



Ontario Energy Board Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2016-0351

NATURAL RESOURCE GAS LIMITED

Application to sell natural gas distribution system to EPCOR Natural Gas Limited Partnership

BEFORE: Cathy Spoel

Presiding Member

August 3, 2017

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1 INTRODUCTION AND SUMMARY

This is the Decision and Order of the Ontario Energy Board (OEB) regarding an application filed by Natural Resource Gas Limited (NRG) requesting:

- Approval to sell its natural gas distribution system to EPCOR Natural Gas Limited Partnership (EPCOR)
- Transfer of NRG's existing OEB-approved franchise agreements, certificates of public convenience and necessity, and rate orders to EPCOR

Section 43 of the *Ontario Energy Board Act, 1998 (Act)* requires leave of the OEB for certain consolidation transactions involving changes in ownership or control in the natural gas sector. Briefly, consolidation transactions include the sale or disposal of a gas transmission, distribution or storage system; amalgamations involving a gas transmitter, distributor or storage company; and the acquisition of share control of a gas transmitter, distributor or storage company or of a company that holds more than 20% of the shares of a gas transmitter, distributor or storage company.

The OEB has applied the no harm test in assessing this application, and has concluded that NRG's proposed sale transaction meets that test.

The OEB therefore grants leave to NRG to sell its natural gas system to EPCOR. The OEB also grants leave to NRG to transfer to EPCOR a number of NRG's regulatory approvals related to that system.

2 THE APPLICATION

NRG filed an application with the OEB on December 1, 2016 seeking approval to sell its natural gas distribution system, in its entirety, to EPCOR under section 43(1)(a) of the Act. NRG filed amendments to the application on January 25, 2017. As part of this application, NRG has requested that NRG's existing OEB-approved franchise agreements, certificates of public convenience and necessity, and rate orders be transferred to EPCOR under section 18 of the Act. The applicant has also filed requests for confidentiality relating to certain information contained in the Asset Purchase Agreement (APA), which sets out the terms of the proposed transaction.

NRG is a privately-owned utility that sells and distributes natural gas in southwestern Ontario. The company provides natural gas to over 8,000 customers. EPCOR is an Ontario limited partnership and is a wholly-owned indirect subsidiary of EPCOR Utilities Inc. (EUI). EUI is a corporation incorporated under the laws of the Province of Alberta and wholly owned by the City of Edmonton. The two corporate partners of EPCOR are EPCOR Power Development Corporation (the sole limited partner) and EPCOR Ontario Utilities Inc. (the general partner). Both of these corporate partners are subsidiaries of EUI. The general partner will control and have the full and exclusive power, authority and responsibility for the management and day-to-day operations of EPCOR.

According to the terms of the APA, NRG has agreed to sell and EPCOR has agreed to purchase NRG's natural gas distribution system in its entirety for \$21 million, exclusive of taxes, subject to the adjustments provided for in the APA.

Process

The OEB issued a Notice of Application and Hearing on February 23, 2017, inviting intervention and comment. The OEB approved intervention requests by Union Gas Limited (Union), the Integrated Grain Processors Co-operative Inc. (IGPC), EPCOR, the Vulnerable Energy Consumers Coalition (VECC), and Tribute Resources Inc./ON-Energy Corp.

The OEB provided for interrogatories and submissions on the application.

3 THE NO HARM TEST

In the assessment of consolidation transactions in the electricity sector, the OEB has consistently applied the “no harm” test since 2005.¹ The no harm test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB’s statutory objectives; where a proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application. The OEB has applied the no harm test in assessing the current application.

The OEB’s statutory objectives in the gas sector are set out in section 2 of the Act:

1. To facilitate competition in the sale of gas to users.
 2. To protect the interests of consumers with respect to prices and the reliability and quality of gas service.
 3. To facilitate rational expansion of transmission and distribution systems.
 4. To facilitate rational development and safe operation of gas storage.
 5. To promote energy conservation and energy efficiency in accordance with the policies of the Government of Ontario, including having regard to the consumer’s economic circumstances.
- 5.1 To facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas.
6. To promote communication within the gas industry and the education of consumers.

The OEB has focused on the objectives that are of most direct relevance to the impact of the proposed sale transaction; namely, price, reliability and quality of gas service, and financial viability.

