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January 12, 2015

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Sent By Electronic Mail

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th Floor, P.O. Box 2319
Toronto, ON M4P 1E4

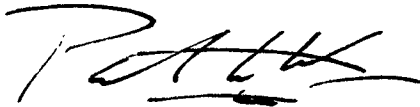
Dear Ms. Walli:

EB-2014-0291
Reply of Natural Resource Gas Limited ("NRG")

Please find enclosed the NRG's Reply Submissions in the above proceeding, served and filed pursuant to Procedural Order No. 1. Two hard copies of the attached materials are being couriered to the Board.

Please do not hesitate to contact me if you have any questions.

Yours very truly,



Patrick G. Welsh
Associate
PW:ls

Enclosure

c: All Parties to EB-2012-0406/EB-2013-0081
Richard King, *Osler, Hoskin & Harcourt LLP*
Michael Millar, *Ontario Energy Board*
Khalil Viraney, *Ontario Energy Board*

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 a review of the capital contribution costs paid by Integrated Grain Processors Co-operative Inc. to Natural Resource Gas Limited pursuant to sections 19 and 36 of the Act;

AND IN THE MATTER OF a motion to review by Natural Resource Gas Limited.

**NATURAL RESOURCE GAS LIMITED
REPLY ARGUMENT**

January 12, 2015

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PART I. INTRODUCTION

1. This Reply Argument responds to the submissions of Board Staff and Integrated Grain Processors Co-operative Inc. (“IGPC”), both served on Natural Resource Gas Limited (“NRG”) and filed with the Ontario Energy Board (the “Board”) on December 23, 2014.

2. In its Argument-in-Chief, NRG submitted that the Board erred in its determination in EB-2012-0406/EB-2013-0081 to award \$150,000 to IGPC for additional costs to maintain an unadjusted letter of credit for the following reasons:

- (a) the amount awarded to IGPC is not supported by any evidence;
- (b) the amount awarded is excessive, to the point of being punitive; and,
- (c) the quantum claimed by IGPC, if accurate, should be partially the responsibility of IGPC.

3. Board Staff agreed with NRG’s view that the award of \$150,000 should be reduced, and agreed with NRG that a more appropriate interest rate for the purposes of calculating such an award is in the range of 1 to 2% (specifically, Board Staff preferred the rate of 1.5%, representing approximately 50% of the prime lending rate used by major Canadian banks). However, Board Staff disagreed with the overall calculations provided by NRG because it disagreed with the appropriate timeframe for calculating such an award.

4. IGPC argued that the Board should deny NRG’s motion to vary the award on the grounds that NRG failed to avail itself of further opportunities to substantiate its estimate of costs and that NRG is merely trying to re-litigate the Board’s decision in EB-2012-0406/EB-

2013-0081 in an effort to inflict harm on IGPC. IGPC argued that the payment is compensatory and not designed to punish NRG.

5. NRG repeats and relies on its submissions in its Argument-in-Chief dated December 15, 2014.

PART II. REPLY SUBMISSIONS

A. **IGPC has failed to point to any evidence that \$150,000 accurately represents the cost of maintaining an unadjusted letter of credit**

(a) *NRG could not have “tested” the evidence because there was nothing to test*

6. NRG maintains its position that the Board erred in awarding \$150,000 to IGPC “representing the cost of maintaining an unadjusted letter of credit for five years” because there was no evidentiary basis whatsoever in the record to award this amount.

7. IGPC, in its submissions, was only able to point to paragraphs 142 to 158 of its Pre-Filed Evidence in EB-2012-0406/EB-2013-0081 in support of the award.¹ However, these paragraphs in IGPC’s Pre-Filed Evidence are merely argument, and not evidence. In fact, as discussed in NRG’s Argument-in-Chief, the paragraphs referenced by IGPC contain the critical paragraph 152, which is the original source of the unsubstantiated \$150,000:

IGPC has had to take the extraordinary step of asking its current lender, RBC, to provide a LC in the amount of the LC currently held by NRG so as to provide a back stop for the former lender to allow the arrangements as between IGPC and its former lender, Société Générale, to be wound down. This has resulted in legal fees and the unnecessary expenditure of time. IGPC currently estimates that it has incurred additional expenses exceeding \$150,000. IGPC is in the process of developing a detailed breakdown of the additional costs incurred and will provide same in the near future.

