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SENT BY E-FILING AND COURIER

Toronto, July 5, 2010

Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Walli:

RE: Five Nations Energy Inc. ("FNEI") – Argument-in-Chief
2010 Transmission Rates (EB-2009-0387)

Please find enclosed FNEI's Argument-in-Chief ("AIG") in the above-referenced matter. The AIG is also being filed on the Board's RESS system, and served on all parties to the proceeding.

Yours very truly,

Richard King

RK/mnm

Encl.

cc. Joe Gaboury, FNEI
Peter Faye, Counsel to Energy Probe
Olena Loskutova, Energy Probe
David MacIntosh, Energy Probe
Carl Burrell, IESO
Maia Chase, IESO

EB-2009-0387

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an application by Five Nations Energy Inc. for an Order or Orders pursuant to section 78 of the *Ontario Energy Board Act, 1998* for 2010 transmission rates and related matters.

FIVE NATIONS ENERGY INC.
ARGUMENT-IN-CHIEF

July 5, 2010

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A. INTRODUCTION

1. This Argument-in-Chief outlines the Application by Five Nations Energy Inc. ("FNEI") for 2010 rates, and summarizes the specific items being requested in that Application. In addition, this Argument-in-Chief will attempt to address certain issues which: (a) at the time of filing the Application, FNEI anticipated would be of particular interest to the Board and intervenors; and (b) during the course of this proceeding, have been the subject of more probative information requests. That having been said, FNEI cannot fully anticipate the submissions to be made by Board Staff and Energy Probe. Rather than speculate on these submissions, FNEI will deal with these in Reply Argument.

2. This Application is only the second application for transmission rates made by FNEI to the Board. FNEI's first rate application (RP-2001-0036) was filed in 2001, prior to FNEI's transmission system coming into commercial operation. That initial rate application had to deal with three unique issues:

   (1) as a "greenfield" transmission system, FNEI had no historic operational data (e.g., operations and maintenance expenses, customer demand data, etc.) to inform the preparation of the evidence in RP-2001-0036;

   (2) as the first non-profit utility to be rate-regulated by the Board, there was considerable discussion at the initial rate proceeding about how to establish an appropriate cost of capital for FNEI; and,

   (3) as a non-profit corporation with no cash on hand or reserve funds, the Board had to consider how FNEI might build up certain reserve accounts for capital and operational purposes, as well as to cover off otherwise insurable incidents.[1]

[1] At the time of FNEI's first rate application (2001), insurance for electricity transmission systems was virtually unavailable, in large part because of the Québec ice storm (1998). Unlike other existing transmitters (that self-insured), FNEI was just commencing operations and had no insurance reserve fund or cash on hand to deal with any potential insurable event.

3. With respect to the first issue (lack of historical data), FNEI now has several years of operating experience, so there is a good base of historical data available for use in the preparation of the evidence in this proceeding. That having been said, FNEI's historical data has to be viewed in light of the significant upgrades made to the FNEI system including the De Beers Victor Mine, which connected to the FNEI system in late 2006 and is still in the process of ramping up to full operation.

4. In the years leading up to FNEI's initial rate application, FNEI was largely a shell company established by the three First Nation communities of Attawapiskat, Fort Albany and Kashechewan to plan, finance, develop and construct the new transmission line. The project development work was done by a variety of technical, legal, and finance advisors that were retained by the communities and paid as external consultants/advisors. They were not employees of FNEI, and the work was not the typical work of transmission company employees (i.e., operating and maintaining an existing transmission system). While the developers of the FNEI system had understood that a number of capital upgrades would be carried out in the years after the FNEI line came into commercial operation (e.g., putting spare transformers on potential, upgrading the telecommunications system, etc.), FNEI nevertheless expected to transition from an entity focused on "project development" to an entity that was focused on the day-to-day operation and maintenance of its transmission system assets. As a result, FNEI expected to move from an entity largely reliant on external "project development" advisors to one utilizing internal employees fairly soon after coming into commercial operation.

