



ONTARIO ENERGY BOARD

BOARD STAFF SUBMISSION

UNION GAS LIMITED

REDUCTION OF CERTAIN PENALTY CHARGES APPLIED TO DIRECT PURCHASE CUSTOMERS

EB-2014-0154

September 12, 2014

Introduction

Union Gas Limited ("Union") filed an application dated April 3, 2014 with the Ontario Energy Board under section 36 of the *Ontario Energy Board Act, 1998*, S.O. c.15, Schedule B, for an order of the Board approving a one-time exemption from its approved rate schedules to reduce certain penalty charges applied to direct purchase customers who did not meet their contractual obligations during the months of February and March, 2014. The Board made provision for the filing of interrogatories on Union's evidence, the filing of intervenor evidence, and the filing of submissions.

The following is Board staff's submission on Union's application.

Background

In its application, Union requested that, on a one-time basis, the penalty charges applied for Rate T1 / T2 Supplementary Inventory and Rate 25 Unauthorized Overrun Gas Commodity in February and March, 2014 be reduced. In addition, Union requested that the penalty charge applied to bundled T-Service customers that did not meet their contractual balancing obligations in February, 2014 be reduced in the same manner.

To date, customers that were not in compliance with their contractual obligations in February and March, 2014 were applied penalty charges based on the highest daily spot cost of gas at Dawn in the month of or the month following the month in which the gas was sold.

Union's proposal, as set out in its application, would reduce the noted penalty charges to the second-highest spot cost of gas at Dawn in the month which the gas was sold.

The effect of Union's proposal is to reduce the penalty charges for customers that did not meet their contractual obligations in February 2014 from \$78.73 / GJ to \$50.50 / GJ. For customers that did not meet their contractual obligations in March 2014, Union's proposal would reduce the penalty charge from \$78.73 / GJ to \$52.04 / GJ.

Union made its proposal to reduce the penalty charges in recognition of the exceptional weather conditions experienced during the 2014 winter. Union noted that the five-month winter period of November 2013 to March 2014 was the coldest in Union's records, which date back to the 1969 / 1970 winter, for its southern service area.

Board Staff Submission

Board staff supports Union's proposal to reduce the noted penalty charges for the following reasons.

Union brought forward this application in order to help some of its customers that, due to the application of a penalty charge, experienced significant financial harm. Union noted that four of its customers were charged in excess of \$800,000 and that the impact of these charges was potential financial impairment or even bankruptcy. Board staff notes that had Union not filed this application, these customers would have been subject to the full penalty charge in accordance with the applicable rate schedules and terms of their contracts. Board staff commends Union for filing this application with the Board as it seeks to establish an outcome that best serves its customers' interests while respecting the intent of the penalties.

Board staff is of the view that the reduction to the penalty charges, as proposed by Union, adequately balances the competing issues of the intent of the penalty charges and providing financial relief to customers that are significantly harmed by the application of those charges.

The intent of the penalty charge applicable to bundled T-Service customers that do not meet their contractual balancing obligations was set out by the Board in the RP-2001-0029 Decision with Reasons, dated September 20, 2002 (Union's 2002 rates proceeding). In that decision, the Board stated the following:

The Board accepts the premise that it 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.¹

The Board further stated:

In the Board's view, the penalty must be sufficiently costly to defaulters to strongly discourage strategic non-compliance with balance obligations, and the careless or incompetent acceptance of contractual obligations which are not reasonably achievable. The Board is concerned that parties wishing to engage in the market, either directly or through agents, must be appropriately encouraged to manage their obligations responsibly. The system as a whole requires that.²

In the same proceeding, Union proposed to change the penalty charge applied to T1 / T2 customers for Supplementary Inventory to be consistent with the charge applied to the bundled T-Service customers that do not meet their contractual balancing

¹ Decision with Reasons, RP-2001-0029, September 20, 2002 at p. 31.

² Ibid.

obligations.^{3 4} In regard to Union's proposal related to the Supplementary Inventory charge, the Board stated the following:

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. The penalty revenue will be credited to the Other Purchased Gas Costs deferral account, not to the credit of the shareholder. The Board accepts the proposed modifications to the unauthorized storage space overrun charge.⁵

Board staff submits that penalty charges based on the second-highest spot cost of gas in the month which the gas was sold, as proposed by Union, aligns with the intent of the penalty charges as it continues to encourage compliance with the contractual obligations applicable to Union's direct purchase customers in the context of the exceptional weather conditions experienced over the 2014 winter.

