

EB-2014-0053

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

AND IN THE MATTER OF an Application by Natural Resource Gas Limited, pursuant to section 36(1) of the *Ontario Energy Board Act*, 1998, for an order or orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission, and storage of gas as of April 1, 2014; and

AND IN THE MATTER OF the Quarterly Rate Adjustment Mechanism.

Natural Resource Gas Limited (“NRG”) Argument in Chief

November 5, 2014

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PART I – INTRODUCTION

1. This is an application by Natural Resource Gas Limited (“NRG”) filed before the Ontario Energy Board (the “Board”) on March 11, 2014. It will hereinafter be called the “NRG QRAM Application”.
2. The NRG QRAM Application seeks to adjust the rates to be paid by its system natural gas customers (“System Customers”) to, *inter alia*, reflect the cost of gas incurred to April 1, 2014. In Board Decision and Order dated December 6, 2013 in EB-2013-0412, the Board approved a Purchase Gas Commodity Variance Account (“PGCVA”) reference price of \$0.183683 per m³ and a gas supply charge of \$0.185376 per m³. Both the price and the charge were effective January 1, 2014. Based on actual and forecast natural gas prices for the period April 2013 through March 2014, the PGCVA balance was projected to be a charge of approximately \$299.17 per residential customer.
3. In this application, NRG seeks a further order effective April 1, 2014 changing the reference price and the gas supply charge effective April 1, 2014 as follows:
 - (i) an Order changing the reference price authorized by the Board’s EB-2013-0412 Decision and Order for use in determining the amounts to be recorded in the PGCVA (Account No.: 179-27) by \$0.189379 per m² from the board-approved level of \$0.183383 per m³ to \$0.373062 per m³; and
 - (ii) an Order changing the rates and other charges from those authorized by the Board’s EB-2013-0412 Decision and Order to reflect a projected \$0.201530 per m³ change in the gas supply charge from the board-approved level of \$0.185376 m³ to a projected cost of \$0.386906 per m³. This change is the sum of the change in the PGCVA reference price, the change required to prospectively clear the balance of the *Gas Purchase Rebalancing Act* (the “GPRA”) and the continuation of the system gas supply cost approved in EB-2010-0018.
4. Evidence in support of the NRG QRAM Application was filed on March 11, 2014.
5. By letter dated March 13, 2014, Board Staff put questions to NRG regarding NRG’s delivery obligations under its direct purchase bundled transportation contract with Union Gas Limited (“Union”). Those questions were answered by NRG in its filing dated March 19, 2014. On March 20, 2014, Board Staff wrote to the Board and NRG seeking a “delayed issuance date” for the requested Board Order. On March 21, 2014, the Board accepted the Board Staff request and asked that the Board Staff and any other parties interested make submissions no later than Monday, March 24, 2014 and March 27, 2014, respectively. On March 24, 2014, Board Staff filed its written argument and sought, *inter alia*, a full prudence review of NRG’s incremental gas purchases (the “Prudence Review”). On March 27, 2014, NRG answered the Board Staff submissions on the basis that, *inter alia*, the decisions of NRG’s management did not properly require a prudence review based on the exceptional conditions that were extant in the winter of 2013/2014,

the market conditions for the purchase and delivery of natural gas in January and February 2014, historic norms for natural gas pricing, and in the interests of NRG's customers and shareholders. NRG also asked that the Board reduce the penalty rate from \$78.72805 per GJ to Union's actual cost of gas fixed at \$12.31 per GJ.