5. Instead, FNEI received a connection request from De Beers Canada Inc. fairly soon after coming into commercial operation. The process of connecting De Beers involved substantial upgrades to FNEI's system, and effectively prolonged FNEI's status as an entity concerned primarily with project development. It has only been in the past year or so, with the De Beers assets now fully in service and the bulk of FNEI's planned upgrades complete, that FNEI has commenced the move to more typical, "business as usual" operations. For example, FNEI hired a Chief Executive Officer in 2009 to take over the bulk of tasks previously carried out by an external project development consultant, and only this past spring has FNEI hired an additional technical expert to take over duties from an external technical advisor. Both the external project development

consultant and external technical advisor have been advisors to FNEI since the mid-1990s (i.e., since the outset of the planning and development work for the initial line construction). Their assistance through the completion of FNEI's major capital upgrades and the DeBeers connection process was critical. In the past year, however, their role has diminished substantially and is now focused on providing minor assistance and training to FNEI's CEO and technical staff.

6. As a result, the bulk of FNEI's historical data filed with this Application has to be viewed with this in mind. Specifically, FNEI considers the following to be of particular note in regards to FNEI's historical data:

- FNEI's operations and maintenance expenses have yet to follow a predicatble pattern. In particular, it is unclear as of yet how much of FNEI's expenses for external consultants can be moved "in-house" to employees now that the De Beers upgrades and foreseeable capital expenditures are complete. FNEI is still a small company, and the extent to which FNEI can justify hiring employees in certain areas instead of relying on external support is really only now being addressed in a meaningful way. This is reflected in the Numerical Summary of Operations, Maintenance and Administration (Exhibit 4, Tab 2, Schedule 3), which shows declining expenses for external services employed (Account 5630) and increasing internal salaries and expenses (Accounts 5605, 5610 and 5615) in the past few years.

- FNEI's capital expenditures in the short- to medium-term are expected to decrease from the capital expenditure levels in FNEI's first eight years of operation. When the FNEI transmission line was initially constructed, it was basically a "bare bones" system, with virtually no redundancies (for reliability purposes) and a very basic communications system. It had always been FNEI's plan to bolster the FNEI system to provide for system redundancies and upgrade the telecommunication system, both of which are critical given the remote location of the assets (and the inability to be easily access these assets for repair). Now that there are second transformers on potential and a fibre optic system in place, FNEI foresees less capital expenditures going forward.

7. With respect to the second and third issues (appropriate cost of capital for FNEI; and requirement for capital, operating and insurance reserves), these were dealt with in RP-2001-0036 by way of Board Directives (to be considered in this proceeding). Consequently, these two issues are discussed in Part C of this Argument-in-Chief (Board Directives from RP-2001-0036).

B. SPECIFIC APPROVALS REQUESTED

8. In this Application, FNEI is requesting approval of its forecasted 2010 transmission revenue requirement of $6,466,100. FNEI's current Board-approved revenue requirement is $5,178,000 (as per RP-2001-0036). This represents an increase in FNEI's annual revenue requirement of $1,288,100. Because FNEI represents such a small portion of the provincial (pooled) transmission revenue requirement, the approval of FNEI's applied-for revenue requirement would not result in any increase in the Ontario Uniform Transmission Rates.

9. Other approvals requested by FNEI in its Application have been partly dealt with in the Board's Interim Rate Decision in this proceeding (dated April 27, 2010). FNEI had requested that FNEI's rates be declared interim as of January 1, 2010, and that a deferral account be established to record the revenue deficiencies incurred from January 1, 2010 until FNEI's proposed 2010 rates are implemented. In its Interim Rate Decision, the Board determined: (a) that the current Uniform Transmission Rates as they relate to FNEI would be made interim as of March 1, 2010 (to respect the completion of FNEI's rate filing in February 2010); (b) that the effective date of any new rates resulting from the decision in this case would be considered later in this proceeding; and (c) that it was not necessary to establish a deferral account at that time. Consequently, in addition to determining FNEI's 2010 revenue requirement, the effective date of any new rates resulting from this proceeding (and the mechanism by which FNEI might recover rates made effective before the date of the ultimate decision in this proceeding) remain issues to be determined by the Board.

