ONTARIO ENERGY BOARD

IN THE MATTER OF an application by Natural Resource Gas Limited to approve certain adjustments to its deferral accounts affecting gas distribution rates and amend Appendix "B" to Rate Order EB-2010-0018

EB-2017-0215

REPLY

OF

NATURAL RESOURCE GAS LIMITED

SEPTEMBER 1, 2017

Osler, Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario, Canada M5X 1B8
Richard J. King
Jeff St. Aubin

TABLE OF CONTENTS

Page

REPLY OF NATURAL RESOURCE GAS LIMITED

OVERVIEW

Natural Resource Gas Limited ("**NRG**") submitted an application to the Ontario Energy Board (the "**OEB**") on June 23, 2016, pursuant to Sections 19 and 36 of the *Ontario Energy Board Act, 1998*[1] (the "**Application**"). The Application initiated this proceeding (EB-2017-0215) and requested the approval of certain corrections to the Reference Prices used for NRG's Purchased Gas Transportation Variance Accounts (each a "**PGTVA**") and an amendment to Order EB-2010-0018 to reflect these corrections.

On July 8, 2016, the OEB directed that an audit (the "**Audit**") be performed by the Audit and Performance Assessment Department (the "**OEB Auditor**"), and that the Application would be heard after the completion of the Audit. The OEB Auditor released its report on March 8, 2017 (the "**Audit Report**").

The Audit Report confirmed that the Reference Prices in EB-2010-0018 were incorrect and resulted in the PGTVA credit balances being overstated by $844,100 as of September 30, 2015.[2] This erroneous credit balance would result in an excessive refund to customers upon the clearing of the PGTVAs.

The processing of the Application resumed following the completion of the Audit, with Procedural Order No. 1, dated July 13, 2017, directing that the Application proceed by way of a written hearing. NRG subsequently received and responded to the initial and supplemental interrogatories

[1] RSC 1998, c 15 (Sched B).

[2] Audit Report at Page 4.

of OEB Staff, following which OEB Staff filed its written submission on August 25, 2017 (the "**OEB Staff Submission**").

This Reply has been structured to include three primary sections. The first section discusses the PGTVAs generally and the error that occurred in calculating the Reference Prices; the second section sets out reasons supporting the corrections; and the third section considers issues raised in the OEB Staff Submission.

NRG submits that the Reference Prices should be corrected, as the corrections will:

a) lead to the correct result, as customers will receive a refund such that they will only pay for the actual costs of transporting purchased gas, while NRG will not have a gain or incur a loss in relation to the costs of transporting purchased gas;

b) have no impact on the distribution rates established by EB-2010-0118; and

c) have no impact on customers because the PGTVAs were not cleared and the Reference Price Error is therefore only notional at this time.

NRG submits that allowing these corrections will lead to a fair and reasonable result, while OEB Staff has noted that they have no concerns if the OEB approves the requested corrections.[3]

3 OEB Staff Submission at 5.

1.0 THE PGTVA AND THE REFERENCE PRICE ERROR

1.1 Overview

The PGTVA is a mechanism used to ensure that NRG does not lose money or earn a profit in relation to the transportation of purchased gas. This principle of cost neutrality will be referred to in this Reply as the "**Pass-Through Principle**".

To aid in the explanation of the PGTVA and the Reference Price, a graphic has been included in Section 1.5, which illustrates the concepts discussed in the following sections.

1.2 The Two Stages of the Pass-Through Principle

The first stage in giving effect to the Pass-Through Principle occurs as part of the rate setting process. During this process, the OEB and a gas distributor must estimate what the future transportation costs of purchased gas will be (the "**Estimated Tx Cost**"). This Estimated Tx Cost is incorporated into the distribution rates set by the OEB.

The second stage in giving effect to the Pass-Through Principle occurs after the distribution rates have been set. This second stage is necessitated by the fact that the actual transportation cost of purchased gas ("**Actual Tx Cost**") will vary from the Estimated Tx Cost, as the Actual Tx Cost fluctuates due to changing tariff charges and variance in throughput and local production. This differential between the Estimated Tx Cost and the Actual Tx Cost (the "**Tx Variance**") would, if not adjusted for, violate the Pass-Through Principle by resulting in the gas distributor earning a profit or incurring a loss in relation to the transportation of purchased gas.