¹ Decision of the OEB in combined proceeding RP-2005-0018/EB-2005-0234/-0254/-0257, August 31, 2005.

4 DECISION ON THE ISSUES

4.1 Application of the No Harm Test

Price

NRG asserted that based on EPCOR's underlying cost structure, the costs to serve NRG's customers post transaction are not expected to be higher than they otherwise would have been with NRG. Among other things, NRG's application notes that EPCOR's cost of debt borrowed from its parent company at market rates reflective of EPCOR's credit worthiness should be lower relative to NRG's cost of debt.

OEB staff requested that NRG provide a comparison of the costs to serve customers by NRG versus the anticipated costs to serve customers by EPCOR. NRG stated that EPCOR is unable to provide a detailed breakdown of future costs to serve customers in advance of finalizing an amended rate application to enable such a comparison of costs. NRG filed a rate application (EB-2016-0236) in August 2016. At NRG's request, the OEB placed the rate application in abeyance until a determination is made on this application. EPCOR has committed to file an amended rate application within six to nine months of the closing of the proposed sale transaction.

OEB staff submitted that the OEB can accept the assertions of the applicant that costs will not be higher than would be the case if the transaction had not occurred on the basis that costs will be fully reviewed in the amended rate application to be filed by EPCOR. OEB staff also noted that the applicant has presented anticipated directional changes in certain cost categories – regulatory, legal, consulting – suggesting longer term cost efficiencies which would benefit customers.

The application states that gas production wells owned by NRG Corp. (a related company to NRG) provide enhanced supply reliability on NRG's distribution system. The APA requires NRG Corp. to negotiate in good faith to conclude a gas purchase agreement (GPA) for supply from the wells with EPCOR, which must be executed by the closing of the proposed sale transaction. OEB staff expressed concern regarding the cost of the gas being supplied by NRG Corp., noting that NRG has been paying, and continues to pay, a premium for that gas. OEB staff also expressed concern about the term of the GPA. Under the terms of the APA, the GPA would be in force until September 30, 2020, and is subject to extension upon the agreement of the parties. However, OEB staff also noted that the OEB is expected to undertake a detailed examination of the costs of the NRG Corp. gas supply in the amended rate application to be filed by EPCOR and may not allow EPCOR to recover the premium paid to NRG Corp. through interim rates.

IGPC requested that the OEB require EPCOR to file the amended rate application prior to January 1, 2018 as well as include evidence in the rate application to calculate the repayment to

customers for the period in which interim rates have been in effect, and a proposal for repayment to customers that have overpaid during the period of interim rates.

VECC requested that the OEB make clear that EPCOR will be at risk in the rate proceeding for any amounts that may be determined to be unrecoverable as a result of the delay that the current application caused to the rate application.

In its reply argument, NRG submitted that all matters related to rates applicable to the NRG distribution system will be addressed during the rate proceeding, and will be decided on the basis of the evidence filed in that proceeding. With respect to the system integrity gas supply from NRG Corp., NRG submitted that the prudence of the costs that EPCOR pays to NRG Corp. will be assessed in future proceedings.

OEB Findings

The OEB is satisfied that the proposed sale transaction meets the no harm test in relation to price.

The OEB considers that all matters concerning system integrity gas supply, and all rate-related matters including rates, interim rates, and any repayment to customers are properly the subject of the rates proceeding. The OEB notes NRG's acknowledgment that the prudence of gas supply costs will be reviewed as part of a future rates proceeding.

The OEB accepts the commitment by EPCOR to file an amended rate application within six to nine months of the closing of the proposed sale transaction, and will therefore not set the timing of the rates proceeding as requested by IGPC.

Reliability and Quality of Gas Service

NRG asserted that service quality and reliability will be maintained, submitting that EPCOR will be bound by all current and future regulatory requirements of the OEB (including, among others, those pertaining to reporting obligations, gas distribution access, and relationships with affiliates). EPCOR will also operate the distribution system in accordance with regulatory standards, such as Technical Standards and Safety Authority (TSSA) requirements regarding fuel safety, and Measurement Canada obligations regarding metering.