C. BOARD DIRECTIVES FROM RP-2001-0036

10. In FNEI's previous rate proceeding, the Board gave three directives to FNEI, as follows:

Description	Board Directive
Design for Reserve Funds and Maintenance of Non-Profit Status	"… the Board directs FNEI to file, at its next rate case, a design for a reserve fund as the Company has indicated it is willing to do. The Board also directs the Company to include in this report a description of the measures that will be taken to deal with the issue of maintaining its non-profit status." (Board Decision, RP-2001-0036, p. 16)
Internally Generated Funds versus ROE	"Given that FNEI does not, by its form of incorporation, have share capital, the Board believes that it is inappropriate to describe amounts included in its revenue requirements that are in excess of its projected expenditures as a 'return on equity'…The Board directs FNEI to describe this excess of revenue over expenditures as 'Internally Generated Funds', until such time as the Board can consider and approve FNEI's proposal for one or more reserves." "The Board also directs FNEI not to use this Internally Generated Funds account to charge against this account expenditures that would otherwise be charged to revenue requirement or rate base accounts." (Board Decision, RP-2001-0036, pp. 16 & 17)
TIER Mechanism	"The Board notes the use of the TIER mechanism by non-profit utilities in other jurisdictions and directs FNEI to use this method of calculating the amount to be included in its revenue requirement in future rate hearings." (Board Decision, RP-2001-0036, p. 17)

(a) Directive re: Reserve Fund Design

11. At its last proceeding, three potential reserve funds were discussed: (a) an insurance reserve (i.e., a fund to self-insure FNEI's transmission assets); (b) a capital reserve; and (c) an operating reserve. FNEI has established an Insurance Reserve and as of March 2007 considered it to be fully funded (at $4 million). The appropriate "cap" (i.e., upper limit) for the Insurance Reserve was determined by FNEI's lenders, and is based on their assessment of exposure to loss due to weather and other incidents.

See Board Staff IR #2

12. In addition to the Insurance Reserve, FNEI's balance sheet also shows an Operating Fund and Capital Reserve. In the first three quarters of any calendar year, FNEI's current earnings are recorded in the Operating Fund, and at the end of the year these amounts are transferred to the Capital Reserve to bring the Operating Fund balance to zero. FNEI's Capital Reserve is unfunded at present because FNEI has made significant capital expenditures since its last rate proceeding (as described in Exh. 2/1/1, "Rate Base Overview").

See Board Staff IRs #3 and 5

13. Now that the Insurance Reserve is fully funded, FNEI will start to build up its Capital Reserve and Operating Fund. As a matter of priority, FNEI intends to follow the same approach that it has in recent years; namely, appropriating funds to the Operating Fund during the first three quarters of every year, and transferring any funds in the Operating Fund to the Capital Reserve at year-end. Obviously, if funds in the Insurance Reserve need to be drawn down to cover insurable-type incidents, FNEI will immediately replenish the Insurance Reserve out of whatever funds are available in the Operating Fund or Capital Reserve. If insufficient funds are available to replenish the Insurance Reserve, FNEI will then begin to allocate current earnings directly to the Insurance Reserve.

14. FNEI does not propose to set any "caps" for the Capital Reserve or Operating Fund (as it does for the Insurance Reserve), nor does FNEI propose to establish any rules related to the disbursement or transfer of funds in the Capital Reserve or Operating Fund. Indeed, FNEI submits that any such caps or rules would be both unfair to FNEI (and its members) and unnecessarily restrict FNEI's ability to efficiently manage its operations.