6. On April 1, 2014, the Board made a Decision and Order. It approved NRG's calculation of the forecasted price of gas for the next twelve-month period. On an interim basis, the Board approved a gas commodity charge in accordance with NRG's QRAM application as filed with the following exception: In regard to the Surplus Sale over Consumer Premium charge of \$78.728 per GJ applied to the 25,496 GJ of natural gas that NRG was short at the time of the Winter Check-point, the Board approved, on an interim basis, the recovery from NRG's ratepayers of a reduced amount, as proposed by Board Staff, of \$695,429 (\$27.276 per GJ). The Board noted that the amounts were approved for recovery in the interim "... are subject to change after the Board has completed its review of NRG's application ...". As a result, an interim rate order was granted by the Board on April 2, 2014.
7. By letter dated May 2, 2014, the Board issued a letter of direction requiring the service of an NRG Board notice, together with a copy of the application and Board Decision and Interim Order dated April 1, 2014 to a number of named interested parties and groups.
8. By letter dated May 6, 2014, NRG asked that the Board hear the NRG QRAM Application together with a certain application brought by Union beginning April 3, 2014 [seeking to change the penalty rate contained in the Bundled T Gas Contract between Union and NRG (and other customers of Union) from the highest daily spot rate at Dawn (\$78.73 per GJ) to the second highest daily spot rate at Dawn \$50.50 per GJ]. This Union application will hereinafter be called the "Penalty Rate Application".
9. By letter dated May 8, 2014, the Board informed NRG and Union that it would hear and make a final decision in the Penalty Rate Application before deciding the NRG QRAM Application. This procedural direction will hereinafter be called the "Joinder Refusal".
10. The Board heard and decided the Union Penalty Rate Application in the period April 3, 2014 to October 9, 2014 and issued its Decision and Order on October 9, 2014 granting Union's application to fix the penalty rate at \$50.50 per GJ and rejecting Union's arguments that NRG, as a public utility itself, had a special status from other Union customers required to pay the penalty rate, that historic norms for gas costs were relevant, or that Union's actual costs of providing rebalancing gas were to be considered in fixing the penalty rate. NRG has appealed this decision.
11. By Procedural Order No. 2 dated October 20, 2014, the Board fixed the times for Board Staff interrogatories, answers by NRG, Arguments in Chief, response arguments and reply.
12. On October 29, 2014, NRG filed its answers to Board Staff interrogatories. The only evidence filed in this Application was therefore that of NRG: evidence filed with the Application and NRG responses to Board Staff interrogatories.

13. This written submission is NRG's argument-in-chief which focuses on the prudence of NRG's management in making purchase decisions and its participation in the Penalty Rate Application to reduce the penalty rate from \$78.73 per GJ to \$50.50 per GJ (although NRG sought a further reduction) to supply winter checkpoint balancing gas on or before February 28, 2014 in the amount of 115,523 GJ. NRG supplied the gas in two ways:
 - (a) buying gas at prevailing market rates for 90,027 GJ at an average price of \$27.276 per GJ;
 - (b) paying Union \$50.50 per GJ for 25,496 GJ of natural gas.

PART II – THE ISSUES, THE PRINCIPLES AND PRUDENCE: OVERVIEW

14. The central issue raised by Board Staff, in this NRG QRAM Application, is the prudence of NRG’s management decisions regarding gas purchases and the failure to supply natural gas to satisfy NRG’s balancing obligations under the Bundled T Gas Contract between NRG and Union, described above.
15. If some aspect of the NRG management decisions were not prudent, Board Staff (there being no Intervenors) appears to suggest through its interrogatories that some amount of the natural gas purchase amount for the penalty charge of the Surplus Sale over the Premium Charge (Penalty Rate) of \$50.50 per GJ (applied to 25,496 GJ of gas) be charged to NRG’s shareholders and not its ratepayers. (*Board Staff Interrogatories 3(a)(i) to (vi)*).
16. A prudence review is normally an “after the fact” committed cost analysis to determine whether the cost incurred and the resulting rate is appropriate under section 33 of the *Ontario Energy Board Act* (the “OEB Act”), namely was it “... just and reasonable ...”.
17. In normal circumstances, the relevant principles have been consistently articulated by the Board, the Ontario Divisional Court, and the Court of Appeal, namely:
 - (i) decisions made by utility management should generally be presumed to be prudent unless challenged on reasonable grounds;
 - (ii) to be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made;
 - (iii) hindsight should not be used in determining prudence, although consideration of the *outcome of the decision* may legitimately be used to overcome the presumption of prudence (and presumably used to support the prudence of action);
 - (iv) prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the *time the decision was made* and must be based on facts about the elements that could or did enter into a decision *at the time*.

Enbridge Gas Distribution Inc. v. Ontario Energy Board [2005]
75 O.R. (3d) 72 (Div.Ct.) at p.5, para.10

Enbridge Gas Distribution Inc. v. Ontario Energy Board (2006),
210 OAC 4 (OCA) at p.4, para.10

Powerworkers Union (Canadian Union of Public Employees, Local 1000) v. Ontario Energy Board, (2013) ONCA 539 (CanLII)
(OCA) at p.4, para.16

18. There is a fundamental distinction between the fixing of future rates which is "... a forecast of compensable [*sic*] costs ..." and a prudence review is a simple regulatory tool developed for past capital expenditures and analysed exclusively on information available at the time the decision was made.

Power Workers Union v. Ontario Energy Board, supra at p.6,
para.27

19. "In a prudence review, the evidence may show that the presumption of prudently incurred costs should be set aside, and that the committed compensation rates and staffing levels were not reasonable; however, the OEB cannot resort to hindsight, and must consider what was known or ought to have been known at the time".