NRG submitted that its general manager as well as the operations and administrative personnel have accepted offers of employment from EPCOR, which ensures the retention of the knowledge of NRG's operations and distribution system and will enable continuity of service for customers. NRG also submitted that EUI has employees with experience in natural gas distribution utilities in the areas of health and safety, regulatory, communications, engineering, planning and capital project management.

OEB staff submitted that EPCOR appears to have the capabilities in place to ensure that service quality and reliability are maintained through the resources and expertise available from EUI and NRG personnel. OEB staff also noted that all rate-regulated gas utilities are required to maintain and file information under the OEB's *Reporting and Record Keeping Requirements*, which encompasses information on financial statements, service quality, and compliance with the *Affiliate Relationships Code for Gas Utilities*, among other matters.

OEB Findings

The OEB expects EPCOR to comply with all regulatory requirements of the OEB as well as the regulatory standards of the TSSA and Measurement Canada. NRG's general manager and operations and administrative personnel have accepted offers of employment from EPCOR, such that EPCOR will have the benefit of their knowledge of NRG's operations and distribution system. The OEB also notes that EPCOR has access to EUI employees with experience in the areas of health and safety, regulatory, communications, engineering, planning and capital project management.

The OEB is satisfied that the proposed transaction will not lead to any adverse impact with respect to the reliability and quality of service, and the OEB finds that the no harm test is met in this regard.

Financial Viability

EPCOR has agreed to purchase NRG's natural gas distribution system in its entirety for \$21 million, exclusive of taxes, subject to the adjustments provided for in the APA. The estimated net book value of the purchased assets is \$14.6 million. NRG stated that EPCOR has the financial capacity necessary to fund the purchase price, and that the amount of consideration paid will not have a material impact on EUI's financial position. The purchase price represents an amount that is less than 0.5% of EUI's total assets.

OEB staff submitted that the proposed transaction permits a new entrant, with the support of a parent company possessing strong financial capacity, to participate in the Ontario natural gas distribution industry. OEB staff noted, however, that if the transaction is approved, unlike EPCOR, which will be regulated by the OEB, EUI is not regulated by the OEB. OEB staff suggested that the OEB consider requiring that a parental guarantee or some other assurance or undertaking be provided by EUI for at least some time until EPCOR is fully operational.

OEB staff also submitted that the OEB clarify that the premium paid by EPCOR for the proposed acquisition, all incremental costs incurred relating to completion of the proposed sale

transaction, and costs associated with the necessary regulatory approvals cannot be recovered through future distribution rates.

In its reply submissions, NRG argued that a parental guarantee or some other form of assurance from EUI is unnecessary as, upon closing, NRG's assets and business will transfer to EPCOR and EPCOR will be "fully operational" in the same way that NRG currently is, and there is currently no parental guarantee in respect of NRG. NRG also submitted that EUI has committed to funding the purchase price to EPCOR for the purchase of the NRG assets and has confirmed that it will provide funding for EPCOR's future capital projects that have been approved by the OEB.

NRG confirmed in its reply argument that EPCOR will not seek to increase future revenue requirements recovered from customers in order to recover transaction costs and premium associated with the proposed sale transaction.

OEB Findings

The OEB finds that the proposed sale transaction meets the no harm test with respect to financial viability. EUI has committed to funding the purchase price to EPCOR for the purchase of the NRG assets; and EUI has confirmed that it will provide funding for EPCOR's future capital projects that have been approved by the OEB. The OEB accepts NRG's evidence that the premium paid for the assets will not impact EPCOR's financial viability.

The OEB finds that there is no need for a parental guarantee to be provided by EUI once EPCOR owns the distribution system as EPCOR will have a stream of revenue from the operation of the system, and is not committing to other major capital outlays. As noted above EUI will provide funding for EPCOR's future OEB-approved capital projects.

4.2 Union Penalty

In the OEB's Decision and Order dated January 14, 2016 (penalty order),² NRG was ordered to pay the remainder (\$1,106,016) of a penalty amount to Union related to NRG's failure to balance its supply at the February 28, 2014 winter checkpoint, in accordance with the schedule set by the OEB in that Decision and Order.