See Board Staff IRs #3 and 6

15. It would be unfair because FNEI should (like other utilities) be permitted to utilize its retained earnings (or unappropriated earnings) in accordance with its corporate objectives. For other (for-profit) utilities, this means paying dividends. As a non-profit utility, FNEI cannot pay dividends but it can utilize funds in accordance with its corporate objectives as set out in its Letters Patent (i.e., to promote the social, economic

and civic welfare and development of Attawapiskat, Fort Albany and Kashechewan). It is entirely appropriate for FNEI to seek to fulfil these corporate objectives. The imposition of a cap on FNEI's Capital Reserve and Operating Fund implies that either: (a) there should be no other use of FNEI funds (i.e., once the Insurance Reserve, Capital Reserve and Operating Fund are fully funded, FNEI should be prohibited from earning any revenues in excess of its costs); or (b) FNEI should not utilize any funds for its corporate objectives until the Insurance Reserve, Capital Reserve and Operating Fund are fully funded. Neither of these positions can be correct. Other utilities are not similarly restricted. The Board scrutinizes dividend payments by utilities to ensure that such payments do not compromise the utility's ability to carry on business at the expense of ratepayers (e.g., by making borrowing more expensive). FNEI would expect the Board to similarly scrutinize FNEI's spending in respect of its corporate objectives. To FNEI's knowledge, other Ontario rate-regulated utilities do not have any capped capital or operating reserve accounts.

See Board Staff IR #8

16. Setting a cap or prescriptive disbursement/transfer rules with respect to the Capital Reserve and Operating Fund would also unduly restrict FNEI's ability to manage its operations. FNEI will, from time to time, require funds for unbudgeted capital expenditures and operating matters (e.g., unexpected new customers, new regulatory requirements, unanticipated equipment failures, etc.). FNEI will use its funds on hand and available credit to cover these expenditures in an appropriate manner. It would be unduly cumbersome to have dollars specifically ear-marked as either "operational" or "capital" with prescriptive rules as to when funds might be transferred from one category to the other.

17. The bottom line is that the standard methodology for setting rates used by the Board will set FNEI's revenue requirement at a level that will result in just and reasonable rates. Those rates will generate funds that FNEI will use to operate and maintain its system. FNEI's capital expenditures will always be subject to scrutiny on a prudence basis for proper inclusion in rate base. FNEI's historic operating expenditures will similarly undergo scrutiny at each cost of service application made by FNEI. So the establishment

of any caps or rules related to FNEI's Capital Reserve or Operating Fund does not bring discipline to FNEI's operational or capital spending. That discipline exists by virtue of the Board's jurisdiction to set just and reasonable rates. However, the establishment of caps and prescriptive rules related to reserve funds would be both unfair to FNEI and unduly restrict FNEI's ability to manage its operations.

18. Finally, it is important to understand that FNEI's ability to earn revenues in excess of its costs and spend such funds on its corporate objectives does not in any way affect FNEI's non-profit status. In FNEI's submission, FNEI's status as a non-profit corporation is immaterial from a rate regulation perspective.[2] Indeed, the question of whether FNEI's activities are consistent with its corporate objectives (as set out in its Letters Patent) and the maintenance of FNEI's status as non-profit are not issues to be determined by this Board. The only real implication of FNEI's status as a non-profit entity is that the Board needs to ensure that FNEI's expenditures on its "corporate objectives" do not put the utility in a compromised position that ends up placing inappropriate costs on transmission customers. This means that FNEI should not fund non-transmission activities in the three communities (even though they may be consistent with FNEI's corporate objectives) if such funding would compromise FNEI's ability to appropriately fund its capital and operating requirements. This is exactly the same scrutiny the Board applies to dividend payments by for-profit utilities. Thus, whereas other transmitters can pay a dividend to their shareholder and their shareholder can do whatever it wishes with that money, FNEI must ensure that any such "dividend-like" funding be spent in accordance with its corporate objectives. The question of whether these "dividend-like" funds fall within the corporate objectives of FNEI's Letters Patent is not a matter for the Board to determine, but rather for FNEI's corporate and tax advisors. What is a matter for the Board to determine is whether the quantum of such "dividend-like" funds spent by FNEI compromise its ability to meet its capital or other operating requirements efficiently or result in inappropriate cost consequences for transmission ratepayers.

[2] The only exception to this is that FNEI (as a non-profit) does not have to pay income taxes, and therefore has no income tax expense included in its revenue requirement.

(b) Directive re: Internally Generated Funds and ROE

19. To some extent, the discussion above informs this Board Directive as well. The fact that FNEI is non-profit, and has "members" rather than "shareholders" does not mean that there is no equity in the company. FNEI's accountants describe the amounts in the Operating Fund, Insurance Reserve and Capital Reserve as "Utility Equity" because FNEI operates as a normal commercial business (whereas some non-profit corporations operate based on fundraising or government grants). Further, FNEI uses the Uniform System of Accounts and complies with the same Filing Requirements as other rate-regulated electricity transmitters.

See Exh. 1/3/1 (Audited Financials)

20. FNEI's status as non-profit, as noted above, has virtually no regulatory implications as far as the Board's rate-setting jurisdiction. Consequently, FNEI has filed this rate application on a traditional cost-of-service methodology, with a proposed capital structure and the Board-approved return on equity.

(c) Directive re: TIER Mechanism

21. For reasons set out below, FNEI submits that the TIER mechanism is not the appropriate methodology for assisting in the determination of FNEI's revenue requirement. Instead, FNEI's Application is based on a traditional cost-of-service methodology, using the Board-approved return on equity. However, for illustrative purposes, the Times Interest Earned Ratio ("TIER") calculation was completed (using FNEI's applied-for revenue requirement of $6.466 million) and included in FNEI's pre-filed evidence. The result was a TIER of 2.5 (which falls within the acceptable range of between 2.0 and 2.8, and compares to a TIER of 2.4 in RP-2001-0036).

See Exh. 1/1/13 (Status of Board Directives)

22. The basis for the Board's endorsement of the TIER ratemaking mechanism in RP-2001-0036 would appear to be a number of cases that FNEI filed in response to an interrogatory from Board Staff in FNEI's initial rate proceeding. However, the TIER ratemaking mechanism was established for rural electric cooperatives and local publicly

owned systems (as contrasted with investor-owned utilities) in the United States that are not only non-profit, but also: (a) not regulated by FERC or State regulatory commissions; (b) obtain debt financing from the US federal government (or have their financing guaranteed by the US federal government); and (c) are much more heavily debt-financed than regulated for-profit utilities. The federal financing or guarantee comes from the Rural Utility Service ("RUS", an agency of the US Department of Agriculture), which was created by the federal *Rural Electrification Act of 1936* in the United States to make low-interest loans to electric cooperatives aimed at expanding electric service in rural America. The RUS imposes minimum TIER operating ratios on rural electric cooperatives that want to access RUS loans (i.e., the TIER is a loan covenant).

23. There are few similarities between FNEI and these rural electric cooperatives, other than the fact that both are non-profit. FNEI is regulated by the OEB. FNEI's debt financing comes predominantly from private sector lenders. FNEI is not more heavily debt-financed than other utilities. Consequently, FNEI's view is that TIER is not a suitable rate-setting mechanism for FNEI.

D. TRANSMISSION RATE BASE FOR THE TEST YEAR

24. FNEI's rate base for 2010 is forecasted to be $28.688 million, being the average of the net fixed assets ($28.180 million) and allowance for working capital ($0.508). This represents a slight increase in the Board-approved rate base from RP-2001-0036 (which was $25.439 million). However, these two figures on their own do not reflect the evolution of FNEI's asset base. As noted in Exhibit 2, Tab 1, Schedule 2 (Numerical Summary of Rate Base), FNEI's rate base decreased dramatically in the first few years of operations (to a low of $10.042 million in 2005) before gradually increasing to $18.020 million in 2009. There is then a significant increase in rate base for the 2010 test year.

25. The significant decrease in rate base from 2001 to 2005 was not due to assets coming out of service, but rather was due to FNEI receiving funds from the Department of Indian Affairs and Northern Development pursuant to the terms of a Multi-Year Funding Agreement entered into as part of the initial FNEI project. Funds received by FNEI were used to pay down FNEI's private-sector debt financing ($12 million to each of Bank of

Montreal and Pacific & Western, and $2 million to SNC Lavalin). Due to the fact that the Multi-Year Funding Agreement was not a loan, FNEI's rate base was reduced by the amount of funds received under the Multi-Year Funding Agreement. However, over the period from 2001 to 2009, FNEI did make substantial capital additions. The largest of these is the fibre-optic project (detailed in the Rate Base Overview at Exhibit 2, Tab 1, Schedule 1, page 37), which was fully in service by the end of 2009. This accounts for the significant increase in rate base in the 2010 test year.

