



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

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## DECISION AND ORDER

**EB-2014-0053**

**EB-2014-0361**

**EB-2015-0044**

## NATURAL RESOURCE GAS LIMITED (NRG)

**Combined Proceeding: (a) NRG's April 2014 Quarterly Rate Adjustment Mechanism Application; (b) NRG's request for rate relief from the imposition of interest charges; and (c) OEB's own motion regarding the appropriate penalty charge applicable to NRG**

**BEFORE: Ken Quesnelle**  
Presiding Member and Vice-Chair

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**January 14, 2016**

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## 1 INTRODUCTION AND SUMMARY

Natural Resource Gas Limited (NRG) is a company that distributes and sells natural gas in its service territory in Southern Ontario. NRG's service territory is surrounded by the service territory of Union Gas Limited (Union). One of NRG's responsibilities as a regulated distributor is to procure natural gas on behalf of its system supply customers (i.e. customers that elect to buy their gas from NRG). Although NRG purchases a small amount from local gas wells, the majority of the natural gas used by NRG's customers is transported to NRG's service territory through Union's system. NRG is therefore a customer of Union.

NRG has a Southern Bundled Transportation contract with Union. These contracts are used by "direct purchase" customers of Union. Direct purchase customers are typically large volume customers who make their own arrangements to purchase gas from upstream markets (traditionally from Western Canada, but now increasingly from the US Northeast). Under a Southern Bundled Transportation contract, direct purchase customers arrange to have the gas delivered to the edge of Union's service territory, and then Union transports the gas directly to the customer through Union's system. NRG is one of hundreds of Southern Bundled Transportation direct purchase customers served by Union.

Direct purchase customers are obligated to deliver a fixed amount of gas each day to Union. This amount is determined by Union and is based on the expected annual volume of gas to be consumed (or demand) divided by 365 days (366 in a leap year). Direct purchase customers are required to periodically balance their supply with their demand. This may require direct purchase customers to purchase additional gas or shed excess gas.<sup>1</sup>

Under its Southern Bundled Transportation contract with Union, NRG is required to balance its supply with its demand on the Union system at the end of the contact year (September 30) within a +/- 4% tolerance level. NRG is also required to balance deliveries and consumption at the winter checkpoint by February 28 of each year.<sup>2</sup> The

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<sup>1</sup> EB-2014-0053, Natural Resource Gas Limited Application, March 11, 2014 at Schedule 1, p. 2.

<sup>2</sup> Ibid at pp. 2-3.

purpose of this is to ensure the integrity of Union's system. If a customer fails to balance at either of these checkpoints, penalties are imposed pursuant to the Southern Bundled Transportation contract.

Southern Bundled Transportation direct purchase customers receive a Direct Purchase Status Report (DPSR) from Union each month. This report provides direct purchase customers with detailed information regarding the volume of gas that they delivered to Union and the volume of gas that they consumed in previous months. The DPSR also sets out the projected variance in a direct purchase customers' banked gas account (which is an account that tracks the difference between deliveries and consumption) at the time of the next balancing checkpoint. This forecast provides direct purchase customers with the information they need to begin addressing any shortfalls, or excesses, of gas relative to the checkpoint balancing requirements in advance of the checkpoint date.

NRG and several other direct purchase customers failed to balance at the February 28, 2014 winter checkpoint. Consequently, they incurred penalties under the Southern Bundled Transportation contract. The dispute over how much the penalty should be and who should pay the penalty (as between NRG itself or NRG's customers) has been the subject of several OEB proceedings.

In this decision, the OEB will provide detailed findings on the following issues:

- Does NRG's status as a natural gas distributor warrant a different treatment, with respect to certain penalty charges, from Union's other non-compliant direct purchase customers? If so, what is the impact of this consideration on setting an appropriate penalty charge to be applied to NRG for not meeting its contractual balancing obligations?
- Did NRG act prudently with regard to its gas supply procurement during the 2013-2014 winter? If not, what portion of the penalty charges applied to NRG should be approved for recovery from ratepayers?
- Should NRG be granted rate relief and/or a stay from the imposition of interest on the amounts due for payment to Union related to the application of certain penalty charges?

A summary of the key findings set out in this decision are set out below:

- NRG's status as a natural gas distributor does not warrant a different treatment from Union's other non-compliant direct purchase customers.
- NRG shall pay the entire penalty amount (\$1,287,548 - as established in Union's Penalty Reduction Proceeding – EB-2014-0154) to Union.
- NRG's management of its gas supply procurement during the 2013-2014 winter was not prudent.
- NRG's customers on system supply shall only be responsible to pay the portion of the penalty amount that is equal to Union's average cost of gas (\$181,531).<sup>3</sup>
- NRG's shareholder shall pay the remainder of the penalty amount (\$1,106,016).<sup>4</sup>
- NRG will be granted interest rate relief associated with the penalty amount due for payment to Union.
- NRG will credit its system supply customers the difference between the amount that was previously approved for collection related to the penalty charge<sup>5</sup> and the reduced amount approved for recovery by the OEB in this Decision and Order.<sup>6</sup>

The OEB's findings in this decision will impact the rates applicable to all of NRG's system supply customers. NRG's system supply customers will see a reduction to their bills as a result of this decision.

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<sup>3</sup> NRG's system supply customers will pay \$181,531 ( $\$7.12/\text{GJ} * 25,496 \text{ GJ}$ ).  $\$7.12 / \text{GJ}$  reflects the average price that Union paid for 29.8 Petajoules (PJ) of spot gas that it purchased during the 2013-2014 winter (December 12, 2013 to February 21, 2014). EB-2014-0154, Union Gas Limited Interrogatory Responses, June 17, 2014 at Exhibit B.Staff.1, p. 3.

<sup>4</sup> The remainder of the penalty amount is the difference between the total penalty amount (\$1,287,548) and the amount to be paid by system supply customers based on Union's average cost of gas (\$181,531). The amount to be paid by NRG's shareholder is \$1,106,016.

<sup>5</sup> EB-2014-0053, Decision and Interim Order, April 1, 2014 at p. 5.

<sup>6</sup> NRG's system supply customers will be credited \$513,897 which is the difference between what was previously allowed for collection in rates associated with the penalty amount (\$695,429) and the amount that system supply customers are now responsible for related to the penalty amount (\$181,531).

## 2 BACKGROUND AND THE PROCESS

NRG is a Southern Bundled Transportation direct purchase customer of Union, which means that NRG is responsible for purchasing its own gas commodity and delivering the gas to the edge of Union's service territory.

Like all Southern Bundled Transportation direct purchase customers, NRG is required to periodically balance the amount of gas that it brings to Union's system with the amount of gas it actually takes from Union's system at pre-determined checkpoint dates. Under the terms of their contracts with Union, direct purchase customers incur penalties if they fail to balance at the checkpoints. During the winter of 2013-2014, NRG failed to balance at the winter checkpoint as NRG was short of gas as of February 28, 2014. Failure to balance at the winter checkpoint results in Union applying to the direct purchase customer a charge, on the volume of gas that the direct purchase customer was short, that is equal to the higher of the daily spot price for gas at the Dawn trading hub in either February or in March.<sup>7</sup> Union has hundreds of Southern Bundled Transportation customers (including NRG), all of which are subject to these penalty provisions if they fail to balance at the checkpoints.

The winter of 2013-2014 was unusually cold, which resulted in high demand and high prices for natural gas. Although gas was available to be purchased on the market throughout almost all of the 2013-2014 winter, several Southern Bundled Transportation direct purchase customers, including NRG, failed to balance at the winter checkpoint. Union noted that of its approximately 600 South Bundled Transportation contracts, 11 of these contracts were not in balance at the time of the winter checkpoint.<sup>8</sup> Pursuant to the terms of the Southern Bundled Transportation contract, Union applied penalties to these customers. The penalty applicable to these non-compliant customers, including

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<sup>7</sup> In addition to the winter checkpoint (February 28), customers that hold Southern Bundled Transportation contracts may also be required to balance at contract expiry (and at other times during a year). In general terms, customers that fail to balance at any of the checkpoints are applied a charge to the volume of gas that the customer is "short" that is equal to the higher of the daily spot cost of gas at Dawn in the month of, or in the month following the month, in which the customer failed to balance.

<sup>8</sup> EB-2014-0154, Union Gas Limited Interrogatory Responses, June 17, 2014 at Exhibit B.CME.1.