The mechanism by which the Pass-Through Principle is preserved during the second stage is through the use of the PGTVA, which records and nets the Tx Variances over time. Specifically, the OEB-approved methodology is for the PGTVA to:

a) record the difference (on a monthly and unit basis) between the Actual Tx Cost and the approved Reference Price (discussed further below); and

b) multiply the difference determined in (a) by the actual volume of gas delivered into NRG's system (including local production).

The PGTVA is periodically "cleared", at which time the net Tx Variance will be refunded to the customers if the Actual Tx Costs have been less than the Estimated Tx. A key element of the PGTVA is the Reference Price, which is explored in the next section.

1.3 The Reference Price

The Reference Price is the benchmark used to determine the Tx Variances recorded in the PGTVA. The Reference Price and the Estimated Tx Cost are related concepts, but it is helpful to keep these concepts distinct, as this is critical to understanding NRG's current application and the rationale supporting it.

The Estimated Tx Cost is established during the rate setting process for the setting of the distribution rates (the first stage of the Pass-Through Principle), whereas the Reference Price is used to determine the Tx Variances to be recorded in the PGTVA (the second stage of the Pass-Through Principle).

1.4 The Reference Price Error

NRG's consultant made an error in the calculation of the Reference Prices for the EB-2010-0018 proceeding (the "**RP Error**"). The RP Error was the result of the consultant incorrectly basing the Reference Prices on the transportation volume of Union Gas Limited alone, whereas the Reference Prices should have been based on NRG's load forecast sales volume, which includes both the transportation volume of Union Gas Limited and the gas purchased by NRG from wells and producers within the NRG franchise area.

The incorrect Reference Prices set in EB-2010-0018 and the correct Reference Prices sought in this Application are set out in the table below.

PGTVA	Incorrect Reference Price (set in EB-2010-0018)	Correct Reference Price
1 – 5	$0.023909/m^3	$0.018339/m^3
6	$0.0105000/m^3	$0.009885/m^3

The RP Error and the corrected Reference Prices have been confirmed by the OEB Auditor in the Audit Report.[4]

The effect of the RP Error was that the Tx Variances recorded in the PGTVAs were incorrect, with the result being that the cumulative credit balances (amounts owing to customers) were overstated by $844,100.[5]

---

[4] Audit Report at Page 5.

[5] Audit Report at Page 5.

It is equally important to understand what the RP Error did not effect, specifically:

d) <u>the RP Error has no impact on the distribution rates</u> established by EB-2010-0018 because the Estimated Tx Costs used for setting the distribution rates were correctly based on the total throughput volume of gas; and

e) <u>the RP Error has no impact on customers</u> because the PGTVAs have not been cleared and the RP Error is only notional at this time.