Union has submitted in this proceeding that NRG has paid \$399,543 of the amount owing which leaves \$706,474 (+ HST) of the penalty amount outstanding. In response to interrogatories from Union, NRG confirmed that EPCOR is not assuming responsibility for the penalty payment obligation. Union submitted that as a condition of approving the transaction, NRG should be required to pay the outstanding balance upon closing or in the alternative require EPCOR to assume the obligation. VECC also made similar submissions regarding the penalty order in its final argument.

In its reply submissions, NRG argued that following closing, NRG will continue to exist as an entity and the OEB's penalty order will continue to apply to NRG as it is not to be transferred to EPCOR. As well, pursuant to Clause 6.1.12 of the APA, at the time of closing, NRG will either have satisfied, or will have reached an agreement with Union to settle, all amounts owing as a result of the penalty order, when due and payable. NRG submitted that the additional conditions proposed by Union and VECC are therefore unnecessary and should not be imposed by the OEB.

OEB Findings

The OEB accepts NRG's submissions regarding the payment of the penalty. The transfer of assets to EPCOR does not change the fact that the penalty payment obligation is an NRG liability enforceable against it.

4.3 Transfer of Regulatory Approvals

The application seeks orders under section 18 of the Act granting leave to NRG to transfer to EPCOR a number of regulatory approvals relating to NRG's distribution system.

Franchise Agreements and Certificates of Public Convenience and Necessity

NRG has several existing certificates of public convenience and necessity (certificates) that permit it to operate its natural gas distribution business and to construct works to supply natural gas in a municipality, together with a number of orders related to franchise agreements. NRG

² Combined Proceeding - EB-2014-0053/EB-2014-0361/EB-2015-0044

requested that the existing franchise agreements and certificates be transferred from NRG to EPCOR.

NRG and Oxford County were parties to a 20-year franchise agreement dated June 14, 1989. On June 12, 2017, NRG filed an application with the OEB for approval of a new proposed franchise agreement between NRG and Oxford County.³

OEB staff supported the transfer of the existing OEB-approved franchise agreements and certificates from NRG to EPCOR but submitted that the franchise agreement between NRG and Oxford County which includes a corresponding certificate must first be approved by the OEB before it can be transferred to EPCOR.

In its reply submissions, NRG requested that if the proposed franchise agreement between NRG and Oxford County has not been approved by the OEB by the time the OEB renders its decision on the present application, the OEB conditionally approve the transfer of the franchise agreement and related certificates for Oxford County to take effect following OEB approval of the proposed franchise agreement and a by-law being passed by Oxford County.

Rate Orders

NRG is subject to the following OEB rate orders:

- Decision and Order in OEB File No. EB-2015-0115 (2016 IRM rate adjustment, which established NRG's current distribution rates, made interim via Procedural Order No. 1 in EB-2016-0236 dated September 28, 2016)
- Decision and Order in OEB File No. EB-2017-0221 (order approving quarterly rate adjustment for the period July 1 to September 30, 2017, which reflects NRG's current commodity rates)
- Decision and Order in OEB File No. EB-2016-0330 (interim order approving NRG's proposed rates to recover the cost consequences of its Cap and Trade Compliance Plan effective January 1, 2017).

NRG requested the transfer of these rate orders from NRG to EPCOR. OEB staff supported this request.

OEB Findings

The OEB finds it is appropriate for the existing OEB-approved certificates and rate orders to be transferred from NRG to EPCOR, and grants NRG leave to transfer those certificates and rate orders to EPCOR.

³ NRG Franchise Renewal Application – EB-2017-0232

The OEB also finds that it is appropriate to grant leave to NRG to transfer to EPCOR all of the OEB's orders related to NRG's existing franchise agreements.

With respect to the Oxford franchise agreement, as noted previously, a proposed franchise agreement between NRG and Oxford County is currently the subject of OEB File No. EB-2017-0232. The OEB grants leave to NRG to transfer to EPCOR such final order as the OEB may issue in that proceeding.

4.4 Confidentiality Requests

As part of its application, and pursuant to Rule 10 of the OEB's *Rules of Practice and Procedure* and in accordance with the OEB's *Practice Direction on Confidential Filings* (Practice Direction), NRG filed requests for confidentiality relating to certain information contained in the APA between NRG and EPCOR. NRG's requests for confidentiality relate to information that it considers commercially sensitive as well as "personal information" within the meaning of the *Freedom of Information and Protection of Privacy Act (Ontario)*(FIPPA).