¹ EB-2014-0291, Submissions of Integrated Grain Producers Co-Operative (December 23, 2014)[“**IGPC Submissions**”], p. 4 of 7, at para. 24

As stated on numerous occasions, IGPC has never provided a detailed breakdown, or any evidence at all, regarding these costs.

8. NRG submits that it is inappropriate and incorrect to suggest that “NRG had ample opportunity to test the evidence and expressly chose not to do so,” as has been argued by IGPC.² Put simply, there was no evidence to test. In light of IGPC’s unmet promise to provide a detailed breakdown of these costs, the Board should have determined that IGPC abandoned its position in regards to these alleged costs.

9. It is not reasonable for the Board to expect NRG to shepherd IGPC through the Board’s process, reminding IGPC of its promises and obligations, particularly in light of the clear adversity of interest between IGPC and NRG. Nor is it reasonable to impute any “silence” on the part of NRG as acceptance of IGPC’s evidence when this evidence was never provided, despite representations to the contrary from IGPC. Furthermore, there were a number of complex issues reviewed by the Board in EB-2012-0406/EB-2013-0081. Board Staff, in its submissions, acknowledged that the letter of credit issue was an ancillary issue among a number of other issues in a complex proceeding before the Board.³ In light of the number of issues in the proceeding, the only reasonable and logical conclusion to draw from IGPC’s failure to provide substantiating evidence as promised was that IGPC had abandoned its position, there being no basis for the Board to assess and render a decision accordingly. NRG maintains its position that the Board erred by awarding any amount to IGPC on a position that it effectively abandoned.

² IGPC Submissions, *supra*, p. 5 of 7, at para. 31

³ EB-2014-0291, Board Staff Submission on NRG Motion to Review Letter of Credit Costs (December 23, 2014) [**“Board Staff Submissions”**] at page 5.

- (b) *The \$150,000 represents costs associated with substituting or replacing rather than reducing the letter of credit, which are not recoverable from NRG*

10. A closer examination of paragraph 152 of IGPC's Pre-Filed Evidence, above, and IGPC's submissions in this proceeding,⁴ shows that the \$150,000 claimed by IGPC are not for costs associated with maintaining an unadjusted letter of credit but are rather costs associated with *substituting or replacing* the letter of credit, initially provided by Société Générale but eventually replaced by a letter of credit provided by the Royal Bank of Canada. NRG submits that the costs associated with substituting or replacing the letter of credit should be borne by IGPC because this was a consequence of IGPC's own banking arrangements. Further, IGPC is barred from recovering these costs from NRG under section 7.8 of the Pipeline Cost Recovery Agreement ("PCRA"):

The costs and expenses of establishing, renewing, substituting, cancelling, increasing and reducing the amount of (as the case may be) any letter of credit required under this Agreement shall be borne by the Customer [IGPC] (emphasis added).⁵

11. Additionally, NRG had the right under section 7.9 of the PCRA to determine whether or not the substitute letter of credit was acceptable to it or its lenders:

The Utility shall return any letter of credit held by the Utility to the Customer, if the Customer is substituting a letter of credit with another letter of credit or such other financial assurance, where that substitute is acceptable to the Utility and its lender (emphasis added).⁶

⁴ See IGPC Submissions, *supra*, p. 4 of 7, at para. 21: "In addition to the actual financing costs to its lenders, IGPC stated that it had incurred additional legal and other costs related to the refusal of NRG to accept replacement of the letter of credit – even when such was offered without reduction." (emphasis added).