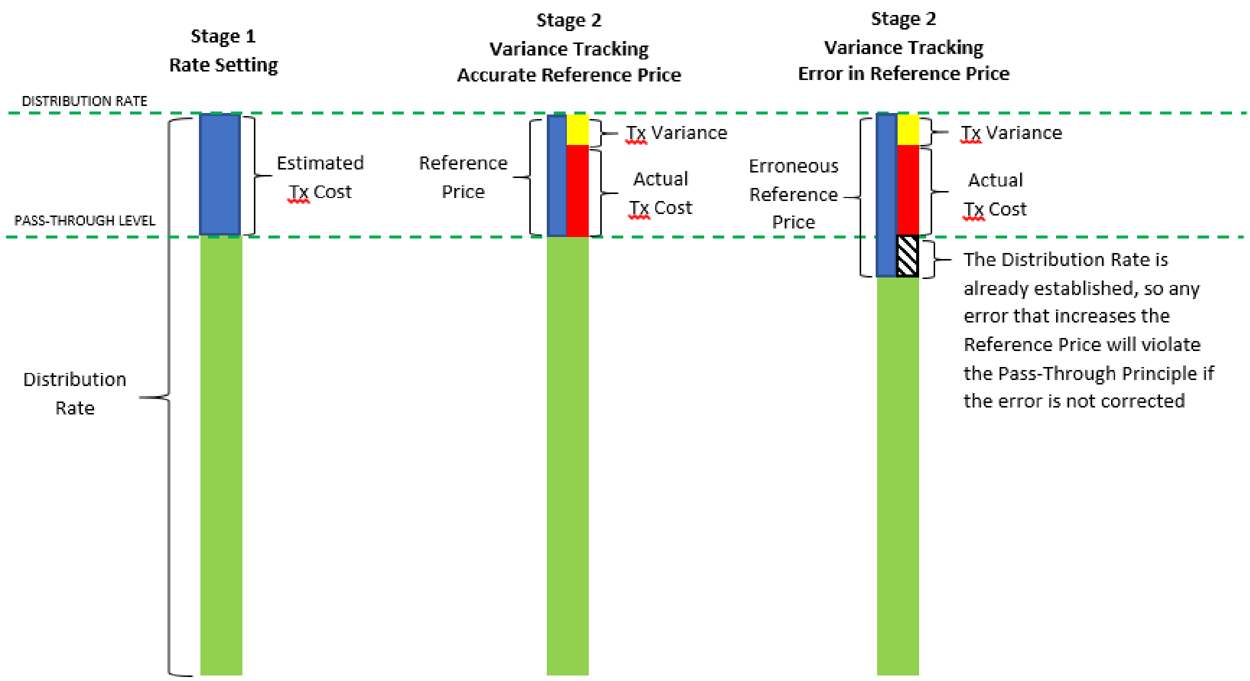
1.5 Graphical Representation of PGTVA, Reference Price, and Error

The graphic below illustrates, by way of:

a) the graphic on the left, the component of the distribution rate, established during the rate setting process, that represents the Estimated Tx Cost, and how this cost is intended to be a pass-through that does not give rise to any gains or losses for a gas distributor;

b) the graphic in the centre, the operation of the PGTVA, which records the Tx Variance that is determined by comparing the Reference Price and the Actual Tx Cost; and

c) the graphic on the right, the effect of an error that overstates the Reference Price, which results in a violation of the Pass-Through Principle, as discussed further below.



The centre graphic above demonstrates that the Tx Variance (recorded in the PGTVA) is intended to preserve the Pass-Through Principle by representing the difference between the Reference Price and the Actual Tx Cost. Formulaically, this can be represented by:

Tx Variance = Reference Price – Actual Tx Cost

In the example illustrated above, this Tx Variance would be recorded as a credit and refunded to the customers on the clearing of the PGTVA, thereby ensuring that the gas distributor incurs no gain or loss in relation to the cost of transporting purchased gas. In other words, from the perspective of the distributor, the final result is that they recover the distribution rate up to the pass-through level, plus the actual costs of transporting purchased gas.

The graphic on the right demonstrates that if there is an error and the Reference Price is overstated, then the excess Reference Price (that component represented by the error) does not increase the distribution rate (which had been previously set using the Estimated Tx Cost), but instead "displaces" a component of the distribution rate that is "below" the pass-through level. This result is incorrect, as the very purpose of the Tx Variance is to preserve the Pass-Through Principle. Based on the graphic above, if one cannot rely on the Reference Price (due to it being incorrect), then the Tx Variance could be determined as follows:

Tx Variance = Distribution Rate – Pass-Through Level – Actual Tx Cost

This formula would result in a Tx Variance that preserves the Pass-Through Principle and does not include the erroneous component of the Reference Price. In contrast, if the erroneous portion of the Reference Price were allocated to the Tx Variance, this would result in the distribution of an excessive refund to customers on the clearing of the PGTVA, which would violate the Pass-Through Principle and penalize the gas distributor.

2.0 THE REFERENCE PRICES SHOULD BE CORRECTED

2.1 Correcting the RP Error Leads to the Correct Result

The PGTVAs are intended to preserve the Pass-Through Principle and the RP Error has compromised this result. NRG submits that the proper approach is to permit the corrections so as to achieve the correct result unless there are compelling reasons to do otherwise. For the reasons set out in the following sections, NRG submits that there are no compelling reasons to deny the corrections.

