



EB-2006-0243

IN THE MATTER OF the *Ontario Energy Board Act*
1998, S.O.1998, c.15, (Schedule B);

AND IN THE MATTER OF an Application by Natural
Resource Gas Limited for an Order pursuant to
Section 90(1) of the *Ontario Energy Board Act*, 1998,
granting leave to construct a natural gas pipeline and
ancillary facilities in the Township of Malahide,
Municipality of Thames Centre and the Town of
Aylmer.

AND IN THE MATTER OF Section 19 of the *Ontario*
Energy Board Act, 1998.

BEFORE: Gordon Kaiser
Presiding Member and Vice Chair

Ken Quesnelle
Member

Cathy Spoel
Member

DECISION

March 12, 2008

Background

This Decision relates to a Decision of the Board dated February 2, 2007 which granted Natural Resource Gas Limited (“NRG”) authority to construct 29 km of 6 inch diameter steel pipeline to supply natural gas to a new ethanol plant (the “Facility”) being constructed by Integrated Grain Processors Co-operative Inc. (“IGPC”), in Aylmer, Ontario.

That Decision also approved a Gas Delivery Contract (“GDC”) and the gas Pipeline Cost Recovery Agreement (“PCRA”) which requires IGPC to provide certain security to underwrite the cost of constructing the pipeline.

Subsequently disputes arose with respect to those agreements and the amount of the security. On February 15, 2008 IGPC filed a notice of Motion seeking an Order establishing a timetable for completion of the pipeline by NRG, an Order requiring NRG to pay all third party suppliers on a timely basis, and an Order confirming that IGPC is required to provide NRG a delivery Letter of Credit in the amount of \$ 5.3 million. NRG filed certain correspondence in response to this notice of Motion. On February 22, 2008 the Board issued a Notice of Review on the Board’s Motion to review matters related to the Board’s Order granting leave-to-construct as amended on December 28, 2008 (the “Motion”).

The Motion was heard in Aylmer, Ontario on February 28, 2008. A number of the issues were determined that day, and in a supplemental written Decision was issued on March 4, 2008.

Four cost items were not resolved at the time: M9 Delivery Costs of \$422,217.00; Operations & Maintenance (O &M) expenses of \$50,000.00; Capital Taxes of \$25,935.00; and Property Taxes of \$58,405.00. NRG claims that these annual costs will be incurred for each of the seven years of the contract regardless of whether or not IGPC is still a customer of NRG. NRG also argued that the amount of the letter of credit should be increased to reflect these costs.

At the February 28, 2008 Hearing the parties agreed that these matters could be dealt with in writing without further evidence, and that the Decision of the Board with respect to these four matters would be binding on the parties.

The M9 Delivery Costs

The M9 contract is a gas delivery agreement between Union and a counter party to secure the upstream gas transportation that will be necessary to supply the Facility.

When the Board heard the Motion on February 28, 2008, NRG claimed it would incur a liability for M9 delivery costs in the amount of \$422,217.00 annually for each of the seven years of the contract. NRG sought security from IGPC for these amounts.

The estimated cost of the pipeline is \$9.1 million of which \$3.8 million is to be covered by a capital contribution from IGPC, and \$5.3 million is to be covered by a letter of credit by IGPC. The letter of credit is essentially to guarantee NRG the revenues required from the sale of gas to the ethanol plant to cover the remaining cost of the pipeline. Accordingly the amount of the letter of credit is reduced annually as the depreciation on the capital costs are recovered through rates.

The complication is that there are two sections of pipe that need to be constructed;

- (a) an extension pipeline of approximately 1.5 km to be built by Union Gas including a custody transfer station which will permit the Union Gas extension pipeline to connect to the new pipeline to be built by NRG, and
- (b) a 28.5 km pipeline to be built by NRG commencing at the connection with Union Gas and ending at the ethanol facility being built by IGPC in Aylmer, Ontario.

In the executed Pipeline Cost Recovery Agreement, Article III section 3.1, states that the amount of \$180,000.00 is for the Union Gas Aid-to-Construct and is included in the total capital cost of the project of \$ 9.1 million. There is no indication that any of that amount or any separate amount is included in the agreement to cover a security required by Union related to the revenues it expects to receive as a result of specified gas volume sales. The capital contribution of \$3.8 million and the letter of credit of \$5.3 million deals primarily, but not completely, with the NRG portion.

The purported need for adjustment in the security arrangements results from:

- (a) an increase in the capital cost of the Union portion from that estimated with a resulting increase in the aid to construct; and
- (b) an absence of security required by Union to cover the loss of revenue from the annual volume charges (Minimum Annual Volume Charges) and for security covering the first two months of Monthly Demand Charges.

The \$3.8 million capital contribution which IGPC agreed to pay NRG, included a capital contribution that NRG would have to pay Union. That amount was \$180,000.00 It is now agreed that that the new amount is \$343,000, a difference of \$163,000.00. Accordingly it is necessary to adjust that element of the security arrangement. There appears to be no dispute with respect to this.

The issue to be determined relates to the purported absence of security to cover Union's total exposure costs related to the provision of the pipe and delivery service and whether or not the \$5.3 million letter of credit is intended to cover these costs. The Union submission in this regard states:

“Upon NRG signing an M9 Contract for the ethanol plant, Union would ordinarily require that NRG provide a letter of credit (or other Financial Assurance) to Union to secure the full amount of the capital costs of the project and the first two months of Monthly Demand Charges and Minimum Annual Volume charges. The total amount of Financial Assurance required by Union (regardless of whether NRG signs a one year or a seven year contract) is \$881, 497.”

Taking into account the \$343,000 which the parties have agreed to pay to Union by way of the aid-to-construct, leaves a letter of credit that Union is demanding, with respect to the balance of the capital cost of the Union project plus the Minimum Annual Volume Charges and the first two months of Monthly Demand charges, in the amount of \$538,497.

Union acknowledges that this letter of credit would be less if it is a one year contract. In that event, the aid to construct would be \$736,000 instead of the \$343,000 under a seven year contract.

The IGPC position is that the \$5.3 million letter of credit is established in the PCRA and should not and cannot be increased by the Board. IGPC further argues that NRG is in effect seeking a review of the Board's Decision of February 2, 2007 without meeting any of the statutory tests.

The Board does not accept this argument. First, the Board is considering this matter as a result of the Motion which it initiated in response to various submissions by IGPC and NRG. The notice specifically states: "The examination will include a review of the PCRA." In the IGPC submission dated February 15, 2008 IGPC sought an Order confirming that the proper amount of the letter of credit was \$5.3 million. That, in the Board's view, raises the question as to the proper amount of the letter of credit. Moreover as IGPC pointed out in its submitted material, the contract between IGPC and NRG provides that the Board act as an arbitrator in the event of disputes.

Accordingly, the Board believes it has the necessary jurisdiction to deal with this dispute. Moreover it is in the public interest that this dispute be resolved. The fact is that Union is not going to provide service unless they receive financial assurance that they are entitled to in the amount of \$881,497. Some of this assurance has already been provided or agreed to, however an amount of \$538,497 is not covered by the \$5.3 million letter of credit (nor in the agreed to capital contribution) that IGPC has agreed to provide NRG.

The reason for the omission may be that NRG was not aware of the exact terms of the M9 contract at the time the original Hearing. Regardless of the reasons for the omission, it must be dealt with now. These agreements do reflect a recognition that actual costs may turn out to be different from the estimated costs. Indeed the parties agree that given the increased capital costs of the Union portion the aid-to-construct should increase from \$180,000 to \$343,000. The same principle should apply in this situation where it appears that a real and tangible liability was not considered.

With respect to the NRG claim that it is entitled to security to indemnify the utility for M9 delivery costs of \$ 422, 217 annually over a period of seven years, it is the Board's view is that these costs will not be incurred by NRG in the event that NRG provides Union with an additional letter of credit in the amount of \$538, 497.

This letter of credit of course must be backed by a letter of credit in favour of NRG from IGPC in the same amount. The amount of the letter of credit will of course decline annually in the same fashion as the letter of credit of \$5.3 million in favour of NRG declines annually.

The overriding principle where a utility is incurring capital costs for an individual customer such as IGPC is that in the event the project fails, the other ratepayers should not be responsible for those capital costs.

Union has indicated that the amount of security required to secure the full amount of the capital cost of its project is \$881,497. This is to be made up by an aid to construct of \$343,000 and the letter of credit of \$538,497 which in effect relates to the loss of income which Union would receive on the flow of revenue from the annual volume charges (Minimum Annual Volume Charges) and for security covering the first two months of Monthly Demand Charges.

Union does, however, state;

“to be clear although Union does not ask for security for the Demand Charge and the minimum annual volume (MAV) Deficiency Charges for the full term of the M9 contract, the M9 Contract still requires NRG to pay those charges for the full term of the contract”

This presumably leads to NRG’s claim in this Motion that IGPC must indemnify NRG for the annually delivery charges of some \$422,217.00 for the term of the contract.

The Board does not believe that Union is entitled to guaranteed revenues or guaranteed profits. It is, however, entitled to complete security on the full amount of the capital cost, and the first two months of the Monthly Demand Charge and the Minimum Annual Volume Charges. Union states that the amount of that security is \$881,497. Accordingly, the Board believes that if either NRG or IGPC posts a letter of credit for that amount, there should be no further liability to Union.

IGPC in its submission states that it should not be responsible for providing any amount of Union’s letter of credit. IGPC is however prepared to provide the Union aid-to-construct. IGPC argues that in the event the Facility ceases operation, the new pipe will be integrated into the NRG system. It will still be used and useful, and accordingly the ratepayers should incur the cost.

On the Motion IGPC argued that NRG had stated that if the ethanol plant ceased operation, the pipe could be integrated into the NRG system at a cost of \$600,000, that those costs would form part of the rate base, and that the cost to ratepayers would be insignificant. The Board accepted that argument and ruled that NRG was not entitled to security for decommissioning costs.

The same argument could apply to Union. However, that does not remove the need for Union's letter of credit with respect to minimum annual volumes. That is totally a separate issue.

The letter of credit relates to the cost of the Union construction, not the cost of decommissioning. These gas volumes are being provided to one customer and one customer only. If the revenues from the gas volumes supplied are being used to underwrite part of the capital cost of construction, those revenues need to be secured by a letter of credit. Otherwise the other ratepayers will be at risk.

In short, there is no reason why NRG or IGPC should not provide the necessary letter of credit to Union with respect to the volumes of gas that IGPC wishes Union to supply.

There is, however, no need for NRG to enter these discussions. These arrangements can proceed directly between IGPC and Union. However the same principle will apply. The Union rate payers must be protected in the event there is a failure on the part of IGPC. There will need to be a letter of credit in the amount of \$538,497 with respect to the gas volumes, unless of course IGPC wishes to underwrite the entire cost of the Union construction with an aid-to-construct.

The Board recognizes the importance of this project to the Community and the substantial financial commitment of the Co-operative, the Government of Canada and the Province of Ontario.

At the same time we recognize that this project is unusual in the sense that this one customer doubles the rate base of the utility. That situation has never risen before.

It is clear from the number of emergency motions the Board has heard on this manner that a project of this size has placed significant demands on the management resources of NRG. In these circumstances the Board believes it is best that IGPC deal separately with the two utilities with respect to the two separate sections of the pipeline. The same principles will apply in terms of security and follow long established Board principles.

O & M Expenditures, Capital Taxes and Property Taxes

No utility has guaranteed revenues. There are risks of running a utility and shareholders bear those risks. The profits they receive reflect those risks.

However, where there is substantial capital investments for the benefit of one customer, there must be security to at least cover the capital cost of that project, to ensure that there are not stranded assets that will impose costs on rate payers. This principle applies to both NRG and Union.

This principle also applies to the other costs which NRG is claiming in this Motion namely \$50,000.00 a year in O & M expenses; \$ 25,935.00 in Capital Taxes; and \$58,405.00 in Property Taxes. These are expenses which NRG may incur as part of a plan to secure this important new customer. NRG however is not guaranteed recovery. These are matters that can be dealt with in a rate case in the event of failure of the ethanol plant. At that time they will be dealt with on actual facts and an analysis whether NRG was prudent in making these decisions. The Board does not find it necessary to deal with them at this time.

There is little new with respect to these costs. These costs were recognized by NRG at the time it filed this initial application with the Board and are set out in Mr. Aiken's analysis in Tab 4 of Exhibit C of the pre-filed evidence.

The Board sees no need to increase the letter of credit to reflect these cost items. They were fully considered by the Board previously and the evidence that NRG filed reflected these costs. If the letter of credit should have reflected these costs, which the Board doubts, the matter should have been raised by NRG at that time. In any event, these costs are minor.

The Board agreed to deal with these four issues on the basis of written submissions and agreement by the parties that no further evidence was required and that the Decision would be binding on the parties. Further evidence has been submitted by NRG. The Board has not relied upon this in making its Decision. We believe there is sufficient evidence currently on the record on these matters, and we have proceeded on that basis.

Costs of the Motion

IGPC has raised an additional issue which the Board is not prepared to entertain at this time. This is the matter of costs incurred by IGPC relating to this dispute.

At the time of the Aylmer Motion, there were a number of invoices that NRG had submitted to IGPC that were unpaid. The parties agreed to deal with matters separately and not involve the Board at this time. It was further agreed that even if there was a failure to resolve these matters, they would not hold up the pipeline construction. The Board expects that IGPC will follow the same process with respect to any costs that IGPC believes should be borne by NRG.

DATED at Toronto **March 12, 2008.**

ONTARIO ENERGY BOARD

Signed on behalf of the panel

Original signed by

Gordon Kaiser

Presiding Member and Vice Chair