⁵ See PCRA, section 7.8 at EB-2012-0406/EB-2013-0081: Pre-Filed Evidence of Integrated Grain Processors Co-Operative Inc. (June 3, 2013)[**"IGPC Pre-Filed Evidence"**], at Exhibit B, Tab 1, p. 16 of 26.

⁶ PCRA, section 7.9. IGPC Pre-Filed Evidence, *supra*, at Exhibit B, Tab 1, p. 16 of 26.

The additional costs incurred by IGPC in substituting the letter of credit are not NRG's to bear, particularly in light of the fact that the risk of any such costs and expenses were clearly allocated to IGPC under section 7.8 of the PCRA, and that NRG had the right to consider the acceptability of such a substitute under section 7.9 of the PCRA.

12. As such, NRG submits that IGPC's own submissions in this proceeding clarify the nature of the approximately \$150,000 allegedly spent, and enhance NRG's position that it was an error for the Board to award \$150,000 to IGPC because this amount clearly does not represent the cost of maintaining an unadjusted letter of credit. Rather, this amount represents "legal and other fees" incurred by IGPC relating to replacing the letter of credit.

13. Had IGPC provided its "detailed breakdown" as promised, it is likely that the Board would have dismissed IGPC's claim in its entirety. At minimum, NRG would have had the opportunity to address the appropriateness of IGPC's claim. But, NRG had no such opportunity.

B. IGPC should bear some of the costs of maintaining an unadjusted letter of credit due to its inaction

14. As discussed above, there is no evidence before the Board that IGPC incurred additional costs in maintaining an unadjusted letter of credit. However, if the Board is of the view that IGPC should be compensated for maintaining an unadjusted letter of credit, then any such compensation should be determined on a calculated, principled basis rather than by way of an unsubstantiated lump sum. NRG is willing to accept Board Staff's selection of 1.5% as an appropriate proxy for the interest rate of a letter of credit. However, NRG disagrees with Board Staff regarding the appropriate time period for assessing the amount.

15. NRG submits that the appropriate start date for calculating the proper amount representing IGPC's additional carrying costs is not January 2011, as suggested by Board Staff, but rather is sometime between March 28, 2012 and May 9, 2012.

(a) ***Reducing the Letter of Credit is IGPC's responsibility – it is not automatic***

16. Board Staff selected January 2011 as a start date because this was after the Board's Decision in EB-2010-0018 wherein it determined the date that IGPC's pipeline was closed to rate base.⁷ Further, Board Staff argued that the PCRA "clearly contemplates an annual reduction in the letter of credit corresponding to the net book value of the pipeline. The reduction does not depend on IGPC requesting the reduction via letter as claimed by NRG."⁸ With respect, Board Staff has misinterpreted the terms of the PCRA.

17. Section 7.6 of the PCRA does not "clearly contemplate" an automatic annual reduction in the letter of credit. Rather, this section entitles IGPC to reduce the letter of credit:

Subject to 7.7, the Customer [IGPC] shall be entitled to reduce the amount of the Delivery Letter of Credit on each anniversary of the commencement of deliveries under the Gas Delivery Agreement to an amount equal to the net book value of the Utility Connection Facilities allocated to the Customer at the time, as determined by the Utility in accordance with OEB-approved methodology.⁹

In other words, IGPC has the ability and the right (i.e., it is "entitled") to reduce the amount of the letter of credit, but it is the entitlement to effect the reduction, and not the reduction itself, that occurs annually. The onus clearly lies on IGPC to exercise its entitlement to reduce the

⁷ Board Staff Submissions, *supra* at page 5.

⁸ Board Staff Submissions, *supra* at pp. 5-6

⁹ PCRA, section 7.6. IGPC Pre-Filed Evidence, *supra*, at Exhibit B, Tab 1, p. 16 of 26.

letter of credit. To interpret section 7.6 otherwise (for example, to interpret it as saying “the letter of credit shall be reduced annually...”) overlooks the plain language of the contract.

