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January 16, 2015

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

Dear Ms Walli:

**Natural Resource Gas Limited ("NRG")  
Reply Submission (Board File No. EB-2014-0274)**

Please find attached the Reply Submission of NRG, filed and delivered in accordance with Procedural Order No. 3 in the above-noted matter. Two paper copies have been sent to the Board via courier.

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

Yours very truly,

  
Richard King  
RK:hi

**Enclosure**

c: P. Welsh, *Osler, Hoskin & Harcourt LLP*  
L. O'Meara, *Natural Resource Gas Limited*  
B. Lippold, *Natural Resource Gas Limited*  
P. McMahon, *Union Gas Limited*  
S. Stoll, *Aird & Berlis LLP*  
M. Millar, *Ontario Energy Board*  
K. 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** an Application by Natural Resource Gas Limited for an Order or Orders approving or fixing just and reasonable rates and other charges for the sale, distribution, transmission and storage of gas effective October 1, 2014.

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**NATURAL RESOURCE GAS LIMITED  
REPLY SUBMISSION**

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January 16, 2015

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## **PART I. INTRODUCTION**

1. This Reply Submission 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 January 9, 2015.

2. The substantive portion of this Reply Submission (Part II) is organized into two sections. The first section responds to the arguments of Board Staff and IGPC with respect to the appropriate effective date for rates established pursuant to this proceeding. The second section responds to the arguments made by IGPC that NRG’s IR Plan be modified to include a stretch factor of 2.8%.

3. NRG submits that:

- (a) The effective date for NRG’s distribution rates should be October 1, 2014; and,
- (b) IGPC’s arguments for an alternative stretch factor are beyond the scope of this proceeding, because the Board approved NRG’s existing IR Plan (with a stretch factor of 0.4%) in its November 11<sup>th</sup> oral decision. In the alternative, NRG submits that the existing IR Plan parameters (including the stretch factor of 0.4%) are the most appropriate to use for setting distribution rates in this proceeding.

4. For the purposes of this Reply Submission, the “Two-Year Extension Application” refers to the application and pre-filed evidence submitted by NRG on August 25, 2014, and the “IRM Application” refers to the application filed by NRG on November 25, 2014 following the Board’s oral decision on the Two-Year Extension Application.

## PART II. REPLY SUBMISSIONS

**A. The most appropriate effective date for NRG's distribution rates is October 1, 2014**

- (a) *Filing a rate application "late" is not the sole, or even most important, factor to be considered when determining the effective date for new rates*

5. Both Board Staff and IGPC take the position that NRG's rates established in this proceeding should be made effective on a date following the Board's decision. They both rely, solely, on the fact that NRG did not file its two-year IR Plan extension application until August 25, 2014. Both take a fairly indignant tone – saying that there was no justification for filing in August,<sup>1</sup> that NRG is being "unreasonable" to request an October 1<sup>st</sup> effective date,<sup>2</sup> that NRG "should not be permitted to benefit from its own delays",<sup>3</sup> and even that NRG's filing in August "was intended to ensure the Board had no option but to grant the IRM approach"<sup>4</sup> (i.e., that NRG deliberately duped the Board into approving an IR Plan extension). In essence, Board Staff and IGPC are stating that NRG should be punished for filing late, and proper punishment would be delaying the effective date for NRG's new distribution rates.

6. This is the sum total of the Board Staff and IGPC submissions on this point: that NRG was at a minimum negligent, or worse deceitful, and that should govern (to the exclusion of all other factors) the Board's determination of when rates are made effective.

7. With respect, this is simplistic and incorrect.

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<sup>1</sup> Board Staff Submission, p. 3.

<sup>2</sup> Board Staff Submission, p. 3.

<sup>3</sup> IGPC Submission, para. 28.

<sup>4</sup> IGPC Submission, para. 25.