Power Workers Union v. Ontario Energy Board, supra at p.7,
para.38

20. The above principle illustrates that the present case is unique, in that the penalty rate of \$50.50 per GJ was decided by the Board after NRG had made its decisions which are under consideration in this Prudence Review. This necessitates using facts which arose after the NRG decisions regarding gas purchasing for meeting its checkpoint balancing had been made. The penalty rate decision is now being used in the prudence review even though the law requires that the prudence review be based solely on historical circumstances extant when the decisions were made. The unique nature of this decision illustrates the problematic impact upon the Board's jurisdiction, as hereinafter set out.

21. The Board was asked and decided that the Penalty Rate Application would not be heard together with the NRG QRAM Application (Prudence Review) in the Joinder Refusal decision. The Joinder Refusal may have a serious impact upon the Board's jurisdiction in this prudence review.

22. In this NRG QRAM Application, the Board is asked to consider the prudence of NRG's gas purchasing decisions for winter checkpoint gas. Had the two matters been heard together, the Board could have considered all relevant factors. By hearing the two matters separately, the Board ruled circumstances specific to NRG to be irrelevant and may be prevented from considering those important circumstances in the prudence review. The result may be a loss of jurisdiction in the Board to fix just and reasonable rates in the prudence review.

23. NRG will discuss these issues in the following parts:

- (i) Part III – The Facts
- (ii) Part IV – The Penalty Rate Application and Decision
- (iii) Part V – The NRG QRAM Application
- (iv) Part VI – The Financial Impacts on NRG
- (v) Part VII – Submissions and Conclusion

PART III – THE FACTS

NRG Evidence and Purchase Under Review

24. NRG filed evidence in the Application, in the answers to interrogatories and through Mr. Brian Lippold, General Manager for NRG. The evidence has not been made the subject of cross-examination. The Board must therefore accept NRG's testimony. (*NRG Evidence: Lippold Affidavit – para. 1*)
25. 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*)
26. 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*)
27. NRG is a customer of Union. NRG receives gas from Union pursuant to a southern bundled T contract and was required to purchase and supply 115,523 GJ of gas by February 28, 2014 for winter checkpoint balancing.
28. NRG is one of only a few utilities in Ontario which supply natural gas, transportation and related services to consumers in the province. NRG has a complex and unique relationship in Ontario with natural gas vendors, TCPL transmission from the wellhead to Union's system in Ontario, Union's transportation within Ontario, the use and availability of Union's storage and the nature of NRG customers, being system supply customers and direct purchase customers. (*Interrogatory Answer 1(a)*).
29. NRG is a bundled direct purchase customer of Union. Union has no other private customer in the province of Ontario which is a natural gas utility itself. NRG must annually understand and fix with Union Gas the amount of gas which is predicted to be consumed by NRG customers and then fix the amount of DCQ gas which must be delivered to Union on a daily basis. For example, in the period November 2014 to October 2015, NRG is required to deliver to Union 2,380 GJs per day. Of this amount, it is predicted that all the direct purchasers who had contracts with NRG must supply 197 GJs. NRG then supplies the balance. It has purchased 2,055 GJs on contract, and intends to purchase 128 GJs in the spot market. This represents the baseline for natural gas purchases that must be adjusted throughout the year to accommodate variations in usage and weather affecting gas usage among all NRG customers; variations of gas volume that must be supplied by NRG direct purchase customers and variations in gas volume that must be supplied by NRG to Union for balancing. (*Interrogatory Answer 1(a)*).
30. In the purchase of natural gas, the price at the wellhead in Alberta has remained in a five-year average range of approximately \$4.00 per GJ to \$6.00 per GJ. In order to fix the price of natural gas for an NRG customer, the cost of transportation on TCPL system,

transportation on Union system, storage and related facilities must be added to the cost of natural gas. (*Interrogatory Answer 1(a)*).