Board staff submits that a penalty charge priced below the proposed February price of \$50.50 / GJ and March price of \$52.04 / GJ would reflect a price that may be below the prices that compliant customers paid in order to meet their contractual obligations. Board staff agrees with Union's position that it would be inappropriate for compliant customers to pay a price higher than non-compliant customers. As such, Board staff is of the view that the penalty charges should not be reduced to levels below the prices proposed by Union.

On April 22, 2014, the Board asked Union whether it was aware of any customers that purchased gas at prices higher than the proposed reduced penalty charges. Union responded on April 24, 2014 indicating that it is not privy to the prices paid by direct purchase customers and is not aware of any customers that purchased gas at prices higher than the reduced penalty charges.⁶

The question of what price may have been paid by compliant customers also arose in the EB-2014-0145 proceeding. On September 4, 2014, a witness from Union, referring to the price customers may have paid for natural gas at the end of February 2014, said:

³ Ibid at p. 107.

⁴ In the RP-2001-0029 Decision with Reasons, the charge for Supplementary Inventory was described as an Unauthorized Storage Space Overrun Charge.

⁵ Ibid at pp. 109-110.

⁶ Union Response Letter, EB-2014-0154, April 24, 2014.

Oh, I would suspect customers paid even more than that [\$20 or \$25 / GJ], because the price did get higher. It obviously was higher than 50, and it did get to 78.

I do believe there were -- we did know of transactions that customers took on the last day of March [corrected to February].⁷ And assuming that they were buying at what the screen was saying, then that would assume they were paying \$78 to balance.⁸

It appears to Board staff that while Union does not know definitively what its customers paid, it is possible that one or more direct purchase customers would have paid more to meet their contractual obligations than would be paid under the proposed reduced penalty charges.⁹ However, Board staff expects that if any customers paid more than the proposed reduced penalty charges, the number of customers who did so would be very small. Board staff is of the view that the benefit arising from reducing the penalty charge is greater than the inequity that could result if any compliant customers paid more to meet their balancing obligations than the proposed penalty charge.

TransCanada Energy Ltd. ("TCE") filed evidence proposing that Enbridge Gas Distribution's ("Enbridge") methodology for calculating the charges associated with Unauthorized Supply Overrun for Rate 125 customers be used to calculate the penalty charge for T2 customers only. Board staff does not support this proposal.

Under Enbridge's methodology, customers are charged 150% of the highest price in effect on the day that any gas is deemed to have been Unauthorized Overrun. Board staff notes that the methodology for calculating the penalty charge approved by the Board in RP-2001-0029 for Supplementary Inventory is based on the highest daily spot cost of gas at Dawn in the month of or the month following the month in which the customer failed to meet its delivery obligation. As such, TCE's proposal reflects a fundamental change in the manner in which the Supplementary Inventory charge has been calculated since the Board's approval of this methodology in RP-2001-0029. Board staff submits that this type of fundamental change is not appropriate for a one-time reduction of the penalty charges due to the exceptional weather conditions of the 2014 winter.

In addition, Board staff observes that this suggested change from a "monthly" to a "daily" approach appears to assume that the timing of Union's actions to remedy the default coincides with the occurrence of the default. Board staff invites Union to comment on TCE's proposal in its reply submission.

⁷ It was later clarified that the witness was referring to the end of February 2014 (not the end of March 2014).

⁸ Oral Hearing Transcripts, Volume 2, EB-2014-0145, at p. 61.

⁹ Board staff invites Union to comment on this issue in its reply submission.

Overall, Board staff is of the view that Union's proposal to reduce the penalty charge results in a just and reasonable outcome for Union's direct purchase customers (both those customers that did not meet their contractual obligations and those that did). Board staff submits that the Board should grant Union's application for a one-time exemption from the use of its approved tariffs with respect to the penalty charges applied to direct purchase customers who did not meet their contractual obligations during the months of February and March, 2014.

Board staff notes that the Board, in its letter of May 8, 2014, stated that the penalty charge set in this proceeding would be utilized for Phase 2 of Natural Resource Gas Limited's ("NRG") Quarterly Rate Adjustment Mechanism proceeding (EB-2014-0053). Board staff submits that the reduced penalty charge applicable to bundled T-Service customers that did not meet their contractual balancing obligations in February, 2014, as proposed by Union, should be applied equally to all customers. Therefore, NRG, as a customer of Union that did not meet its balancing obligations in February 2014, should be charged the same penalty as all of Union's other bundled T-Service customers that did not meet their contractual balancing obligations.

Board staff submits that NRG should not be granted any special treatment in terms of the price, or the applicability, of the penalty charge. NRG, as a natural gas distributor that provides natural gas service to its own small and large volume customers, has an equal, or perhaps even greater, onus to manage its gas supply portfolio (and any associated contractual obligations) as any other bundled T-Service customer served by Union.

All of which is respectfully submitted.