8. The over-riding purpose of the Board's rate-setting function is to establish rates that are just and reasonable. This means rates that strike a proper balance between: (a) consumer interests in low, stable and predictable rates, on the one hand, and (b) a utility's need to recover its costs and earn a fair return on its invested capital, on the other hand.<sup>5</sup> To that end, the Board exercises its statutory powers to scrutinize a utility's claimed costs, allocate those costs fairly, and employ rate design tools to ensure that ultimate rates are just and reasonable.

9. The Board's determination as to the effective date of NRG's rates should be made in this broader context. An effective date of October 1, 2014 (and consequent foregone revenue rate rider) would not result in rates in fiscal 2015 that are unusually high or too volatile based on a comparison of existing distribution rates. The IR Plan rate increases are small, with residential bill impacts of 1.2% if an October 1, 2014 effective date is used.<sup>6</sup> These bill impacts only increase to between 1.4 and 1.7% as a result of a rate rider that would recoup revenues lost as a result of not having implemented new rates on October 1, 2014 (with an implementation date of January 1, 2015).<sup>7</sup>

10. Simply put, the rate increases associated with an effective date of October 1, 2014 are minimal regardless of the implementation date, so there is no principled rate-making reason to deny an effective date of October 1, 2014. NRG's ratepayers would not be materially impacted by a foregone revenue rate rider. This is not a case of rate shock or rate volatility.

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<sup>5</sup> *Northwestern Utilities, Ltd. v. Edmonton (City), Board of Public Utility Commissioners of Alberta*, [1929] S.C.R. 186 at p. 192; and *Union Gas Ltd. v. Ontario (Energy Board)* (1983), 1 D.L.R. (4<sup>th</sup>) 698 (Ont. Div. Ct.), at p. 710.

<sup>6</sup> IRM Application, p. 17.

<sup>7</sup> IRM Application, p. 16.



11. Moreover, this is not a circumstance where one would expect NRG to over-earn if rates were made effective as of October 1, 2014. The evidence in this case is that there has been no over-earning under the existing IR Plan. If anything, NRG has been earning at the low end (and in one year just beyond the low end) of the earnings sharing band.<sup>8</sup> The revenues generated from a foregone rate rider that allows for NRG's rates to be effective as of October 1, 2014 is not expected to result in over-earning.

(b) *There are legitimate reasons why NRG delayed filing its application for a two-year extension until August 2014*

12. Both Board Staff and IGPC claim that there was no justification for delaying the filing of the two-year extension application. That is not what the evidence reflects.

13. In response to an interrogatory from IGPC, NRG responded: "NRG would have preferred to file a cost-of-service application with a multi-year IR Plan, but as noted in NRG's August 25, 2014 evidence, several factors made that impossible (most notably, the uncertainty around IGPC's operations post-2016)."<sup>9</sup>

14. Indeed, a substantial amount of the evidence in NRG's two-year extension application (EB-2014-0274) is devoted to explaining: (a) NRG's attempts to get better financial information from IGPC; and (b) NRG's difficulties in putting together a cost-of-service application in the absence of better information.<sup>10</sup> As indicated in another NRG response to an

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<sup>8</sup> Two-Year Extension Application, Exh C/1/1, p. 3.

<sup>9</sup> IRR to IGPC #1(b).

<sup>10</sup> Two-Year Extension Application, Exh C/4/1 and C/4/7.

IGPC interrogatory<sup>11</sup>, NRG had started to consider filing an IR Plan extension application (as opposed to a cost-of-service application) in November 2013. As NRG stated:

At that point, NRG had no greater certainty around IGPC's future. It is difficult to establish a precise date as to when a final decision was made to file a two-year extension, but based on our review of internal correspondence, preparation for the current application began in early 2014.

15. In a nutshell, IGPC's uncertain financial future, and its unwillingness to provide financial information to NRG, meant that in the fall of 2013 NRG had to change course and contemplate filing some other type of unique rate application that it had not expected to file. Work began on a new application (the two-year extension) in early 2014. It was completed and filed in August.