31. In the months of January and February 2014, it was not the cost of natural gas which caused the spike in prices, but the cost of transportation in getting the gas from the wellhead to Union's hub at Dawn. Cold weather was not the only factor which limited the ability to transport gas from the wellhead to Dawn and therefore increased the cost of delivered gas in February 2014 at Union's hub at Dawn. Enbridge does not have fixed balancing dates like Union. The relevant Union balancing date was February 28, 2014. Enbridge has a flexible balancing date, but this year chose it to be in February. This decision by Enbridge put pressure on the transportation system and therefore the price of gas delivered to Dawn on the spot market that had not been previously experienced. The spike in prices for spot gas and the need for the quantity of the spot gas delivered to Ontario was not foreseeable. (*Interrogatory Answer 1(a)*).
32. NRG received the Union Volume Management Report in January indicating a forecast need of gas at the February 28 checkpoint of 115,000 GJs. NRG had reviewed Volume Management and Sport Purchasing monthly. During the last week of January, spot prices were fixed at between \$5.00 and \$8.00 per GJ. This price was considered exorbitant. From and after January 31, 2014, the pricing escalated. NRG began to watch the pricing carefully and review it with its purchasing agent, Shell Canada. Discussions to purchase checkpoint gas occurred with Shell throughout the month of February. NRG authorized Shell to buy gas if the price was less than \$10.00 per GJ on February 6, 2014. NRG began to watch the pricing for natural gas hourly. On February 7, 2014, NRG continued to take advice from Shell and began to focus on waiting for any dip in the price. On February 19, 2014 NRG met with Shell, who indicated they had never seen anything like the gas pricing then being experienced. NRG continued to review the gas pricing with Shell and on February 21, 2014 wrote to Union requesting that they waive the checkpoint requirement temporarily. Union refused to give any waiver. NRG sought the assistance of the Board, but did not receive a reply.
33. NRG has an Ontario Energy Board-approved gas purchasing policy that has been in place since January 31, 2011. That policy reads as follows: "In the past, NRG Ltd. gas purchases were weighted with fixed based seasonable strips – 30% to 40% allocated to spot. Going forward we will be implementing a more diverse strategy with a blend of both fixed and indexed positions in order to capitalize on the current and projected lower prices while allowing flexibility to adjust to market trends." NRG has followed that policy in the conduct of its gas purchasing relevant to this matter. (*Interrogatory Answer 1(a)*).
34. NRG's options between February 26, to February 28, 2014 must be viewed in context of the above description. NRG produces, as part of this answer, the Affidavit evidence of Brian Lippold, General Manager of NRG. This evidence was previously filed in EB-2014-0154 and is re-filed in this case. (*Interrogatory Answer 1(a)*).
35. NRG had multiple conversations with Shell via phone and email on February 26th attempting to purchase the fuel with their trader as well as working with their inside sales

staff to determine what bids would be successful. However, the pricing was not remotely in the acceptable range. (*Interrogatory Answer 1(a)*).

36. On February 26, NRG had additional conversations with Shell and explored the possibility of title transfers but nothing became available. (*Interrogatory Answer 1(a)*).
37. Nearing market close on February 26, NRG called Union and arranged a conference call at 11:30 am with Patrick Boyer of Union. Natural gas price purchase markets operate in two two-hour windows daily from 8:00 a.m. to 12:00 noon. NRG asked what options may be available from Union to avoid default in the event that NRG could not provide all of the fuel in time. Union replied that it could go out to market on NRG's behalf at current market prices. (*Interrogatory Answer 1(a)*).
38. On the morning of February 27, NRG placed numerous bids and was successful with 6 separate transactions amounting to 58,375 GJs. (*Interrogatory Answer 1(a)*).
39. At 10:00 in the morning on February 27, NRG called Patrick Boyer asking for updated bids from Shell. It appeared that it would be impossible to secure enough gas by market close with the limited volumes offers on the board. NRG asked if Union had any other contacts whom it thought may be able to assist with the purchase. Mr. Boyer provided NRG with David Alicandri's contact details. Mr. Alicandri was the Vice-President of Blackstone. NRG spoke with Mr. Alicandri and asked for assistance. He reached out to his contacts and returned NRG's call within one hour and indicated they he would be unable to find that volume of gas for NRG. (*Interrogatory Answer 1(a)*).
40. In the afternoon of February 27 after the market had closed, Shell called NRG to offer a title transfer, roughly in the amount of 31,000 GJs. (*Interrogatory Answer 1(a)*).
41. NRG worked with Shell on the morning of February 28. Shell indicated that there were few offers on the screen and there were only very small quantities. The market closed on February 28, and NRG was unsuccessful in securing the remaining balance. NRG reached out again to Patrick Boyer of Union asking for any resources that Union may have available. At that time Mr. Boyer agreed to make contact with what he described as "a customer in their franchise area that had excess gas that may be willing to sell and they could title transfer and still deliver the gas same day." Mr. Boyer advised that he would reach out to that customer and provide NRG's contact information to negotiate a possible deal. NRG waited for the remainder of that day and evening and received no contact from that person. (*Interrogatory Answer 1(a)*).
42. The discussions with Shell are detailed in the e-mails attached to the answer at Interrogatory 1(c). It is important to note that Shell informed NRG that: "... there likely would be very little to no same day gas for the next couple of days ..." (referring to an email dated February 26, 2014). (*Interrogatory Answer 1(a)*).
43. NRG therefore had options to arrange for timely delivery of gas from the spot market through its agent Shell and through Union. These options proved to be unfruitful through no fault of NRG. The problem lay in delivering gas to Union at the Dawn hub or at any other delivery point on the Union system on the final days of February 2014. The only