In Procedural Order No. 1, the OEB allowed, as an interim measure, parties to review the confidential information claimed as commercially sensitive after signing a copy of the OEB's Declaration and Undertaking, and filing it with the OEB. The OEB also stated that parties would not be allowed to review personal information filed in confidence until the OEB determined whether the disclosure of the personal information is permitted under FIPPA. No party filed a Declaration and Undertaking in response to the Procedural Order.

Procedural Order No. 1 provided for a process for parties to object to the requests for confidentiality and stated that subsequent to any and all submissions received, the OEB would make its findings with respect to NRG's claims for confidentiality. No parties filed submissions except for OEB staff which supported the applicant's confidentiality requests.

OEB Findings

The OEB accepts NRG's requests for the confidential treatment of information contained in the APA.

5 CONCLUSION

The OEB concludes that NRG's proposed sale transaction meets the no harm test and grants NRG leave to sell its natural gas distribution system to EPCOR. The OEB also grants NRG leave to transfer its regulatory approvals to EPCOR as set out in this Decision and Order.

6 ORDER**THE BOARD ORDERS THAT:**

1. Natural Resource Gas Limited is granted leave to sell its natural gas distribution system to EPCOR Natural Gas Limited Partnership.
2. Natural Resource Gas Limited shall promptly notify the OEB of the completion of the transaction referred to in paragraph 1 above.
3. The leave granted in paragraph 1 above shall expire 18 months from the date of this Decision and Order.
4. Natural Resource Gas Ltd. is granted leave to transfer to EPCOR Natural Gas Limited Partnership the certificates of public convenience and necessity, rate orders and other orders issued by the OEB, and the authority granted thereunder, in the following proceedings:

Certificates of Public Convenience and Necessity:

- E.B.C.111 and 119, dated May 5, 1982
- E.B.C. 239, dated October 16, 1995
- E.B.C. 212, dated February 9, 1996
- E.B.C. 242, dated September 6, 1996

Rate Orders:

- Decision and Order EB-2015-0115 (2016 IRM rate adjustment, which established NRG's current distribution rates, made interim via Procedural Order No. 1 in EB-2016-0236 dated September 28, 2016)
- Decision and Order EB-2017-0221 (order approving quarterly rate adjustment for the period July 1 to September 30, 2017, which reflects NRG's current commodity rates)
- Decision and Order EB-2016-0330 (interim order approving NRG's proposed rates to recover the cost consequences of its Cap and Trade Compliance Plan effective January 1, 2017).

Orders related to Franchise Agreements:

- EB-2012-0072 (Town of Aylmer)
- EB-2012-0447 (Municipality of Bayham)
- EB-2012-0446 / EB-2014-0186 (Municipality of Central Elgin)
- EB-2015-0205 (Township of Malahide)
- EB-2012-0475 (Township of South-West Oxford)
- EB-2012-0444 / EB-2014-0153 (Municipality of Thames Centre)

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- EB-2012-0445 / EB-2014-0188 (City of London)
 - EB-2012-0476 / EB-2014-0207 (County of Norfolk)
 - EB-2015-0307 (Elgin County)
 - EB-2016-0145 (Middlesex County)

5. Natural Resource Gas Ltd. is granted leave to transfer to EPCOR Natural Gas Limited Partnership such order, and the authority granted thereunder, as may be issued by the OEB in proceeding EB-2017-0232.

6. The Vulnerable Energy Consumers Coalition shall file with the OEB and forward to Natural Resource Gas Limited its cost claim no later than 7 days from the date of issuance of this Decision and Order.

7. Natural Resource Gas Limited shall file with the OEB and forward to VECC any objections to the Vulnerable Energy Consumers Coalition's claimed costs within 17 days from the date of issuance of this Decision and Order.

8. The Vulnerable Energy Consumers Coalition shall file with the OEB and forward to Natural Resource Gas Limited any response to any objection to its cost claim within 24 days from the date of issuance of this Decision and Order.

9. Natural Resource Gas Limited shall pay the OEB's costs of and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

DATED at Toronto August 3, 2017

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary