the Board adopt the central principle that the penalty rate (in these extreme weather conditions leading to unprecedented spot prices) should be based on the following principles:

(a) the central guiding principle is Union's costs;

(b) the Board should impose a rate that discourages strategic non-compliance;

(c) the penalty rate should encourage parties to manage their obligations responsibly;

(d) in the exceptional conditions of the 2013/2014 Winter, the non-compliant party should pay a penalty rate which reflects Union's costs and avoids any other party bearing the costs of NRG's non-compliance;

(e) the Board should consider NRG's behaviour in attempting to meet its contractual obligations and in drawing its conclusions as to whether NRG was involved in strategic non-compliance or failed to manage its obligations responsibly;

(f) the Board should take note of the fact that NRG is a utility who is purchasing gas for its own customers as a flow-through price and obligation;

(g) the Board should take into account the principle that Union and its customers should not have a windfall gain arising out of the hardship occasioned by extreme weather conditions in 2014; and

(h) the Board should take into account the principle that NRG's residential and industrial customers should not suffer a detriment occasioned by extreme weather conditions in 2014 unless it is based on reasonable costs to Union.

80. As set out above, the only issues before the Board are: (a) whether it will accept any change to the penalty rate, (b) if so, what principles should be applied in fixing the new penalty rate and (c) what that penalty rate should be for NRG.

81. NRG submits that the Board should find that NRG acted responsibly in acting to fulfill its contractual obligations, that it was not acting with strategic non-compliance, that it is willing to pay the costs and its failure to supply to not impose any unrecovered costs to Union or its customers or put the integrity of the Union system at risk.

82. NRG submits that the penalty rate should be based on costs to Union the gas that it sold to NRG to complete its contractual obligations under the NRG/Union contract. This is in a range of $4.87 to $7.12.

83. If the Board remains concerned that a penalty rate should include some factor seeking to impose more responsible purchasing efforts on NRG, then the Board may decide to impose the highest cost paid by Union for natural gas supplies purchased in the spot market during the 2013/2014 Winter season, namely $12.31 per GJ paid on February 21, 2014 *(Exhibit B.TCE.2, Table 1)*.

PART VII – CONCLUSION

84. NRG respectfully submits that the Board should fix a penalty rate that reflects the extreme weather conditions and unprecedented high prices which occurred in the Winter 2013/2014. All parties agree that these extreme weather conditions require relief from the penalty rate which is derived from the Penalty Formula. As set out above, NRG respectfully submits that the Board should take a principled approach to fixing the new

one-time penalty rate. The central principle that the Board should apply is fixing a penalty rate based on Union's actual costs of selling gas to NRG.

85. NRG respectfully submits that NRG's special factual circumstances eliminate the need for encouraging NRG to act responsibly in its gas purchases in the future. In short this was a one-time event based on unpredictable circumstances. NRG did the best it could in the circumstances with every intention to fulfill its contractual obligations to Union.

86. It is therefore respectfully submitted that the penalty rate be fixed in a range of $4.74 per GJ, being Union's 2014 Ontario Landed Reference Price and $7.12 being Union's average weighted cost of spot purchases in the market between December 12, 2013 and March 1, 2014. In the alternative, it is submitted that the upper end of the range be $12.31 per GJ, being the highest price paid by Union in February 2014.

All of this is respectfully submitted by NRG this 12th day of September 2014.

Campion.

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