NRG, was \$78.73/GJ pursuant to the terms of the contract (i.e. the highest spot price at the Dawn hub during February or March).<sup>9</sup>

As part of the April 2014 QRAM proceeding, NRG applied for the full recovery from its system gas customers of the penalty amount levied by Union. However, given the abbreviated and written nature of QRAM proceedings, the OEB determined that this issue would be dealt with separately from the ordinary QRAM issues. Therefore, the OEB moved the penalty issue to a separate phase of the proceeding which will be referred to as “the Phase 2 Review” (which remained under the same OEB file number). However, the OEB approved, on an interim basis, the recovery of the costs of the supply shortfall at a reduced rate.

The purpose of the Phase 2 Review is to consider the prudence of NRG’s conduct with respect to its attempts to balance at the winter 2014 checkpoint. Ultimately the proceeding will determine who should pay the penalty: NRG or its ratepayers.<sup>10</sup> The Phase 2 Review was placed on hold pending the release of the OEB’s Decision in Union’s Penalty Reduction Proceeding.<sup>11</sup>

Union recognized that on account of the very cold winter and the resulting high natural gas prices, the penalty charges applicable to direct purchase customers that breached their contracts were very high. Union filed an application with the OEB seeking approval to, on a one-time basis, reduce the penalty from the highest daily spot price at Dawn in February (\$78.73 / GJ) to the second highest daily spot price at Dawn in February (\$50.50 / GJ) (Union Penalty Reduction Proceeding).<sup>12</sup> The OEB’s approval was required for such a reduction because the penalty is a component of Union’s rates, and any changes to a rate must be approved by the OEB. NRG was one of the intervenors in Union’s Penalty Reduction Proceeding.

After holding a hearing, the OEB approved Union’s application.<sup>13</sup> As a result, all direct purchase customers who failed to balance at the winter checkpoint saw their penalties

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<sup>9</sup> EB-2014-0154, Union Gas Limited Application, April 3, 2014 at p. 1.

<sup>10</sup> EB-2014-0053, Ontario Energy Board Correspondence, May 8, 2014.

<sup>11</sup> EB-2014-0053, Ontario Energy Board Correspondence, June 17, 2014.

<sup>12</sup> EB-2014-0154, Union Gas Limited Application, April 3, 2014 at p. 1.

<sup>13</sup> EB-2014-0154, Decision and Order, October 9, 2014.

reduced by approximately 36%. The penalty amount applicable to NRG was reduced from \$2,007,250 to \$1,287,548.

After the release of the Decision and Order in Union's Penalty Reduction Proceeding, the OEB resumed the Phase 2 Review and proceeded by way of a written hearing.<sup>14</sup> NRG requested, as part of the Phase 2 Review, the opportunity to review certain consultant reports that it expected would be released as part of the 2014 Natural Gas Market Review.<sup>15</sup> The OEB granted NRG's request.

Subsequently, NRG filed another letter requesting an oral hearing to make further argument in the Phase 2 Review, based on the information that it received from the 2014 Natural Gas Market Review. In that letter, NRG also stated that it would be filing a Motion to Review the OEB's Decision in Union's Penalty Reduction Proceeding.<sup>16</sup>

Prior to filing its Motion to Review of the Decision and Order in Union's Penalty Reduction Proceeding, NRG filed an application for interest rate relief associated with the penalty charges applied to NRG by Union.<sup>17</sup> The OEB issued a Notice of Application and Interim Order, which stated that interest would not be charged on the penalty amount until after the OEB made its final decision on the penalty charges.<sup>18</sup>

Subsequently, NRG filed a Motion to Review the Decision and Order in Union's Penalty Reduction Proceeding (NRG Motion).<sup>19</sup> NRG filed its Motion on the basis that new evidence arose in the Board's 2014 Natural Gas Market Review that it did not have at the time that Union's Penalty Reduction Proceeding was ongoing.<sup>20</sup> The OEB dismissed

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<sup>14</sup> EB-2014-0053, Procedural Order No. 1, October 10, 2014.

<sup>15</sup> EB-2014-0053, Natural Resource Gas Limited Correspondence, November 19, 2014. In its letter, NRG requested the opportunity to review certain reports that were to be released in the Natural Gas Market Review under OEB File No. EB-2014-0289.

<sup>16</sup> EB-2014-0053, Natural Resource Gas Limited Correspondence, December 5, 2014.

<sup>17</sup> EB-2014-0361, Natural Resource Gas Limited Application, December 1, 2014.

<sup>18</sup> EB-2014-0361, Notice of Application and Interim Order, December 19, 2014 at p. 1.

<sup>19</sup> EB-2014-0375, Motion to Review, December 10, 2014.

<sup>20</sup> On November 6, 2014, NRG appealed the OEB's October 9, 2014 Decision and Order in Union's Penalty Reduction Proceeding to the Divisional Court. In its December 10, 2014, Motion to Review, NRG asked Union and the OEB to consent to a stay of the appeal. Union and the OEB consented to NRG's request that the Divisional Court appeal be stayed until after the OEB made its final decision on NRG's Motion of the EB-2014-0154 Decision and Order. The OEB issued its Decision on NRG's Motion of the

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NRG's Motion on the basis that the threshold test was not met. However, in the Decision and Order, the OEB stated that it did have some concerns with the narrow question of whether the implications of NRG's status as a natural gas distributor regulated by the OEB was thoroughly addressed in Union's Penalty Reduction Proceeding.<sup>21</sup> On that basis, the OEB launched its own Motion to Review the Decision and Order in Union's Penalty Reduction Proceeding.

As NRG's April 2014 QRAM proceeding (EB-2014-0053) and NRG's interest rate relief proceeding (EB-2014-0361) were still ongoing, the OEB combined the hearing of its motion to review (EB-2015-0044) with these two proceedings. Therefore, the records from these proceedings, and from Union's Penalty Reduction Proceeding which was being reviewed, were available to the OEB in making its decision. This decision addresses all outstanding issues which arise from the various proceedings before the OEB related to NRG's penalty for failing to balance at the winter 2014 checkpoint.

At Schedule A, a more detailed procedural history for the related proceedings is provided.

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Union Penalty Reduction Proceeding on March 13, 2015. NRG has not, at the time of drafting this decision, perfected its appeal.

<sup>21</sup> EB-2014-0375, Decision and Order on Motion, March 13, 2015 at p. 5.

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### 3 STRUCTURE OF THE DECISION

In Chapter 4, the OEB will first provide its findings on its own motion to review the October 9, 2014 Decision and Order in Union's Penalty Reduction Proceeding. The findings in this chapter will discuss whether NRG's status as a natural gas distributor warrants a different treatment, with respect to certain penalty charges, from Union's other non-compliant direct purchase customers. The chapter will also include the OEB's findings on the appropriate penalty charge that will be applicable to NRG.

In Chapter 5, the OEB will set out its findings in relation to the Phase 2 Review of NRG's April 2014 QRAM Application. This chapter will focus on the issue of NRG's prudence with regard to its natural gas supply procurement during the 2013-2014 winter. This section will also include the OEB's findings on the appropriate level of recovery from ratepayers associated with the penalty charges incurred by NRG during the 2013-2014 winter.

In Chapter 6, the OEB will provide findings on NRG's interest rate relief application. This chapter will set out the OEB's findings regarding whether NRG will be granted rate relief and/or a stay from the imposition of interest on the amounts due for payment to Union related to the application of certain penalty charges.

A concluding chapter will be included where the OEB will discuss the manner in which its findings shall be implemented and it will also discuss cost awards.

## 4 OEB MOTION ON DECISION AND ORDER IN UNION'S PENALTY REDUCTION PROCEEDING

### 4.1 Background

NRG is a direct purchase customer of Union. As part of its Southern Bundled Transportation contract with Union, NRG was required to rectify imbalances in its banked gas account prior to the winter checkpoint (February 28, 2014). In its April 2014 QRAM application, NRG noted that, based on the DPSR that it received from Union for the month ending January 31, 2014, it was notified that it was required to purchase 115,523 GJ of gas in order to meet its contractual obligation.<sup>22</sup>

NRG attempted to purchase the gas required to meet its contractual obligation in late February 2014. NRG purchased 90,027 GJ of natural gas in late February 2014, prior to the winter checkpoint, but stated that it was unable to purchase the remaining shortfall of 25,496 GJ in February. NRG stated that there was no gas available to be purchased and delivered to Union's system prior to February 28, 2014. As NRG did not meet its balancing obligation, Union provided the remaining shortfall quantity to NRG. Union applied a penalty charge of \$78.73 / GJ, in accordance with NRG's contract, to the 25,496 GJ of natural gas that NRG was short at the time of the winter checkpoint. This resulted in a total penalty charge of \$2,007,250.<sup>23</sup>

NRG was one of 11 Southern Bundled Transportation contract-holders that failed to meet its winter checkpoint balancing obligations and incurred penalties under the terms of its contract.<sup>24</sup> Union's shareholder does not keep the amounts arising from the penalty charges; they are instead used as an offset to the gas rates paid by Union's system gas customers.<sup>25</sup> Union recognized that the 2013-2014 winter was exceptionally

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<sup>22</sup> EB-2014-0053, Natural Resource Gas Limited Application, March 11, 2014 at Schedule 1, pp. 3-4.

<sup>23</sup> Ibid at pp. 4-5.

<sup>24</sup> EB-2014-0154, Union Gas Limited Interrogatory Responses, June 17, 2014 at Exhibit B.CME.1.

<sup>25</sup> EB-2014-0145, Decision and Order, October 30, 2014 at p. 10. The OEB set out its findings on the appropriate allocation of the amounts arising from the penalty charges applied to non-compliant direct purchase customers in Union's 2013 Deferral Account Disposition Proceeding (EB-2014-0145).

cold and sought permission from the OEB to grant a one-time reduction to the penalty charge.<sup>26</sup>

The OEB approved Union's application to reduce the penalty charge applied to NRG and Union's other direct purchase customers that did not meet their contractual obligations in February 2014 from \$78.73 / GJ to \$50.50 / GJ.<sup>27</sup> This decision reduced the penalty amount owed by NRG to Union from \$2,007,250 to \$1,287,548.

NRG filed a motion to review the decision in Union's Penalty Reduction Proceeding.<sup>28</sup> This motion was heard by the Board and dismissed.<sup>29</sup> However, the OEB noted that it was concerned that the implications of NRG's status as a natural gas distributor may not have been adequately addressed in Union's Penalty Reduction Proceeding.<sup>30</sup> On that basis, the OEB launched its own motion to review its decision in Union's Penalty Reduction Proceeding.

In this chapter, the OEB will set out its findings in regard to the questions which were identified as being part of the OEB's motion to review, namely:

- Does NRG's status as a natural gas distributor warrant a different treatment, with respect to certain penalty charges, from Union's other non-compliant direct purchase customers?
- If so, what is the impact of this consideration on setting an appropriate penalty charge to be applied to NRG for not meeting its contractual balancing obligations?

## 4.2 Findings

The OEB finds that NRG's status as a natural gas distributor does not warrant a different treatment, with respect to the applicability or quantum of the penalty charges applied to it by Union for not meeting its contractual obligations, from Union's other non-compliant direct purchase customers. As such, NRG shall pay Union the total penalty amount of \$1,287,548.

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<sup>26</sup> EB-2014-0154, Union Gas Limited Application, April 3, 2014.

<sup>27</sup> EB-2014-0154, Decision and Order, October 9, 2014 at p.5.

<sup>28</sup> EB-2014-0375, Motion to Review, December 10, 2014.

<sup>29</sup> EB-2014-0375, Decision and Order on Motion, March 13, 2015.

<sup>30</sup> Ibid at p. 5.

NRG made a number of arguments supporting its position that it should be treated differently from Union's other non-compliant direct purchase customers and should be applied a further reduced penalty charge.

The main arguments made by NRG can be categorized as follows:

- (a) NRG is unique in that it is a gas distributor, and it makes no profit from the sale of natural gas commodity to its system gas customers;
- (b) The OEB has a mandate to set just and reasonable rates and to protect the public interest; and
- (c) The OEB's Decision and Order in Union's Penalty Reduction Proceeding already set aside the sanctity of the Direct Purchase contract.

The OEB will address these arguments in order.

#### **4.2.1 NRG's Status as a Natural Gas Distributor**

NRG stated that as a monopoly distributor it does not profit from the sale of the natural gas commodity. NRG noted that under the flow-through cost-recovery model it does not earn a return on the sale of the natural gas commodity to its system supply customers. NRG argued that requiring NRG's system supply customers or its shareholder to pay a penalty cost (that is unrelated to Union's actual cost of gas) creates an undue hardship on either NRG's system supply customers or its shareholder (depending on how the cost recovery is apportioned). NRG noted that this hardship results in a windfall gain to Union's system supply customers.<sup>31</sup>

NRG also made the distinction that as a distributor it must deliver supply to its customers to meet demand. Therefore, it does not have the flexibility that other non-utility direct purchase customers (i.e. commercial, industrial, institutional) have to either

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<sup>31</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at p. 13; and EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Reply Submissions, June 1, 2015 at p. 6.

avoid over consuming relative to their contracts or to recover additional costs through higher prices for goods sold.<sup>32</sup>

NRG argued that its unique characteristics as a monopoly distributor should result in a different treatment than Union's other non-compliant direct purchase customers when the OEB fixes a penalty rate for NRG. NRG stated that the OEB should set the penalty rate for NRG at Union's average cost of gas during the winter of 2013-2014 (\$7.12 / GJ)<sup>33</sup> and weigh the analysis in favour of NRG and its customers as opposed to enforcing the penalty aspect of the contract in the context of the extreme weather conditions present during the 2013-2014 winter.<sup>34</sup>

The OEB understands that there are differences between NRG, as a distributor, and Union's other non-utility direct purchase customers. However, the OEB notes that NRG has been a direct purchase customer of Union since at least 1996. NRG chose to be a direct purchase customer of Union to obtain the least costly and most secure supply of natural gas for its own customers.<sup>35</sup> NRG does not have to be a direct purchase customer; it could instead choose to be a system supply customer of Union, in which case Union would manage all of its gas supply arrangements and it would not be subject to any balancing obligations. Regardless of the rationale for electing a direct purchase arrangement with Union, the OEB finds that NRG, just like any other direct purchase customer, has a number of responsibilities associated with its contract. One of those responsibilities is ensuring that its balancing obligations are met as required under the contract. NRG was aware, at the time that it was procuring natural gas during the 2013-2014 winter that certain penalty provisions of the contract would apply if those balancing obligations were not met.

The OEB finds that simply because NRG does not earn a "profit" on the sale of natural gas or that it has no mechanisms whereby it can control the consumption of its

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<sup>32</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at pp. 21-22.

<sup>33</sup> \$7.12 / GJ reflects the price that Union paid for 29.8 PJ of spot gas that it purchased during the 2013-2014 winter (December 12, 2013 to February 21, 2014). EB-2014-0154, Union Gas Limited Interrogatory Responses, June 17, 2014 at Exhibit B.Staff.1, p. 3.

<sup>34</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at p. 22.

<sup>35</sup> EB-2014-0053, Natural Resource Gas Limited Interrogatory Responses, October 29, 2014 at pp. 8-9.

customers, does not remove or alter NRG's responsibilities with respect to its direct purchase contract with Union. The OEB agrees with OEB staff<sup>36</sup> that the importance of NRG effectively managing the procurement of gas supply is directly linked to protecting its customers from the excessive gas costs that can arise if contractual obligations are not met. The fact that NRG does not charge a mark-up on the commodity itself is not a reason for special treatment.

The OEB notes that the purpose and intent of the penalty charge applicable to direct purchase customers that do not meet their contractual balancing obligations was established by the OEB in the RP-2001-0029 Decision with Reasons. In that decision, the OEB stated the following:

The Board accepts the premise that it is important to encourage compliance with contractual obligations to balance in a system such as Union's, where a wide variety of users are dependent on such balancing to ensure the integrity, security and efficient operation of the system. The failure to balance can place compliant system participants at risk, and may result in additional costs...

In the Board's view, the penalty must be sufficiently costly to defaulters to strongly discourage strategic non-compliance with balance obligations, and the careless or incompetent acceptance of contractual obligations which are not reasonably achievable. The Board is concerned that parties wishing to engage in the market, either directly or through agents, must be appropriately encouraged to manage their obligations responsibly. The system as a whole requires that.<sup>37</sup>

The OEB finds that the characteristics of the direct purchase customer is not relevant to the intent of the penalty regime (i.e. encouraging compliance with contractual obligations in order to protect Union's system for the benefit of all customers). Union requires that all of its direct purchase customers, regardless of whether they are a distributor or an industrial / commercial / institutional customer, to deliver sufficient gas to meet contractual obligations to ensure the integrity of Union's system.

As such, NRG's "unique status" arguments are dismissed and the reduced penalty charge established by the OEB in Union's Penalty Reduction Proceeding must apply

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<sup>36</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Oral Hearing Transcripts, May 14, 2015 at p. 86.

<sup>37</sup> RP-2001-0029, Decision with Reasons, September 20, 2002, at p. 31.

equally to NRG as it does to all of Union's other non-compliant direct purchase customers.

#### **4.2.2 The OEB's Mandate to Set Just and Reasonable Rates and to Protect the Public Interest**

NRG made a number of related arguments regarding the OEB's mandate to set just and reasonable rates and to protect the public interest. Although the Southern Bundled Transportation contract is a contract between Union and its direct purchase customers, it is still a "rate" within the meaning of the OEB Act, and any payments made under the contract must be "just and reasonable" pursuant to section 36 of the OEB Act. Moreover, Union's rate schedules include the penalty provision for failure to comply with balancing obligations.

NRG submitted that a penalty rate of \$50.50 / GJ does not reflect a rate that is just and reasonable to be applied to NRG for not meeting its contractual obligations in the 2013-2014 winter. NRG submitted that reducing the penalty charge applicable to NRG to Union's average cost of spot gas (\$7.12 /GJ) is the only reasonable rate to be fixed by the OEB given the extraordinary weather conditions experienced during the 2013-2014 winter.<sup>38</sup>

NRG also submitted that the OEB's central mandate is to protect the public interest. NRG stated that the public interest is best protected by reducing the penalty charge to Union's cost of gas and eliminating any windfall to Union's system supply customers, which occurs at the detriment of NRG's shareholder or its system supply customers. NRG further stated that its request allows the OEB to exercise its central mandate at no cost to Union or anyone else on Ontario's natural gas system.<sup>39</sup>

NRG's arguments that it must be treated differently than other non-compliant direct purchase customers for the OEB to set just and reasonable rates and protect the public interest presumes that the penalty amount would be passed on to NRG's system supply customers. This will not be the case.

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<sup>38</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at p. 15.

<sup>39</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Reply Submissions, June 1, 2015 at p. 9.

An objective of the OEB, as established by the OEB Act, is to protect the interests of consumers with respect to prices and the reliability and quality of gas service.<sup>40</sup> The OEB finds that it would not be reasonable for NRG's system supply customers to be burdened with the penalty costs, which were incurred as a result of insufficient care and attention given by NRG to its gas supply requirements over the 2013-2014 winter. As will be discussed further in Chapter 5, NRG's actions were not prudent. As such, the OEB will ensure that the interests of NRG's ratepayers will be protected with respect to the price of gas service by apportioning some of the costs resulting from the application of the penalty charge to NRG's shareholder. The OEB will also meet another objective, as established in the OEB Act, to facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas<sup>41</sup> through the payment schedule that it will establish for the repayment of the penalty amount by NRG.

NRG is also itself a customer of Union, and is subject to the protections set out in the OEB's objectives. However, for the reasons set out in section 4.2.1, the OEB finds that the penalty amount is just and reasonable.

The OEB recognizes that its findings requiring NRG to pay the entire reduced penalty amount results in a benefit to Union's system supply customers, as the penalty amounts collected from all of the direct purchase customers who failed to balance are used to offset the natural gas costs for these customers. The OEB sees nothing improper in this arrangement. Using the penalty as an offset for other customers of Union ensures that Union receives no benefit from the penalty (other than the benefit of encouraging direct purchase customers to balance and ensuring the integrity of its system), and has no incentive to see its direct purchase customers fail to balance at the checkpoints.

#### **4.2.3 The "Sanctity" of the Direct Purchase Contract**

NRG also argued that the findings made by the OEB in its Decision and Order in Union's Penalty Reduction Proceeding, which reduced the penalty charge applicable to Union's non-compliant direct purchase customers, sets aside the "sanctity" of the direct purchase contract with the intent of serving the public interest. NRG argued that, as the

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<sup>40</sup> Ontario Energy Board Act, 1998, Section 2, part 2.

<sup>41</sup> Ontario Energy Board Act, 1998, Section 2, part 5.1.

sanctity of the contract has already been set aside by the OEB, the OEB can further reduce the penalty applicable to NRG without undermining the purpose and intent of the penalty provisions in the context of the extraordinary weather conditions experienced during the 2013-2014 winter.<sup>42</sup>

NRG also argued that it, as a natural gas distributor that does not profit from the sale of natural gas, has no incentive to default in the supply of gas to Union as part of its contractual balancing obligations.<sup>43</sup>

The OEB, in EB-2014-0154, was already asked by Union to consider a reduction to the penalty amount in the context of the exceptional weather conditions experienced in the 2013-2014 winter. The OEB in its decision granted Union approval to reduce the penalty charge applicable to all non-complaint direct purchase customers. In its decision, the OEB stated:

The Board is of the view that Union's proposed reduction of the penalty charges to the second-highest spot cost of gas at Dawn in the month which the gas was sold is appropriate considering the exceptional circumstances that affected customers during the winter of 2014. The 2014 winter was extraordinary and it is in the context of this anomalous winter that the Board is granting Union approval to reduce the penalty charges. This is an unprecedented step by the Board, and should not be seen as an invitation to utilities or their customers to seek a reduction in penalty charges in general. The Board finds that in this case, the reduced penalty as proposed by Union continues to achieve the intent of the penalty charges as established by the Board in RP-2001-0029. 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. The Board considers Union's proposed penalty to be appropriate in striking this balance.<sup>44</sup>

The OEB does not agree with NRG's assertion that the OEB can further reduce the penalty applicable to NRG without undermining the purpose and intent of the penalty

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<sup>42</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Reply Submissions, June 1, 2015 at pp. 4-8.

<sup>43</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at p. 15.

<sup>44</sup> EB-2014-0154, Decision and Order, October 9, 2014 at p. 6.

provisions in the context of the extraordinary weather conditions experienced during the 2013-2014 winter. The OEB already considered the extraordinary weather conditions in making its decision to reduce the penalty charge to \$50.50 / GJ in Union's Penalty Reduction Proceeding. Also, the OEB's decision, set out above, clearly states that the reduced penalty charge proposed by Union of \$50.50 / GJ achieves the intent of the penalty regime.

The OEB finds that a further reduction to the penalty charge would not continue to uphold the intent of the penalty regime. As argued by OEB staff, if the OEB were to approve a penalty charge for NRG at Union's average cost of gas, and in the future, natural gas prices were high at a time that NRG is required to balance in accordance with its contractual obligations, NRG could be incentivized towards contractual default and an after the fact attempt to reduce the penalty charge to a lower price. The OEB agrees with OEB staff's statement that "this squarely undermines the intent of the penalty and puts Union's system at future risk".<sup>45</sup>

For all of the above reasons, the OEB finds that NRG's status as a natural gas distributor does not warrant a different treatment, with respect to certain penalty charges, from Union's other non-complaint direct purchase customers. As such, the OEB orders that NRG pay Union the entire penalty amount of \$1,287,548.

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<sup>45</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Oral Hearing Transcripts, May 14, 2015 at p. 90.

## 5 NRG APRIL 2014 QRAM - PHASE 2 REVIEW

### 5.1 Background

As part of its April 2014 QRAM Application, NRG requested that the OEB approve the recovery of costs from its system supply customers related to the penalty charge applied to NRG by Union of \$2,007,250 for the 25,496 GJ (\$78.73 / GJ) of natural gas that NRG was short relative to its contractual balancing obligation.<sup>46</sup> As discussed previously, the amount of the penalty was later reduced by the OEB to \$1,287,548.

The OEB approved NRG's application, as filed, on an interim basis with one exception. In regard to the penalty charge applied to NRG by Union, the OEB allowed NRG to recovery from its customers on system supply a reduced amount of \$695,429 (25,496 GJ at a cost of \$27.276 / GJ) on an interim basis.<sup>47</sup> The OEB also stated that NRG's requests had not been sufficiently evaluated during the proceeding and ordered the continued review of NRG's application in the Phase 2 Review.<sup>48</sup>

Below, the OEB will set out its findings regarding the recovery from system supply customers of the penalty charges applied to NRG by Union related to the 25,496 GJ of gas that NRG was short relative to its contractual balancing obligation.

### 5.2 Findings

The OEB finds that NRG's system supply customers shall pay only the portion of the penalty amount equivalent to Union's average cost of gas for the 25,496 GJ of gas that NRG was short relative to its contractual balancing obligation (\$181,531).<sup>49</sup> NRG's system supply customers would have paid this amount for the purchase of 25,496 GJ of gas had NRG managed to procure incremental natural gas supply at the same average cost that Union did over the 2013-2014 winter period. The OEB finds that \$7.12 / GJ reflects a reasonable price for natural gas that could have been attained had NRG

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<sup>46</sup> EB-2014-0053, Natural Resource Gas Limited Application, March 11, 2014 at Schedule 1, p. 5.

<sup>47</sup> EB-2014-0053, Decision and Interim Order, April 1, 2014 at p. 5.

<sup>48</sup> Ibid.

<sup>49</sup> This amount is calculated as follows: \$7.12 / GJ (Union's average cost of gas) x 25,496 GJ (NRG's shortfall relative to its contractual obligations at the winter checkpoint) = \$181,531.

managed its gas supply procurement in a prudent manner over the 2013-2014 winter. NRG shall pay to Union the portion of the penalty amount associated with Union's average cost of gas (i.e. \$181,531), which has already been collected from system gas customers, no later than March 1, 2016 (the March 2016 Payment).

NRG's shareholder shall be responsible for paying the remainder of the penalty amount (\$1,106,016)<sup>50</sup> due to NRG's imprudent management of its gas supply procurement during the 2013-2014 winter. The OEB expects that no reduction in planned capital or operating costs will result from the OEB's decision. In other words, NRG's ratepayers shall not, in any way, be burdened by the incremental costs of the penalty charges that are above Union's average cost of gas.

The reasons for the OEB's decision are set out below.

Under section 36 of the OEB Act, all rates approved by the OEB must be just and reasonable. In situations where the OEB determines that costs have been imprudently incurred by a distributor, the OEB has a responsibility to disallow the recovery of those costs from ratepayers. The OEB recognizes that it is conducting an "after the fact" analysis of NRG's actions. After the fact reviews are sometimes referred to as "prudence reviews"; however the Supreme Court has recently confirmed that "prudence" in this context has essentially the same meaning as "reasonable" as taken from the wording of section 36 of the OEB Act.<sup>51</sup> In making its decision, the OEB has considered only what NRG knew, or reasonably ought to have known, at the time its gas procurement decisions (or lack thereof) were made.

The OEB finds that NRG did not fulfill its duty to its customers to manage natural gas procurement in a reliable, prudent and cost-effective manner during the 2013-2014 winter. The OEB finds that NRG's decision to wait until near the end of February 2014 to purchase gas to meet its balancing obligations with Union was not prudent. NRG's decision ignored information that it had, or ought to have had, during the 2013-2014 winter.

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<sup>50</sup> The remainder of the penalty amount is the difference between the total penalty amount (\$1,287,548) and the amount to be paid by ratepayers based on Union's average cost of gas (\$181,531). The amount to be paid by NRG's shareholder is \$1,106,016.

<sup>51</sup> *ATCO Gas and Pipelines Ltd. v. Alberta (Utilities Commission)*, 2015 SCC 45 (CanLii), para 35.

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The OEB notes that NRG receives a DPSR from Union each month, which sets out the expected balance in its banked gas account with Union at the time of next balancing checkpoint. In this case, the winter checkpoint (February 28) is the relevant balancing checkpoint. NRG's December 2013 DPSR, which NRG would have received in early January 2014, indicates that that NRG started its contract year (October 2013) with a negative balance in its banked gas account. The same report also indicates that beginning in October 2013 NRG's actual monthly consumption was higher than its contracted forecast monthly consumption.<sup>52</sup> This leads to a deficit in the banked gas account at the time of the winter checkpoint if no incremental gas purchases are made and delivered to Union.

Based on the information contained in the DPSRs, the OEB also finds that NRG was aware that the expected shortfall in its banked gas account was growing larger over the winter period.<sup>53</sup> NRG knew that it was in a growing deficit position and could have purchased incremental natural gas in order to balance its banked gas account at virtually anytime over the 2013-2014 winter period. However, NRG took no action until the days immediately prior to the winter checkpoint.

NRG noted several times that the winter of 2013-2014 was unprecedented in terms of cold weather.<sup>54</sup> No one disputes that the winter was very cold. However, an unusually cold winter does not remove NRG's contractual obligation to balance at the winter checkpoint. Although prices were high, natural gas was available for purchase at virtually every point of the winter. The vast majority of Union's other Southern Bundled

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<sup>52</sup> The OEB is referencing NRG's December 2013 DPSR as it is the earliest report that is filed on the record in the combined proceeding related to the 2013-2014 winter. However, the OEB notes that NRG would have received a DSPR for each of October 2013 and November 2013 that would have also highlighted that beginning in October 2013, NRG's actual monthly consumption was higher than its contracted forecast monthly consumption. Therefore, NRG would have been aware as early as November 2013 (which is when it would have received its October 2013 DPSR) that it was expected to be short of gas at the time of the winter checkpoint if it took no action to balance. EB-2014-0053, Natural Resource Gas Limited Interrogatory Responses, March 19, 2014 at Schedule 3 (and related updated filings).

<sup>53</sup> NRG's DPSRs for December 2013 and January 2014 highlight this growing deficit in NRG's banked gas account. EB-2014-0053, Natural Resource Gas Limited Interrogatory Responses, March 19, 2014 at Schedule 3 (and related updated filings).

<sup>54</sup> For example, EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at p. 8.

Transportation direct purchase customers were able to balance despite the weather conditions.<sup>55</sup>

The OEB finds that the wait-and-see strategy followed by NRG during the 2013-2014 winter resulted in NRG attempting to purchase the entire gas shortfall (115,523 GJ) in a compressed time period, which greatly increased the risk borne by system gas customers. There was no need for NRG to wait until the days immediately prior to the checkpoint to attempt to purchase its entire balancing shortfall. By waiting until the last moment, NRG took a risk that gas prices could be very high (or potentially that gas supply would not be available at all). The fact that previous winters had not been so cold did not mean that such a risk was not foreseeable. In the end, NRG was unable to purchase 25,496 GJ of gas to meet its contractual obligations with Union, which resulted in Union applying a penalty charge of \$50.50 / GJ (as reduced by the OEB in Union's Penalty Reduction Proceeding). It was NRG's choice to wait until the eve of the winter checkpoint to try to purchase the gas it was contractually obligated to provide. The fault for failing to balance and breaching the contract lies entirely with NRG, and it would not be reasonable to pass the costs of this breach onto NRG's system supply customers.

The OEB finds that the penalty cost incurred by NRG was caused by NRG's decision to wait until the end of February to purchase the gas necessary to rectify the imbalance in its banked gas account with Union. This decision was not reasonable under the circumstances that the OEB found above were known, or ought to have been known, by NRG at the time the decision was made (namely, that it was well aware over the winter period that it would be short a significant quantity of gas in its banked gas account at the time of winter checkpoint). The OEB finds that NRG's lack of action to rectify the imbalances in its banked gas account during the 2013-2014 winter was not reasonable in the circumstances that were present during the winter period.

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<sup>55</sup> Union noted that of its approximately 600 Union South Bundled Transportation contracts, only 11 of these contracts were not in balance at the time of the winter checkpoint. EB-2014-0154, Union Gas Limited Interrogatory Responses, June 17, 2014 at Exhibit B.CME.1.

The OEB finds that it is precisely the circumstances of an extraordinary winter, characterized by colder than normal weather, that require a gas distributor to be proactive in the management of gas supply for its customers. NRG failed in this regard.

Similar to the OEB findings set out in the E.B.R.O. 486-04 Decision with Reasons<sup>56</sup> (which are discussed below), the OEB expects that NRG would have spread its incremental gas purchases over the winter period in order to diversify the risk associated with the incremental gas purchases. The OEB finds that a prudent strategy would have been to begin to layer in its incremental gas purchases earlier in the winter period given the information that NRG had regarding its expected banked gas account shortfall. A proactive layering strategy would have minimized the risk that no gas was available to purchase and NRG would have avoided the penalty charges associated with its contractual default.

NRG argued, at many times during the proceeding, that as it does not earn a profit from the sale of the natural gas commodity, these costs should be passed through to its ratepayers. Specifically, NRG stated that the gas supply costs that it incurred resulting from the spike in natural gas prices during the 2013-2014 winter was "...never part of the risk that an Ontario utility was meant to take under the *Ontario Energy Board Act* regime."<sup>57</sup>

The OEB finds that because gas commodity costs are a pass-through for NRG does not change the fact that the OEB has a responsibility to ensure that rates are just and reasonable. As argued by OEB staff, many costs incurred by utilities can be considered a form of pass-through, including O&M costs for which the utility earns no return.<sup>58</sup> If the OEB finds that any costs incurred by a distributor are not incurred in a prudent manner, those costs are subject to potential disallowance irrespective of whether the costs do, or do not, generate profits for the utility. The OEB Act makes no distinction between costs for which the utility earns a direct return, and those for which it does not.

The OEB also notes that it has, in the past, made disallowances associated with gas commodity costs. In E.B.R.O. 486-04, the OEB made a finding to disallow recovery of

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<sup>56</sup> E.B.R.O. 486-04, Decision with Reasons, April 12, 1996 at pp. 16-17.

<sup>57</sup> EB-2014-0053, Natural Resource Gas Limited Argument-in-Chief, November 5, 2014 at p. 16.

<sup>58</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Oral Hearing Transcripts, May 14, 2015 at pp. 97-98.

certain gas costs associated with spot gas purchases made by Union. The OEB in that decision said:

The Board would have expected Union to have undertaken a plan to spread its spot gas purchases more evenly over the winter period. The Board is of the view that once Union had identified the 12 Bcf shortfall, it should have taken immediate steps to purchase at least 3 Bcf of spot gas in December to accomplish a more even spreading of spot gas purchases...

The Board finds that the amount of \$5.140 million is most appropriately borne by the shareholder and directs that this amount be removed from the PGVA debit.<sup>59</sup>

NRG argued that the findings in the E.B.R.O. 486-04 Decision with Reasons is not an appropriate comparison to NRG as the disallowance of \$5.14 million only represented approximately 2.5% of Union's net income.<sup>60</sup> NRG submitted that the disallowances recommended by OEB staff represent a significantly larger portion of NRG's net income and the size of the disallowance will negatively impact NRG financially to an extent that renders regulation unprofitable.<sup>61</sup>

The OEB finds that the principle espoused in the E.B.R.O. 486-04 Decision with Reasons is the important factor and not the amount that was disallowed. The OEB, in that decision, found that Union did not manage its gas supply procurement appropriately and therefore directed that some of the incremental costs be borne by its shareholder. The OEB recognizes that the disallowance is significant relative to NRG's shareholder returns (just as the penalty would be a significant burden on system supply customers had the OEB required them to pay it). The OEB finds that the payment schedule set out below appropriately balances the need to protect NRG's ratepayers and protect the financial viability of NRG.

NRG also argued that the evidence it filed with regard to the prudence its gas supply procurement during the 2013-2014 winter is uncontested. NRG noted that no party filed

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<sup>59</sup>E.B.R.O. 486-04, Decision with Reasons, April 12, 1996 at pp. 16-17.

<sup>60</sup> The OEB notes that this is a calculation that was provided in argument by NRG. EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Reply Submission, June 1, 2015 at p. 13.

<sup>61</sup> NRG referred to an argument made by OEB staff to disallow the recovery of \$870,000 from system supply customers. EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Reply Submission, June 1, 2015 at p. 14.

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evidence to the contrary nor did any party cross-examine on NRG's evidence. NRG argued that since no party cross examined NRG on its evidence, all of NRG's evidence must be accepted and that the prudence of NRG's actions cannot be questioned.<sup>62</sup>

The OEB does not agree. Prudence is not a "fact" that can be sworn to in an affidavit. Prudence (or imprudence) is a conclusion arrived at after reviewing the facts. Clearly a utility (or any party) cannot "prove" prudence simply by stating that it was prudent. It is not the role of a party to a proceeding to determine prudence; it is the role of the OEB. As described in detail above, the OEB reviewed the evidence in this proceeding and determined that NRG did not act in a prudent manner.

The OEB is legally required to set just and reasonable rates. It has done so in this instance by protecting NRG's ratepayers from the incremental costs of the penalty charges incurred due to NRG's imprudent management of its natural gas procurement during the 2013-2014 winter. However, the OEB also has a responsibility to facilitate the maintenance of a financially viable gas industry for the transmission, distribution and storage of gas.<sup>63</sup>

The OEB recognizes that the penalty amount that NRG's shareholder is required to pay is significant relative to NRG's annual shareholder returns. In order to ensure that NRG can continue to meet its obligations to supply service to its customers and also meet its obligations to pay Union the penalty amount, the OEB will design a payment plan that considers NRG's ability to pay the charges from the proceeds of its regulated business. Therefore, NRG is required, at a minimum, to pay Union the greater of 50% of its annual shareholder return or \$100,000 each year until the penalty amount is entirely paid. Based on an average of NRG's annual shareholder returns between 2011-2013, the entire penalty amount is estimated to be paid in full within approximately 5 years (if NRG makes only the minimum payment each year).<sup>64</sup> The first annual payment is due by April 30, 2016 and will be based on NRG's 2015 shareholder returns. Each year,

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<sup>62</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Written Submission Summary, May 14, 2015 at p.23; and EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Natural Resource Gas Limited Reply Submission, June 1, 2015 at p. 13.

<sup>63</sup> Ontario Energy Board Act, 1998, Section 2, part 5.1.

<sup>64</sup> Between 2011 and 2013, NRG's average shareholder return was \$459,157. Based on 50% of the average shareholder return, the debt will be repaid in 4.8 years (\$1,106,016 / \$229,578). EB-2014-0053, Natural Resource Gas Limited Interrogatory Responses, October 29, 2014 at p. 16.

thereafter, until NRG's debt related to the penalty amount is entirely paid, NRG shall make its payments no later than April 30<sup>th</sup> and be based on the previous year's shareholder return (the Annual Payment).

To ensure that NRG makes its payments by the deadlines set out above, interest will apply to the March 2016 Payment amount and the Annual Payment amount (as established above) beginning on the day after the payment deadline. The interest rate shall be set at Union's standard late payment rate of 1.50% per month.<sup>65</sup> NRG's shareholder shall be responsible for any financing costs that arise due to late payment. The OEB's detailed findings on NRG's request for interest rate relief are set out in Chapter 6.

The other approvals granted, on an interim basis, in the OEB's April 1, 2014 Decision and Interim Order in NRG's April 2014 QRAM proceeding, which are not specifically discussed above, are made final by this decision.

For all of the above reasons, the OEB finds that NRG did not manage its gas supply procurement during the 2013-2014 winter in a prudent manner. As such, the OEB will disallow the recovery from NRG's system supply customers the penalty costs incurred above Union's average cost of gas (\$181,531). NRG's shareholder is ordered to pay the remainder of the penalty amount (\$1,106,016) in accordance with the payment schedule established above.

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<sup>65</sup> Union's standard late payment charge is equal to 1.5% per month or 18% per annum (for an approximate effective rate of 19.56% per annum).

## 6 STAY / RATE RELIEF FROM THE IMPOSITION OF INTEREST RELATED TO THE APPLICATION OF PENALTY CHARGES

### 6.1 Background

NRG filed an application requesting that no interest charges be applied to the penalty amount until such time that a final order is issued by the Divisional Court and / or the OEB.<sup>66</sup>

The OEB granted an interim order that interest will not be charged to NRG prior to the OEB making a final decision on the penalty charges.<sup>67</sup>

### 6.2 Findings

On a final basis, the OEB will grant NRG a stay from the interest charges applicable to the penalty amount. No interest shall be applied to the outstanding balance owed by NRG to Union in relation to the penalty charges except as discussed below.

In the normal course, interest would begin to accrue on the penalty charges at the time that Union sent NRG an invoice for payment.

The OEB notes that there are two distinct aspects of the penalty charge of \$1,287,548: (a) an amount associated with the actual expense incurred by Union to supply NRG with gas to meet its balancing shortfall (\$181,531)<sup>68</sup>; and (b) an incremental penalty charge (\$1,106,016)<sup>69</sup>.

In regard to the portion of the penalty amount that is related to the actual expense incurred by Union, the OEB notes that NRG attempted to make a payment for this

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<sup>66</sup> EB-2014-0361, Natural Resource Gas Limited Application, December 1, 2014.

<sup>67</sup> EB-2014-0361, Notice of Application and Interim Order, December 19, 2014 at p. 1.

<sup>68</sup> This amount represents NRG's balancing shortfall quantity (25,496 GJ) x Union's average cost of gas (\$7.12 / GJ) for the relevant period.

<sup>69</sup> This amount is the difference between the total penalty amount (\$1,287,548) and the amount related to Union's average cost of gas (\$181,531).

amount and Union rejected its payment.<sup>70</sup> Therefore, for this portion of the penalty amount, the OEB finds that NRG should not be penalized, through the retroactive application of interest charges, as it did undertake reasonable steps to make this payment.

In regard to the incremental penalty charge, the OEB notes that Union incurred no carrying costs associated with this amount. The OEB finds that applying interest charges retroactively to this portion of the penalty amount is not necessary as Union incurred no carrying costs and no further disincentive to NRG's shareholder is required.

For all of the above reasons, no interest charges shall be applicable retroactively to any portion of the outstanding penalty amount owed by NRG to Union.

However, the OEB, in Chapter 5, established a schedule for NRG to pay the outstanding penalty amount and to ensure that the payments are made on, or before, the established deadlines, interest will be applied as follows:

- Interest will apply to the March 2016 Payment amount beginning on the day after the deadline for the payment. The interest rate shall be set at Union's standard late payment rate of 1.50% per month.
- Interest will apply to the Annual Payment amount beginning on the day after the deadline for the payment. The interest rate shall be set at Union's standard late payment rate of 1.50% per month.

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<sup>70</sup> EB-2014-0361, Natural Resource Gas Limited Application, December 1, 2014 at pp. 2-4.

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## 7 CONCLUSION

### 7.1 Implementation

In its April 1, 2014 Decision and Interim Order in EB-2014-0053, the OEB allowed NRG to recover from system supply customers \$695,429 related to the penalty charges applied by Union.<sup>71</sup> On the basis of the findings in Chapter 5, the amount now approved for recovery is \$181,531. As such, NRG must refund to its system supply customers the difference between the amount that was previously collected and the lower amount that is now approved for ratepayer recovery. The OEB directs NRG to refund this amount to its system supply customers as part of its next QRAM application. The OEB directs NRG to provide sufficient evidence in its next QRAM application to allow the OEB to determine that the credit amount was calculated and allocated appropriately. NRG must also provide the bill impact that occurs due to the disposition of this credit as part of its QRAM evidence.

The OEB orders NRG to pay Union the portion of the penalty amount already collected from its system supply customers (\$181,531) (the March 2016 Payment) by March 1, 2016. NRG shall file a letter with the OEB (under OEB File No. EB-2014-0053 / EB-2014-0361 / EB-2015-0044) advising the date that this payment was made.

In addition, NRG shall make the Annual Payment, calculated in the manner set out by the OEB in Chapter 5, no later than April 30 each year. Each year, NRG shall file a letter with the OEB (under OEB File No. EB-2014-0053 / EB-2014-0361 / EB-2015-0044) advising: (a) the date that the Annual Payment was made; (b) the amount that was paid (including a detailed calculation for the payment); and (c) the penalty amount remaining to be paid.

### 7.2 Cost Awards

The OEB may grant cost awards to eligible parties pursuant to its power under section 30 of the OEB Act. When determining the amount of the cost awards, the OEB will apply the principles set out in section 5 of the OEB's Practice Direction on Cost Awards.

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<sup>71</sup> EB-2014-0053, Decision and Interim Order, April 1, 2014 at p. 5.

The maximum hourly rates set out in the OEB's Cost Awards Tariff will also be applied. The OEB notes that filings related to cost awards shall be made in accordance with the schedule set out below.

NRG shall be responsible for paying the costs awarded to eligible parties by the OEB for their participation in any of the proceedings that became part of this combined proceeding.

## 8 ORDER

### THE BOARD ORDERS THAT:

1. NRG shall refund its system gas customers \$513,898, which is the difference between the amount that was previously approved for collection related to the penalty charge in the OEB's Decision and Interim Order in EB-2014-0053 (\$695,429) and the reduced amount approved for recovery by the OEB in this Decision and Order (\$181,531).
2. NRG shall no later than March 1, 2016 pay Union \$181,531.
3. NRG shall pay Union the remainder of the penalty amount (\$1,106,016) in accordance with the payment schedule established by the OEB in Chapter 5 of this Decision and Order.
4. The approvals granted, on an interim basis, in the OEB's April 1, 2014 Decision and Interim Order in EB-2014-0053 that are not specifically changed by this decision are approved on a final basis.
5. Eligible intervenors shall file with the OEB, and forward to NRG, their respective cost claims no later than **January 28, 2016**.
6. NRG shall file with the OEB, and forward to the intervenors, any objections to the claimed costs of the intervenors no later than **February 11, 2016**.
7. If NRG objects to the intervenor costs, intervenors shall file with the OEB, and forward to NRG, any responses to any objections for cost claims no later than **February 18, 2016**.

All filings to the OEB must quote the file number, **EB-2014-0053 / EB-2014-0361 / EB-2015-0044** and be made electronically in searchable/unrestricted PDF format through the OEB's web portal at <https://www.pes.ontarioenergyboard.ca/eservice/>. Two paper copies must also be filed. Filings must clearly state the sender's name, postal address

and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at <http://www.ontarioenergyboard.ca/OEB/Industry>. If the web portal is not available, parties may email their documents to the address below.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Lawrie Gluck at [Lawrie.Gluck@ontarioenergyboard.ca](mailto:Lawrie.Gluck@ontarioenergyboard.ca) and Board Counsel, Michael Millar at [Michael.Millar@ontarioenergyboard.ca](mailto:Michael.Millar@ontarioenergyboard.ca).

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**DATED** at Toronto January 14, 2016

**ONTARIO ENERGY BOARD**



Kirsten Walli  
Board Secretary

**SCHEDULE A**  
**DECISION AND ORDER**  
**NATURAL RESOURCE GAS LIMITED**  
**EB-2014-0053 / EB-2014-0361 / EB-2015-0044**  
**PROCEDURAL HISTORY**  
**JANUARY 14, 2016**

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## Procedural History

NRG filed its April 2014 Quarterly Rate Adjustment Mechanism (QRAM) application on March 11, 2014 pursuant to section 36(1) of the *Ontario Energy Board Act, 1998* (OEB Act), for an order approving rates and other charges for the sale and distribution of natural gas commencing April 1, 2014.<sup>1</sup> This request was made in accordance with the QRAM established by the OEB for dealing with changes in gas costs for all rate regulated gas distributors. The proceeding was assigned OEB File No. EB-2014-0053.

One of the primary issues that was addressed in NRG's April 2014 QRAM proceeding is whether NRG's gas supply procurement was prudent during the 2013-2014 winter. Associated with this issue is the appropriate treatment of penalty charges incurred by NRG as a result of not meeting certain contractual obligations that it has with Union.

In its April 2014 QRAM application, NRG requested that the OEB approve the recovery of penalty charges it incurred for not meeting its contractual obligations. The total penalty amount, for which NRG sought recovery, was \$2,007,250.<sup>2</sup>

After the filing of NRG's April 2014 QRAM application, the OEB received a number of letters of comment.

The OEB issued a Decision and Interim Order on April 1, 2014.<sup>3</sup> In the Decision and Interim Order, the OEB approved NRG's application as filed on an interim basis, with one exception. In regard to the penalty amount, the OEB approved recovery from ratepayers of a reduced amount of \$695,429. This amount is based on the average cost of NRG's spot gas purchases that it made in February 2014 (\$27.276 / GJ) multiplied by the balancing shortfall quantity of 25,496 GJ.<sup>4</sup>

A QRAM proceeding is typically a short, largely mechanical hearing in which a utility's natural gas commodity costs from the last quarter are passed on to ratepayers through rates, and a new gas cost forecast for the next quarter is established. However, given the abbreviated and written nature of QRAM proceedings, the OEB determined that the penalty issue would have to be dealt with separately from the ordinary QRAM issues. Therefore, the OEB moved the penalty issue to a separate phase of the proceeding known as "the Phase 2 Review" (which remained under the same OEB file number).<sup>5</sup>

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<sup>1</sup> EB-2014-0053, Natural Resource Gas Limited Application, March 11, 2014.

<sup>2</sup> *Ibid.* at Schedule 1, p. 5.

<sup>3</sup> EB-2014-0053, Decision and Interim Order, April 1, 2014.

<sup>4</sup> *Ibid.* at p. 5.

<sup>5</sup> *Ibid.*

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The OEB launched the Phase 2 Review with the issuance of a Notice of Application on May 2, 2014.<sup>6</sup> The purpose of the Phase 2 Review was to consider the prudence of NRG's conduct with respect to its attempts to balance at the winter 2014 checkpoint. Ultimately, the proceeding would determine who should pay the penalty: NRG or its ratepayers.<sup>7</sup>

The OEB received some additional letters of comment but did not receive any requests for intervenor status. The Phase 2 Review was subsequently placed on hold pending the release of the OEB's Decision related to a request from Union to reduce certain penalty charges applicable to non-compliant direct purchase customers.<sup>8</sup>

Union filed an application with the OEB on April 3, 2014 seeking approval to, on a one-time basis, reduce the penalty from the highest daily spot price at Dawn in February (\$78.73) to the second highest daily spot price at Dawn in February (\$50.50) (Union Penalty Reduction Proceeding).<sup>9</sup> The proceeding was assigned OEB File No. EB-2014-0154. The OEB's approval was required for such a reduction because the penalty is a component of Union's rates, and any changes to a rate must be approved by the OEB. NRG was one of the intervenors in Union's Penalty Reduction Proceeding.

After holding a hearing, the OEB approved Union's application in its October 9, 2014 Decision and Order.<sup>10</sup> In that decision, the OEB approved Union's request to reduce the penalty charge applied to NRG and Union's other direct purchase customers that did not meet their contractual obligations in February 2014 from \$78.73 / GJ to \$50.50 / GJ.<sup>11</sup> As a result, all direct purchase customers who failed to balance at the winter checkpoint saw their penalties reduced by approximately 36%. The total amount applicable to NRG was reduced from \$2,007,250 to \$1,287,548.

After the release of the OEB's Decision and Order in Union's Penalty Reduction proceeding on October 9, 2014, the OEB resumed the Phase 2 Review in NRG's April 2014 QRAM proceeding.<sup>12</sup> The OEB received submissions from NRG and OEB staff.

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<sup>6</sup> EB-2014-0053, Notice of Application, May 2, 2014.

<sup>7</sup> EB-2014-0053, Ontario Energy Board Correspondence, May 8, 2014.

<sup>8</sup> EB-2014-0053, Ontario Energy Board Correspondence, June 17, 2014.

<sup>9</sup> EB-2014-0154, Union Gas Limited Application, April 3, 2014 at p. 1.

<sup>10</sup> EB-2014-0154, Decision and Order, October 9, 2014.

<sup>11</sup> Ibid at p. 5.

<sup>12</sup> EB-2014-0053, Procedural Order No. 1, October 10, 2014.

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On November 19, 2014, NRG requested, as part of the Phase 2 Review, the opportunity to review certain consultant reports that it expected would be released as part of the 2014 Natural Gas Market Review.<sup>13</sup> The OEB granted NRG's request.

Subsequently, NRG filed another letter on December 5, 2014 requesting an oral hearing to make further argument in the Phase 2 Review, based on the information that it received from the 2014 Natural Gas Market Review. In that letter, NRG also stated that it would be filing a Motion to Review the OEB's Decision in Union's Penalty Reduction Proceeding.<sup>14</sup>

Prior to filing its Motion to Review of the Decision and Order in Union's Penalty Reduction Proceeding, NRG filed an application for interest rate relief associated with the penalty charges applied to NRG by Union.<sup>15</sup> Specifically, NRG requested that the OEB declare that NRG pay only Union's average cost of gas for the 25,496 GJ of gas that NRG was short at the winter checkpoint and that no interest charges be applied to the penalty amount until such time that a final order is issued by the Divisional Court and / or the OEB. The proceeding was assigned OEB File No. EB-2014-0361.

On December 19, 2014, the OEB issued a Notice of Application and Interim Order. In the Interim Order, the OEB recognized that interest will continue to accrue on the outstanding balance related to the penalty charges pending the OEB's decision on NRG's request. As such, the OEB, under section 21(7) of the OEB Act, granted an interim order that interest will not be charged to NRG until after the OEB made its final decision on the penalty charges.<sup>16</sup>

On December 10, 2014, NRG filed a Motion to Review the Decision and Order in Union's Penalty Reduction Proceeding (NRG Motion) under Rule 40 of the OEB's Rules of Practice and Procedure.<sup>17 18</sup> This motion proceeding was assigned OEB File No. EB-

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<sup>13</sup> EB-2014-0053, Natural Resource Gas Limited Correspondence, November 19, 2014. In its letter, NRG requested the opportunity to review certain reports that were to be released in the Natural Gas Market Review under OEB File No. EB-2014-0289.

<sup>14</sup> EB-2014-0053, Natural Resource Gas Limited Correspondence, December 5, 2014.

<sup>15</sup> EB-2014-0361, Natural Resource Gas Limited Application, December 1, 2014.

<sup>16</sup> EB-2014-0361, Notice of Application and Interim Order, December 19, 2014 at p. 1.

<sup>17</sup> EB-2014-0375, Motion to Review, December 10, 2014.

<sup>18</sup> On November 6, 2014, NRG appealed the OEB's October 9, 2014 Decision and Order in Union's Penalty Reduction Proceeding to the Divisional Court. In its December 10, 2014, Motion to Review, NRG asked Union and the OEB to consent to a stay of the appeal. Union and the OEB consented to NRG's request that the Divisional Court appeal be stayed until after the OEB made its final decision on NRG's Motion of the EB-2014-0154 Decision and Order. The OEB issued its Decision on NRG's Motion of the Union Penalty Reduction Proceeding on March 13, 2015. NRG has not, at the time of drafting this decision, perfected its appeal.

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2014-0375. NRG filed its Motion on the basis that new evidence arose in the OEB's 2014 Natural Gas Market Review that it did not have at the time that Union's Penalty Reduction Proceeding was ongoing. The OEB adopted Union and the intervenors from Union's Penalty Reduction Proceeding as intervenors in NRG's motion to review proceeding. The OEB proceeded by way of an oral hearing. The OEB received a written submission from the Canadian Manufacturers and Exporters (CME) and heard oral argument from OEB staff, Union and NRG.

The OEB issued its Decision and Order on NRG's Motion on March 13, 2015. The OEB dismissed NRG's Motion on the basis that the threshold test was not met. However, in the Decision and Order, the OEB stated that it did have some concerns with the narrow question of whether the implications of NRG's status as a natural gas distributor regulated by the OEB was thoroughly addressed in Union's Penalty Reduction Proceeding.<sup>19</sup>

On the basis of its findings on NRG's Motion, the OEB issued a Notice of Motion and Procedural Order No. 3 on March 13, 2015 in which it launched its own motion to review the October 9, 2014 Decision and Order in Union's Penalty Reduction Proceeding with respect to the appropriate penalty charge applicable to NRG.<sup>20</sup> The OEB's motion proceeding was assigned OEB File No. EB-2015-0044.

In the Notice of Motion and Procedural Order No. 3, the OEB combined the motion to review<sup>21</sup> with NRG's interest rate relief proceeding<sup>22</sup> and Phase 2 of NRG's ongoing QRAM proceeding<sup>23</sup>.

The OEB adopted Union and the intervenors from Union's Penalty Reduction Proceeding as intervenors in the combined proceeding. The OEB proceeded by way of an oral hearing. The OEB received written submissions from E2 Energy Inc. and CME and heard oral argument from OEB staff, Union and NRG. NRG also filed a written reply submission.

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<sup>19</sup> EB-2014-0375, Decision and Order on Motion, March 13, 2015 at p. 5.

<sup>20</sup> EB-2014-0053 / EB-2014-0361 / EB-2015-0044, Notice of Motion and Procedural Order No. 3, March 13, 2015.

<sup>21</sup> EB-2015-0044

<sup>22</sup> EB-2014-0361

<sup>23</sup> EB-2014-0053