(c) ***NRG had no motive or incentive to delay filing***

16. The explicit statement by IGPC that NRG delayed filing its two-year extension application in order to leave the Board with no choice but to approve it is patently false. First, the Board had the authority and discretion to do anything it wanted to do with the two-year application. The Board's jurisdiction was in no way impaired by the timing of the application – nor was it practically impaired. Second, filing an IR extension application in August was not the course of action NRG wanted to follow. NRG wanted to file a cost-of-service application<sup>12</sup> but, largely due to IGPC's financial status and failure to clarify same, was forced to change plans at the beginning of 2014. Third, no utility wants to file a rate application late – all that did for NRG

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<sup>11</sup> IRR to IGPC #1(d).

<sup>12</sup> IRR to IGPC #1(b).

was put the effective date at risk, as it would for any utility. No utility has anything to gain by filing late.

**B. IGPC's request for a 2.8% stretch factor is not at issue in this proceeding, and would be inappropriate in any event**

**(a) *NRG applied for continuation of its existing IR Plan, and that is what the Board approved***

17. In its oral decision on November 11, 2014, the Board approved NRG's existing IR Plan, which included a price cap adjustment formula, a Z-factor process, and a ROE deadband for regulatory review. The IR Plan is well-known to the Board and IGPC, and was explained in detail in Exh C/1/1 of NRG's Two-Year Extension Application.

18. NRG was very clear about what it was requesting in its August 2014 application and evidence:

- "NRG seeks the Board's approval of: (a) distribution rates based on a continuation of NRG's current Incentive Regulation ("IR") Plan for NRG's next two fiscal years ..." (Two-Year Extension Application, section 3(a) of Application)
- "NRG seeks an Order(s): (a) fixing distribution rates for the next two years (i.e., through to September 30, 2016) based on a continuation of the existing IR Plan for an additional two years." (Two-Year Extension Application, Exh. B/1/1, p. 1)
- "NRG's earnings under the existing IR Plan was within the ROE deadband of  $\pm 300$  basis points in Fiscal 2011 (9.98%) and Fiscal 2012 (7.16%), and only slightly below the ROE deadband in Fiscal 2013 (6.29%). The IR Plan is therefore operating satisfactorily. On the present information known to NRG, it expects that the IR Plan will continue to operate satisfactorily during the extension period ending on September 30, 2016." (Two-Year Extension Application, Exh. B/1/1, p. 2)
- In Exhibit C/1/1 of the Two-Year Extension Application, under the heading "IR Plan Going Forward" in this Schedule, NRG explains:

If this two-year extension Application were approved, the adjustment factors for the PCA [Price Cap Adjustment] on October 1, 2014 would be:



I = 1.7%

X=0%

S=0.4%

- “NRG is making this Application on the basis that the current IR Plan is operating in a way that is providing NRG with sufficient revenues to cover its costs (capital and O&M) and provide it with a fair return.” (Two-Year Extension Application, Exh. C/5/1, p. 3)

(emphasis added)

19. There can be no suggestion that there was any confusion as to what NRG was applying for in its Two-Year Extension Application, and therefore what was approved. NRG was not applying for a two-year IR Plan with unknown parameters (or parameters to be established at a later date). NRG very clearly applied for continuation of the existing IR Plan. That was what was approved on November 11, 2014.

20. As NRG noted in its IRM Application dated November 25, 2014:

The [Two-Year Extension] Application requested the Board to approve the continuation of the current IRM framework to set distribution rates and other charges for NRG’s next two fiscal years ...

[T]his [IRM] Application is essentially the implementation of the Board’s Decision on the [Two-Year Extension] Application.

21. Notwithstanding the very clear record in this proceeding, IGPC spent the majority of its submission re-litigating the Board’s decision of November 11<sup>th</sup> by suggesting that stretch factor used in NRG’s existing IR Plan elements was inappropriate, and should not be used to establish NRG’s distribution rates for the next two years.