18. The actual terms of the letter of credit describe the process by which a reduction is to be effected:

The amount of this Letter of Credit may be reduced at any time by notice to the Bank signed by the Beneficiary [NRG] accompanied by the original Letter of Credit and all amendments thereto (if any)(each a “Reduction”). We shall endorse the original of this Letter of Credit with the amount of the Reduction and return the original of this Letter of Credit to the Beneficiary.¹⁰

While NRG, as beneficiary, had to authorize the reduction, it is the responsibility of IGPC, as customer of the bank issuing the letter of credit and holder of the credit facility under which the letter of credit was issued, to initiate the reduction. It is unreasonable to suggest that NRG should have taken earlier steps to reduce the security it had from IGPC in the absence of a formal request by IGPC, especially in light of NRG’s well-documented concerns about IGPC’s financial viability.¹¹

(b) *March 14, 2012 was the earliest date in evidence that IGPC requested a reduction*

19. On March 14, 2012, IGPC provided NRG with information regarding a possible amendment to the letter of credit and provided a sign-back for NRG.¹² IGPC has not been able to point to any earlier date wherein it formally attempted to exercise its entitlement under the

¹⁰ IGPC Pre-Filed Evidence, *supra*, at Exhibit C, Tab 12, p. 1 of 4.

¹¹ See, for example, Letter from Larry Thacker to Scott Stoll (May 9, 2012) at IGPC Pre-Filed Evidence, *supra*, at Exhibit C, Tab 16

¹² IGPC Pre-Filed Evidence, *supra*, at Exhibit C, Tab 13, p. 1 of 2.

PCRA to reduce the letter of credit. As such, March 14, 2012 is the only appropriate date in the evidence from when the Board can conclusively determine that IGPC requested a reduction to the letter of credit.

20. Further, NRG cannot be said to have “refused” IGPC’s request on March 14, 2012. On March 23, 2012, NRG informed IGPC that its request to reduce the letter of credit was under advisement.¹³ On May 9, 2012, NRG’s counsel responded to an April 23, 2012 letter from IGPC’s counsel and advised that NRG had considered IGPC’s request and concluded that, due to IGPC’s tenuous financial viability, NRG was considering seeking an order from the Board requiring additional financial security.¹⁴ It is therefore arguable that May 9, 2012 is a more appropriate date to say that NRG “refused” to adjust the letter of credit. These dates are clear and in evidence. All other purported “requests” or “attempts” are merely unsubstantiated allegations.

(c) ***IGPC could have and should have made its request earlier***

21. In the alternative, should the Board decide that the letter of credit could have been reduced as of January 2011 (i.e., after the Board determined that IGPC’s pipeline was closed to rate base in EB-2010-0018 and before IGPC’s March 14, 2012 request) NRG submits that IGPC should have made such a written request at that time. IGPC’s own submissions acknowledge that IGPC was aware of a valuation of the pipeline at a number lower than the value of the letter

¹³ IGPC Pre-Filed Evidence, *supra*, Exhibit C, Tab 14, p. 1 of 1.

¹⁴ IGPC Pre-Filed Evidence, *supra*, Exhibit C, Tab 16.

of credit based on information provided by NRG in EB-2010-0018.¹⁵ As a matter of basic diligence, IGPC should have used this number for the purposes of a written request to reduce the letter of credit, but it did not.¹⁶

22. IGPC's lack of action as of January 2011 is further highlighted by the fact that when it eventually did request a reduction in the value of the letter of credit on March 14, 2012, IGPC used information provided by NRG in EB-2010-0018. IGPC has provided no explanation as to why it did not request a reduction to the letter of credit as of January 2011 using a value it admitted to being aware of. At minimum, it could have "papered" such a request to reduce the letter of credit. However, there is no such evidence before the Board that IGPC took the necessary steps to attempt to reduce the letter of credit.