2.3 Correcting the RP Error Will Not Affect Customers

A recurrent area of concern throughout the course of this proceeding is the potential impact that the corrections may have on customers. However, the corrections will not have any impact on customers because:

a) the PGTVAs have not been cleared, so the RP Error is only notional at this time;

b) the distribution rates set in EB-2010-0118 were determined correctly and will not be affected by the corrections; and

c) after the corrections are made, customers will still receive a refund such that they will only pay for the actual costs of transporting purchased gas, while NRG will not have a gain or incur a loss in relation to the transportation of purchased gas.

2.4 Failing to Correct the RP Error Would Penalize NRG

The RP Error arose from a consultant of NRG applying an incorrect figure in a calculation. NRG does not deny that it should take care in ensuring that all submissions to the OEB are prepared in a careful manner, but NRG also submits that the standard should not be one of perfection. NRG did exercise care in its submissions to the OEB and a mistake should not be left uncorrected simply on the basis that the applicant made a mistake, as such a rationale would deny the correction of any mistake.

In the current circumstances, if the PGTVA balances are not corrected, then NRG will be required to refund $844,100[6] that NRG would otherwise be entitled to retain, but for the error in arithmetic. Such a serious consequence for an innocent error of inadvertence would be an excessive penalty, especially when there are compelling reasons to allow the correction and no compelling reasons to deny it.

2.5 A Credit or Debit in the PGTVA Should Not Determine the Result

NRG appreciates that "[t]he Board is not driven by a need for a symmetrical treatment of ratepayers and utilities where correction of utility mistakes is required".[7] Nevertheless, NRG submits that symmetry may be a relevant factor when considering whether to permit a correction.

In the context of the PGTVAs, if the Reference Prices had been erroneously understated, with the result being that the customers of NRG would receive less of a refund than they would if the arithmetic error had not occurred, then the need for a correction would be patently obvious. To leave the arithmetic error uncorrected would (i) deprive the customers of a refund to which they are rightfully entitled pursuant to the Pass-Through Principle and intention of the PGTVAs, and (ii) allow NRG to retain a gain (resulting from its own error) in relation to the transportation of purchased gas.

To reiterate, NRG understands that symmetry is not a sacred principle, but the counterfactual situation does underscore the logic of permitting the corrections. NRG does not contest that such logic must yield in the face of more important principles (e.g. retroactive ratemaking), but given

[6] Audit Report at Page 4.

[7] EB-2009-0113 at 6, and noted in the OEB Staff Submission at 4.

that the PGTVAs have not been cleared and the corrections will not impact customers, NRG submits that such countervailing principles are not present and the logic in the above scenario merits consideration.

3.0 THE OEB STAFF SUBMISSION

The OEB Staff Submission concludes with OEB Staff stating that they would not have any concern if the OEB approves the requested corrections.[8] In reaching this position, the OEB Staff Submission noted certain issues that NRG has also commented on below.

3.1 Retroactive Ratemaking

During the interrogatory process, certain questions indicated that there may be a concern about the correction of the RP Error constituting retroactive ratemaking.[9] OEB Staff no longer appears to have concerns regarding retroactive ratemaking, noting in the OEB Staff Submission that "OEB staff does agree that since the account has not been disposed of, there is less concern of rate retroactivity",[10] and that "the correction does not appear to raise any issues of rate retroactivity".[11]

NRG also submits that the corrections would not constitute retroactive ratemaking. The Supreme Court of Canada discussed the prospective nature of deferral accounts in *Bell Canada v Canadian Radio-Television & Communications Commission*, where the Court held:

> In my view, the credits ordered out of the deferral accounts in the case before us are neither retroactive nor retrospective. They do not vary the

[8] OEB Staff Submission at 5.

[9] Board Staff Interrogatory #5(b), #6(b), and Supplemental Interrogatory #5.

[10] OEB Staff Submission at 4.

[11] OEB Staff Submission at 5.