(b) *NRG’s existing IR Plan elements (including stretch factor) are appropriate*

22. IGPC proposes that NRG's Board-approved stretch factor of 0.4% be drastically increased to 2.8%. Even IGPC recognizes that its own proposal is "not normal" because such a stretch factor would reduce rates.<sup>13</sup> IGPC nevertheless concludes that an alternative stretch factor and a rate reduction are warranted: (a) "given the admitted over-earning by NRG"; and (b) because NRG's operating costs have increased dramatically, so the existing stretch factor has failed to drive efficiencies in NRG's operations.<sup>14</sup>

23. With respect to the latter argument, there is no basis for concluding that NRG's operating costs have increased – let alone the interaction between at any operating cost increase (if there is one) and the existing IR Plan's stretch factor. As IGPC knows, NRG's financial statements include its hot water tank business (i.e., the financial statements are not solely the utility business).<sup>15</sup> Given that the Board approved the extension of NRG's existing IR Plan, NRG filed its typical annual IR Plan increase application, which does not involve a re-assessment of the stretch factor.

24. With respect to IGPC's statement as to NRG's "admitted over-earning", that too is completely baseless. NRG provided very careful evidence as to its earnings under the IR Plan. That evidence shows that NRG's historic earnings have either been within the earnings deadband or slightly below it.

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<sup>13</sup> IGPC Submission, para. 4.

<sup>14</sup> IGPC Submission, paras. 4 and 6.

<sup>15</sup> Two-Year Extension Application, Exh C/1/1, p. 4.

25. It appears that IGPC is suggesting that NRG has forecasted that it will over-earn in fiscal 2015 and 2016 if the existing IR Plan is continued. NRG has made no such forecast or assertion. IGPC's basis for suggesting that NRG would over-earn lies in a few discrete line items:<sup>16</sup>

- The fact that the existing IR Plan includes a line item for regulatory costs based on a three-year IR Plan.
- IGPC's assumption that NRG has re-financed its debt at a lower rate since NRG's last cost-of-service application.
- The fact that if NRG had re-based, there would have been \$71,000 annual distribution cost savings to IGPC as a result of the depreciation on the IGPC Pipeline. NRG raised this specifically in its pre-filed evidence, but suggested that the amount was immaterial and that there was no practical way to deal with the issue without opening up the entire IR Plan:

In addition to being immaterial, NRG is making this Application on the basis that the current IR Plan is operating in a way that is providing NRG with sufficient revenues to cover its costs (capital and O&M) and provide it with a fair return. NRG will continue to manage its capital and O&M expenditures on an "envelope" basis. The only way for the Application to proceed in a reasonable manner is to refrain from examining individual rate base/capital items (such as Rate 6's declining rate base) or individual O&M line items (see section below).<sup>17</sup>

26. In its November 11<sup>th</sup> decision, the Board agreed with NRG, stating:

The Board notes that the IRM model is not based on a line-item review of costs, revenues, and cost allocation. Inevitably some items will change more than others in ways that may favour one customer class more than others.

The Board does not unpack the IRM model to selectively address customer-specific concerns.<sup>18</sup>

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<sup>16</sup> IGPC Submission, paras. 10 and 13.

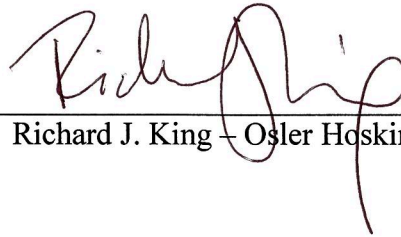
<sup>17</sup> Two-Year Extension Application, Exh. C/5/1, p. 3.

<sup>18</sup> Transcript from November 11, 2014 Oral Proceeding, p. 37, lines 21 to 26.

27. Consequently, there is no evidentiary basis to support an alteration to the existing IR Plan's stretch factor.

**ALL OF WHICH IS RESPECTFULLY SUBMITTED**

January 16, 2015

A handwritten signature in dark ink, appearing to read "Richard J. King", is written over a horizontal line.

Richard J. King – Osler Hoskin & Harcourt LLP