23. The Board, in its Decision and Order, accepted that the net book value of the IGPC pipeline was provided by NRG in its evidence in EB-2010-0018 on August 31, 2011.¹⁷ Even if the Board is of the view that August 31, 2011, and not January 2011, was the earliest that IGPC was aware of the net book value of the pipeline, this does not explain the 6.5 months

¹⁵ See IGPC Submissions, p. 3 of 7, at para. 12: "NRG filed its next cost of service rate application in January 2010 and that proceeding was assigned number EB-2010-0018. NRG's application included a capital request to include the pipeline in rate base at \$5,073,000 as of the fall of 2008. Therefore in January of 2010, NRG was acknowledging the depreciated value of the pipeline was much less than the financial assurance it was retaining."

¹⁶ Alternatively, IGPC could have assumed a 20-year amortization period on the pipeline (this was also decided in EB-2010-0018) and calculated (and requested) a reduction on this basis.

¹⁷ Ontario Energy Board, EB-2012-0406/EB-2013-0081: Decision and Order (February 27, 2014) at p. 24.

between August 31, 2011 and March 14, 2012 where IGPC failed to request a reduction in the letter of credit despite having the necessary information to do so.¹⁸

24. NRG maintains that IGPC should have formally requested a reduction in the letter of credit as of January 2011, when it was aware of a new valuation of the pipeline. This inaction is further highlighted by the fact that IGPC eventually did make such a request, but not until March 14, 2012. IGPC should not be rewarded for its lack of diligence in this regard.

(d) *October 28, 2013 remains a functional end date*

25. NRG agrees with Board Staff's observation that NRG's letter of October 28, 2013 is discussing the replacement letter of credit, from Société Générale to the Royal Bank of Canada ("RBC"), as opposed to a reduction of the value of the letter of credit. However, October 28, 2013 remains a relevant date for the purposes of analyzing the alleged carrying costs of the letter of credit to which IGPC claims it is entitled. This is because, as discussed above, IGPC appears to have inflated its carrying cost calculations by including "additional legal and other costs" incurred to *replace* the letter of credit with costs allegedly incurred due to IGPC's inability to *reduce* the letter of credit.¹⁹ Additionally, when IGPC sought to replace the Société Générale letter of credit, it purportedly "reserved its right to question the amount [of the letter of credit] at a later time",²⁰ however, there is no evidence in the record that IGPC did so, or any evidence

¹⁸ As noted in IGPC's March 14, 2012 letter to NRG requesting a reduction in the letter of credit, the dollar amounts representing the net book value of the IGPC pipeline were taken from NRG's August 31, 2011 interrogatory response to IGPC. See IGPC Pre-Filed Evidence, *supra*, Exhibit C, Tab 13, p. 1 of 2.

¹⁹ See IGPC Submissions, p. 4 of 7, at para. 21: "In addition to the actual financing costs to its lenders, IGPC stated that it had incurred additional legal and other costs related to the refusal of NRG to accept replacement of the letter of credit – even when such was offered without reduction."

²⁰ IGPC Pre-Filed Evidence, *supra*, at Exhibit C, Tab 17, p. 1 of 2.

that IGPC sought to reduce the new (RBC) letter of credit after October 28, 2013 (i.e., the date that NRG agreed to replace the Société Générale letter of credit).

(e) *Formula for calculating an amount representing the cost of carrying an unadjusted letter of credit*

26. Both NRG and Board Staff agree on the formula to calculate an amount representing the cost of carrying an unadjusted letter of credit.²¹ NRG has included a table below to assist the Board in this regard. NRG submits that the months in brackets should be subtracted from the total of 38 months provided by Board Staff.

$$[(\$5,214,173 - \$3,491,731) \times 1.5\% \text{ (per year)} \div 12 \text{ months (per year)} \times \bullet \text{ months} = \$ \bullet]$$