> original amount as approved, which included the deferral accounts, nor do they seek to remedy a deficiency in the rate order through later measures, since these credits or reductions were contemplated as a possible disposition of the deferral account balances from the beginning. These funds can properly be characterized as encumbered revenues, because the rates *always* remained subject to the deferral accounts mechanism established in the Price Caps Decision. **The use of deferral accounts therefore precludes a finding of retroactivity or retrospectivity. Furthermore, using deferral accounts to account for the difference between forecast and actual costs and revenues has traditionally been held not to constitute retroactive rate-setting.**[12]
>
> (citations omitted, emphasis in bold added, emphasis in italics in original)

NRG submits that the correction of the RP Error falls within the scope of the Supreme Court of Canada's decision. Deferral accounts are prospective by nature and the correction does not relate to a deficiency in the rate order, as the distribution rates were properly determined in EB-2010-0118. The correction deals only with the erroneous calculation of the Reference Prices contained an arithmetic error, which should be corrected before the PGTVAs are cleared.

3.2 Out-of-Period Adjustment

OEB Staff noted that the proposed corrections to the PGTVA balances "arguably leads to an out-of-period adjustment".[13] NRG acknowledges that the proposed corrections would be made several years after the error had occurred, but such corrections should be permitted because the PGTVAs have not been cleared, so the corrections do not constitute retroactive ratemaking, nor do they impact customers. The OEB Submission also notes that "OEB staff does agree that since the account had not been disposed of, there is less concern of rate retroactivity".[14] NRG submits that

[12] 2009 SCC 40 at para 63.

[13] OEB Staff Submission at 4.

[14] OEB Staff Submission at 4.

LEGAL_1:45312428.2

any concern regarding an out-of-period adjustment is notional in nature due to the PGTVAs not having been cleared, and that the proposed corrections would cure a harm without introducing others.

3.3 The OEB Decision in EB-2009-0113

OEB Staff referenced the OEB decision in EB-2009-0113, in which the OEB denied the request of North Bay Hydro Distribution Limited ("**NBHDL**") to correct balances in its Retail Service Variance Account ("**RSVA**"). An important difference between EB-2009-0113 and this proceeding is that the RSVA accounts had already been cleared by NBHDL. The OEB Staff Submission acknowledged this distinction[15] and NRG submits that this distinction is critical.

In EB-2009-0113, the OEB held that "[t]he main area contested in the application is the issue of retroactivity",[16] and proceeded to state:

> The purpose of the account is to track the variance with the intent to dispose of the balances in a manner that keeps the applicant whole. However, once the rates, including any associated riders from the clearance of the RSVAs or any other account, have been determined to be final the Board has little, if any, power to alter these rates retroactively.

If the PGTVAs had been cleared, then the correction of the RP Error would present an entirely different set of circumstances for the OEB to consider. However, given that the PGTVAs have not been cleared, EB-2009-0113 is not applicable because that proceeding dealt with the issue of retroactivity, whereas in the current NRG proceeding the OEB Submission notes that "OEB staff

---

[15] OEB Staff Submission at 4, where it states "OEB staff notes that in the North Bay case the balances in the deferral account had already been disposed of through a final rate order. In the current case, they have not".

[16] EB-2009-0113 at 6.

does agree that since the account had not been disposed of, there is less concern of rate retroactivity".[17] NRG therefore submits that its Application should be decided on its own merits, as the situation of NBHDL presented a completely different set of issues for the OEB to consider.

3.4 Customer Certainty

OEB Staff noted that the proposed corrections to the PGTVA balances "may not provide the certainty that customers expect of a ratemaking process",[18] which OEB Staff tempered in the following sentence by noting that the corrections do not appear to raise issues of rate retroactivity.

NRG appreciates that customers should be entitled to certainty, however, NRG does not believe that the proposed corrections undermine this certainty. To the extent that an astute customer is aware of the existence and function of the PGTVAs, then they would equally understand that the very function of the accounts is to preserve the Pass-Through Principle. Such a customer would therefore understand that to the extent that the transportation costs are less than what was originally forecast, then they would be entitled to a refund. The corrections do not compromise this certainty – once implemented, the customers will still receive the full refund that they are entitled to and this certainty is preserved.

All of which is respectfully submitted.

[17] OEB Staff Submission at 4.

[18] OEB Staff Submission at 5.

DATED at Toronto, Ontario, this 1st day of September, 2017.

NATURAL RESOURCE GAS LIMITED

By its counsel, Osler, Hoskin & Harcourt LLP
Per: Jeff St. Aubin on behalf of Richard King