group to make profits in those circumstances were the traders who raised their prices in reaction to market demand for natural gas delivered to the Union system. It is now known that Union had sufficient gas in storage to meet its balancing needs. In short, Union did not need any molecules on February 28, 2014 to operate its system. (*Interrogatory Answer 1(a)*).

44. NRG was able to purchase and deliver gas on March 3, 2014 and thereafter but was told that this would not satisfy Union's requirements for balancing amounts. (*Interrogatory Answer 1(a)*). In that Union did not require the actual molecules of gas on February 28, 2014 to properly operate its system, Union's refusal to permit NRG to purchase and deliver gas on March 3, 2014 was unreasonable and imposed costs which were wholly unnecessary. While the importance of enforcing contracts is normally important, the existence of the unprecedented severe cold weather should have caused all utilities to bend their efforts to the lowest possible cost of gas for Ontario consumers. In short, the penalty costs should have been suspended in the circumstances.

Unprecedented Severe Cold Weather: 2013/2014

45. 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*)
46. 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*)
47. As described below, the Board accepted that the penalty rate should be reduced considering the "... exceptional circumstances that affected customers in the winter of 2014 ..." in the Penalty Rate Application.

48. 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 (*NRG Evidence: Lippold Affidavit – para. 13*).

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

49. NRG did not simply ignore their obligations and thereby stand guilty of ignoring the penalty rate fixed by the Board and contained in the bundled T service contract between Union and NRG. (*NRG Evidence: Lippold Affidavit – para. 19*) and *Interrogatory Answer 1(a) and (c)*)

50. 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. NRG did buy 90,027 GJ of gas at 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 the remaining 25,4965 GJ such that it could be delivered by February 28, 2014.

51. 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*)

52. 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*)

53. 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*)

54. 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*)

55. 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*)
56. The evidence is uncontradicted 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.
57. 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 as a Utility with Customers

58. NRG is itself a utility whose costs for gas are a “flow-through cost”. NRG has not derived any profits from its direct purchase of natural gas. It carries out this process for the benefit of customers that do not themselves purchase gas directly from gas supply companies. NRG does not and cannot seek any gains from its gas purchase obligations in good years. In difficult years, NRG should not suffer the detriments which arise from unique climate conditions and other factors hereinafter described which drove the price and transportation cost of natural gas to unprecedented levels for NRG in the province of Ontario.

Storage at Union

59. Union, in effect, purported to sell gas to NRG under the NRG / Union Contract at the then 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. 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.

60. 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*)
61. 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 (*NRG Evidence: Lippold Affidavit – para. 29*)

Windfall Benefits to Union

62. Union did not purchase any natural gas for NRG in order to meet NRG’s contractual obligations.
63. 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.”
64. 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.
65. At a penalty rate of \$50.50 per GJ, Union’s customers will receive a windfall benefit to the detriment of NRG or its customers of \$43.38 per GJ for 25,496 GJ.
66. 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.
67. A penalty rate of \$50.50 per GJ produces a windfall benefit to Union’s customers arising out of extreme weather conditions and resulting high prices.

PART IV – THE PENALTY RATE APPLICATION AND DECISION

68. In the Board matter deciding the Penalty Rate Application by Union Gas Limited, Union asked the Board to change the penalty rate contained in the bundled T gas contract between Union and NRG (and other penalty rates for other customers) from the highest daily spot rate at Dawn to the second-highest daily spot rate at Dawn. This request by Union was a proposed change from \$78.73 per GJ to \$50.50 per GJ.
69. Union based its argument in the Penalty Rate Application on several principles. The first was 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. Union gave evidence that what it characterized as “exceptional weather conditions in 2014” caused high gas prices. Union also stated that it sought 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.
70. On October 9, 2014 the Board rendered its Decision and Order in the Penalty Rate Application. The Board noted at page 3 of its Decision and Order as follows:

“NRG also agreed that a reduction to the penalty charges is warranted given the exceptional weather conditions experienced over the 2014 winter. However, NRG argued for an alternative penalty charge that would only be applicable to NRG, as it is a distributor and unlike the other customers who purchase their own gas. NRG stated that the Board should consider setting a penalty rate for NRG in the range of \$4.87/GJ to \$7.12/GJ. NRG stated that the penalty rate should be fixed on the basis of historic norms, Union’s actual costs and facts specific to NRG (i.e. that NRG is a distributor and that it did everything it could to meet its contractual obligations)”.
71. The Board dealt with NRG’s arguments at page 7 of its Decision and dismissed NRG’s arguments as follows:

“The Board does not find NRG’s arguments concerning a different method to setting the penalty convincing. Neither is the argument concerning NRG’s special situation accepted. The Board finds that setting the penalty charge that is to be applied to NRG on the basis of historic norms or Union’s gas costs is not appropriate and not consistent with the intent of the penalty. In addition, the Board is of the view that, in this matter, NRG’s status as a distributor does not warrant any different treatment. As such, the Board finds that the same reduced penalty, as proposed by Union, which will be applied to all of the non-compliant customers shall also be applied to NRG”.
72. In deciding the Penalty Rate Application, the Board was exercising its jurisdiction to fix rates under the Ontario Energy Board Act. In doing so, the Board was required to exercise its jurisdiction to fix “just and reasonable rates” under Section 36 of that Act.

Compliant Customers Prices Unknown

73. There is no evidence of what spot price “compliant customers” paid for their gas supplied to Union.

Customer Specific Characteristics

74. In the Decision and Order of the Board in the Penalty Rate Application, it said in part as follows: “... the penalty charges are designed to encourage compliance with contractual obligations. This can be achieved while at the same time reducing the potential for the penalty to unduly impair the financial viability of those required to pay it ...”. In making this decision, the Board took into account customer specific characteristics, namely financial viability of the individual Union customers. While the Board embraces one individual characteristic, it rejected others namely NRG’s status as a utility acting on behalf of ratepayers and NRG’s effort to purchase gas at a reasonable price. Failure to take into account all individual characteristics renders the decision arbitrary.

NRG’s Management of Contractual Obligations

75. NRG did not engage in strategic non-compliance with its contractual obligations and NRG managed its contractual obligations responsibly.

PART V – THE NRG QRAM APPLICATION

76. Known to the Board, Board Staff on March 24, 2014 had placed into issue the “... prudence of NRG’s purchasing decisions over the past winter ...”. By Decision and Interim Order dated April 1, 2014, the Board approved, on an interim basis, a gas commodity charge that was in accordance with NRG’s application subject to the Board’s rejection of the Surplus Sale over Consumer Premium charge of \$78.728/GJ applied to 25,496 GJ of natural gas that NRG was short at the time of the winter checkpoint. The Board approved, on an interim basis, the recovery of NRG’s ratepayers of a reduced amount, as proposed by Board Staff, of \$695,429.00 (\$27.276/GJ). The Board noted that the amounts approved for recovery were subject to change after the Board has completed its review of NRG’s application. As a result, the reference price for use in determining amounts to be recorded in the PGCVA (account number 179-27) were increased from the previous Board-approved level and the balance in the Gas Purchase Rebalancing Account were prospectively cleared. The resulting gas supply charge was therefore increased from the previously approved Board level as of April 2, 2014.
77. On October 10, 2014 the Board issued Procedural Order No. 1 in this matter (the NRG QRAM Application). In the Order, the Board noted that:
- “On April 1, 2014, the Board issued its Decision and Interim Order on the application. In its Decision and Interim Order, the Board stated that the incremental natural gas purchases made in February and the penalty charge applied to NRG had not been sufficiently examined in the QRAM process. The Board decided to establish a process to further consider these issues.”
- “The Board issued a Notice of Application on May 2, 2014 (the “Notice”). In the Notice, the Board stated that as part of phase 2 of NRG’s QRAM proceeding it would review the incremental gas purchases made by NRG in February 2014, including the penalty charge and its recovery from NRG’s ratepayers”.
78. When it made its decision in the Penalty Rate Application, the Board anticipated a review of the impact of the Penalty Rate Application in this NRG QRAM Application.

PART VI – FINANCIAL IMPACTS ON NRG

79. Over the years from 2011 to 2013, NRG has been entitled to earn on its deemed equity 9.85% per year. (*Interrogatory Answer 4(a)*).
80. This has permitted NRG to earn respectively, \$452,608.00, \$459,718.00 and \$465,146.00 for the years 2011, 2012 and 2013. (*Interrogatory Answer 4(a)*).
81. Board Staff asked NRG to comment on certain financial scenarios which assume that certain amounts of gas purchase costs incurred by NRG are paid not by the consumers, but by NRG shareholders. The natural gas purchase costs referred to by Board Staff are \$2,920,601, \$1,460,300, \$2,320,736, \$1,160,368, \$1,287,548, \$592,019 and \$296,200. All of these amounts would have a significant impact on NRG's profitability. This is a significant financial burden on NRG. (*Interrogatory Answer 4(a)*).
82. For example, a decision by the Board to allocate \$296,200 to NRG would reduce NRG's profits per year on deemed equity by more than 50%. A decision by the Board to allocate \$592,019 to NRG would eliminate NRG's annual profits and more. A decision by the Board to allocate \$1,200,000 would eliminate two and one-half years of NRG profits. A decision by the Board to allocate \$2.3-million to \$2.9-million to NRG would eliminate six to eight years of profit. (*Interrogatory Answer 4(a)*).
83. NRG is a unique entity which conducts its business without assuming private enterprise risk and without receiving profits based on private enterprise risk. The natural gas costs spike of \$26.00 per GJ, \$50.50 per GJ and up to \$78.73 per GJ was never part of the risk that an Ontario utility was meant to take under the *Ontario Energy Board Act* regime. An allocation of monies that go to significantly reduced profits in any one year, let alone over multiple years, is not a reasonable risk assessable to NRG under the *Ontario Energy Board Act*. (*Interrogatory Answer 4(a)*).

PART VII – SUBMISSIONS AND CONCLUSION

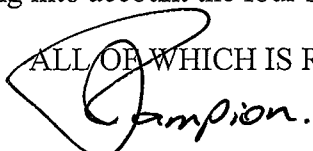
84. The central issue in this NRG QRAM Application is the prudence of NRG's management decisions regarding gas purchases to satisfy NRG's balancing obligations under the Bundled T Gas Contract between NRG and Union.
85. NRG's decisions are presumed to be prudent unless challenged on reasonable grounds.
86. There is no evidentiary basis filed by Board Staff or the Intervenor upon which to challenge the prudence of NRG's decisions. On this ground alone, NRG's Application should be granted.
87. In any event, the prudence of NRG involves a combination of factors which make a prudence analysis in this case unique. NRG sought and failed to have the Penalty Rate Application heard together with the NRG QRAM Application. In the Joinder Refusal, the Board directed that the two matters would be heard separately. The Board decided the Penalty Rate Application first. The Board is now deciding NRG's QRAM Application.
88. The Board's finding in the Penalty Rate Application granted Union's request to reduce the penalty rate for NRG and other direct purchase customers who did not supply all or part of the their winter checkpoint balancing gas. Based upon the exceptional circumstances that affected customers during the winter of 2013/2014 which was described as "extraordinary" and "anomalous" the Board took what it characterized as an "unprecedented step" to accept Union's request that the penalty rate be reduced from \$78.73 per GJ to \$50.50 per GJ.
89. NRG actively participated in the Penalty Rate Application. NRG unsuccessfully sought to reduce the penalty rate to Union's average cost of approximately \$7.00 per GJ. In so doing, NRG urged the Board to consider, *inter alia*, four issues: (i) uncontested evidence of historic norms for the relationship between the average gas cost and the cost of gas arising from the penalty rate formula ("*historic norms*"); (ii) NRG's special status as the only direct purchase utility customer of Union where the cost of its gas purchases are incurred for NRG's ratepayers, carrying with it the obligation to achieve rates which are "... just and reasonable ..." under section 33 of the OEB Act ("*NRG's special status*"); (iii) Union's actual costs of purchasing the gas used to make up NRG's balancing shortfall of 25,496 GJ ranging from \$4.94 per GJ to \$12.31 per GJ and \$20.156 per GJ ("*Union's actual cost of gas*"); and (iv) the windfall gain achieved by Union and its customers at the penalty rate of \$50.50 per GJ, being the difference between \$50.50 per GJ minus the actual Union cost per GJ of \$4.94, \$12.31 or \$20.156 multiplied by 25,496 GJ ("*Union's windfall gain*").
90. It is significant to stress the importance of the Board's finding in the Penalty Rate Hearing that the extraordinary and anomalous winter of 2013/2014 is directly connected to the exceptional circumstances that affected customers during that winter. This finding renders the payment of a penalty rate by NRG reasonable in the circumstances. The \$50.50 per GJ penalty rate was fixed under section 33 of the OEB Act on the basis that it fixed "just and reasonable rates". This rate can be assumed to be reasonable. The

payment of this penalty rate cannot challenge the presumption that NRG's conduct was prudent. It is therefore respectfully submitted that the penalty rate cannot be successfully challenged on any grounds and cannot meet the test set out by the Ontario Court of Appeal to challenge the presumption of prudence.

91. The facts describing NRG's conduct and purchasing decisions and justification for its failure to supply a portion of the balancing gas to Union by February 28, 2014 set out in paragraphs 24 to 44 and 49 to 57 herein illustrate that Union acted responsibly, did not engage in any strategic non-compliance under the contract with Union and were therefore prudent. There was no cross-examination of the facts and conclusions drawn by Mr. Lippold in his evidence or of the facts and conclusions set out in Interrogatory Answers provided by NRG. No evidence to challenge the assumption that NRG was prudent was led by any party.
92. On the basis of the facts summarized in paragraphs 90 and 91 herein, NRG respectfully submits that the purchase of winter checkpoint gas including the purchase under Union's amended penalty rate, was prudent and no evidence was led to challenge the assumption on reasonable grounds. It is therefore submitted that NRG's application should be granted.
93. In addition, the facts defined above as historic norms, NRG's special status, Union's actual gas costs and Union's windfall gains add to the conclusion that NRG was prudent. These facts themselves strongly support NRG's primary position in this application that its purchasing of natural gas including payment of the penalty rate for winter checkpoint balancing under the Union/NRG contract was prudent. It is respectfully submitted the Board should consider these facts in this NRG QRAM Application. On the basis of these four items, it is respectfully submitted that NRG's purchase of winter checkpoint gas was prudent under the principles set out in the decided cases in paragraphs 16 to 20 herein.
94. The financial impact of a Board decision allocating all of a part of the gas costs or penalty costs to NRG adds a significant financial burden to NRG and its shareholders. It will significantly impact on NRG's profitability by reducing or eliminating NRG's annual profits for as much as a six- to eight-year period, depending on the amount that is not recovered in rates from NRG's ratepayers. Because of the unprecedented severe cold weather in the winter 2013/2014 as described in paragraph 45 herein, the penalty rate is a justifiable cost to be paid by the ratepayers and its payment by NRG was not only prudent but also justifies any challenge sought to be made against the presumption of prudence in NRG's favour.
95. On the basis of all of the above, it is respectfully submitted that NRG's QRAM Application, including the payment of the penalty rate of \$50.50 per GJ, should be granted.
96. In the alternative, if the Board does not consider the four special NRG factors set out in paragraph 89 in order to support NRG's prudence and to grant NRG's QRAM Application, it is respectfully submitted that the Board does not have jurisdiction under section 33 of the OEB Act to consider just and reasonable rates under the OEB Act.

97. This challenge to the Board's jurisdiction (respectfully made in the alternative) is based in part on the unique circumstances arising in the combination of two hearings before the Board affecting the outcome of this matter, namely the Penalty Rate Application and the NRG QRAM Application. Normally, the Board can only consider the circumstances that were "... known or ought to have been known to the utility at the time the decision was made ...". Hindsight should not be used, although consideration of the "outcome of the decision" may legitimately be used to support the prudence analysis. Prudence is usually a retrospective factual inquiry based on evidence available at the time the decision was made, and is based on facts about the elements that could or did enter into a decision "at the time the decision was made".
98. In this case, by the Joinder Refusal decision, the Board fixed a rate of \$50.50 per GJ as a penalty rate, knowing that it would be assessing the prudence of that decision in a later case. The Board refused to consider the four special NRG factors in the Penalty Rate Application. These special NRG factors are relevant to both the Penalty Rate Application analysis and the NRG QRAM Application. If these four special NRG factors are not, cannot or will not now be considered in the Board's analysis of this case, the Board will be unable to exercise its statutory jurisdiction under section 33 of the OEB Act in assessing the prudence of NRG.
99. By reasons of the Joinder Refusal decision, the Board is also using the results of its own decision in the Penalty Rate Application, which finding has a significant and obvious impact on NRG's QRAM Application, which was not available at the time the original NRG decisions were made. The fundamental distinction between the fixing of future rates based on prospective matters and the analysis of prudence based on historical matters mentioned in paragraphs 17, 18 and 19 hereof is blurred because of the Joinder Refusal decision. The Board cannot properly exercise its jurisdiction under section 33 of the OEB Act in allocating any part of the penalty rate of \$50.50 per GJ to NRG's shareholders while not taking into account the four special NRG factors.

ALL OF WHICH IS RESPECTFULLY SUBMITTED



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