Key Dates	Description	Months
January 1, 2011 to August 31, 2011	Cost of pipeline is closed to rate base and reduced valuation of pipeline is available to IGPC	(8)
September 1, 2011 to March 14, 2012	Net book value is available to IGPC but no request to reduce letter of credit is made	(6.5)
March 14, 2012 to May 9, 2012	NRG considers IGPC's request to reduce letter of credit	(2)
May 9, 2012 to October 28, 2013	NRG contemplates Board action to seek additional security, and IGPC requests a substitution of letter of credit.	17.5
October 28, 2013 to February 27, 2014	NRG accepts IGPC request to exchange letter of credit; parties await Board decision.	(4)
	Total, corresponding with Board Staff calculation	38
	Total, with all subtractions	17.5 ²²

²¹ See EB-2014-0291, Argument-in-Chief of NRG (December 15, 2014) at para. 12, footnote 3 and Board Staff Submissions at p. 6, footnote 11.

²² NRG's original calculation, 19.5 months, did not factor in the time between March 14, 2012 (i.e., IGPC's request to reduce the letter of credit) and May 9, 2012 (i.e., the date NRG responded to IGPC's request and advised IGPC that it wished to seek additional security). This results in a compensation amount of \$1,722,442 $\times 1.5\% \div 12 \text{ months} \times 17.5 \text{ months} = \$37,678.42$.

C. COSTS

27. On the matter of costs, Board Staff submitted that no party should be awarded costs in this proceeding and that NRG and IGPC should be responsible for their own costs. Board Staff reasoned that had NRG adjusted the letter of credit, there would have been no need to have the matter brought to the Board for resolution. With respect, NRG submits that Board Staff has conflated the issues before the Board in EB-2012-0406/EB-2013-0081 with the issues in this Motion to Review.

28. NRG requested this Motion to Review to address the specific issue of the \$150,000 awarded to IGPC with no evidentiary basis. NRG has not disputed its obligation to allow the adjustment the letter of credit in this Motion. NRG simply wishes the Board to review the basis by which it awarded an amount to IGPC representing the cost of carrying an unadjusted letter of credit, and in the alternative, the quantum of the award.

29. In its submissions, IGPC alleged that NRG's Motion to Review was part of a "continuing pattern of abuse" by NRG, such that IGPC should be awarded its reasonable costs. NRG disagrees with and disputes IGPC's characterization of the Motion. A number of issues were decided in EB-2012-0406/EB-2013-0081, many of which were decided in IGPC's favour, however NRG limited the focus of its Motion to Review to the narrow issue of the \$150,000 awarded to IGPC.

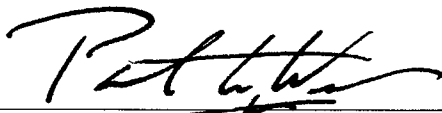
30. NRG has disputed the award on a principled basis in an attempt to correct what it views as an error made by the Board in awarding an amount with no evidentiary basis, such that

NRG had no opportunity to assess or challenge such an amount. Both NRG's and Board Staff's submissions have provided the Board with a reasonable basis to calculate an award representing the cost of maintaining an unadjusted letter of credit, in the event that the Board determines that such an award is appropriate. On the other hand, IGPC has provided no assistance to the Board in understanding the nature of the costs allegedly incurred by IGPC in maintaining an unadjusted letter of credit, and in fact has perpetuated the confusion regarding precisely what IGPC was claiming in its request for \$150,000. Had IGPC provided the "detailed breakdown", as it said it would, all parties would have had the opportunity to assess the appropriateness of the claim and this Motion to Review would not have been necessary.

31. In light of NRG's reasonable, limited, and principled request to review the Board's basis for awarding an unsubstantiated amount to IGPC representing the cost of maintaining an unadjusted letter of credit, NRG maintains its request for its reasonable costs in this proceeding.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

January 12, 2015


per Richard J. King – Osler Hoskin & Harcourt LLP