26. At this point, FNEI is unclear as to whether Board Staff or any intervenors will take the position that some of FNEI's capital expenditures that have since been brought into rate base were imprudent. Consequently, FNEI will need to deal with any such submissions in FNEI's Reply Argument.

27. Generally speaking, FNEI's major capital projects in the past eight years can be broadly classified into the following categories:

- projects that improve availability and reliability of electrical service in the three communities (e.g., putting the second transformers in each community on potential, and accommodating requests for secondary distribution feeders from the local distributors);
- expenditures that facilitate FNEI's ability to efficiently operate and maintain its system (e.g., the garages in the three communities, the purchase of all-terrain vehicles, and the fibre-optic system); and,
- engineering projects identified as critical given the geography and climate of the region (e.g., ice protection berm walls, erosion control measures, etc.).

28. By far the most significant capital expenditure by FNEI has been the fibre-optic project which became operational in the fall of 2009. As noted, the fibre-optic project will provide FNEI with far superior operational control of its system (real-time as opposed to dial-up every thirty minutes), metering communication, and the ability to monitor stations for security and public safety. There will be some cost savings as a result of having the fibre-optic system in place (lower communications costs, fewer trips to the communities

from Timmins to determine equipment status), but the primary rationale for the fibre-optic system is that FNEI's system will be able to be operated in a safer, more efficient and secure manner.

See Exh. 2/1/1, page 37 to 44

29. The opportunity to install the fibre-optic system at a lower-than-expected cost was presented by the upgrades required to connect the De Beers Victor Mine. At the commencement of the planning for the DeBeers upgrades, FNEI approached DeBeers Canada Inc. to discuss the possibility of constructing the new line with an optical ground wire ("OPGW") instead of the normal skywire. DeBeers Canada Inc. agreed and FNEI covered the nominal incremental costs of installing OPGW from Moosonee to Kashechewan (as opposed to normal skywire). In order to complete fibre optics along the entire FNEI system, a separate pole line was constructed from Kashechewan to Attawapiskat supporting an ADSS fibre optic cable.

30. With respect to its capital expenditures in the 2010 test year, FNEI is forecasting very modest expenditures of:

- $150,000 for station equipment (specifically, upgrades to the station battery systems and chargers, as well as the removal of old relay panels and wiring which was completed in February and March of 2010);
- $35,000 for poles and fixtures and $60,000 for overhead conductors and devices (which is for guy work and repairs to the skywire which began in February 2010, and may exceed budget);
- $20,000 for building and fixtures (specifically completion of the new control building in Kashechewan and separating the fibre optic shelter from the rest of the yard); and,
- $10,000 for miscellaneous expenditures.

31. The $275,000 in forecasted capital expenditures for 2010 is by far the lowest capital expenditures in any year since FNEI came into service.

E. TRANSMISSION OPERATING COSTS FOR THE TEST YEAR

32. FNEI's OM&A expenses are estimated to be $3.386 million for 2010. This is a significant increase over FNEI's Board-approved OM&A costs from 2001 (RP-2001-0036) of $1.899 million and the actual eight-year low of $1.821 million in 2004. However, it is nearly the same as FNEI's actual 2002 OM&A expenses of $3.355 million. Explanations of the year-over-year variances are set out in detail in Exhibit 4, Tab 2, Schedule 2.

33. Part of the increase in the 2010 test year is associated with having to operate and maintain significant additional assets that now form part of the FNEI system.

34. With respect to operations, FNEI main expenses are those incurred under Account 4810 (Load Dispatching), Account 4815 (Station Buildings and Fixtures Expenses), and Account 4820 (Transformer Station Equipment – Operating Labour). In the 2010 test year, the amounts in these three accounts total $532,000, compared to $100,000 in Board-approved 2001.

35. The cost increases in Load Dispatching ($100,000 in Board-approved 2001 versus $208,900 in 2010 test year) is due to increased HONI hourly rates under FNEI's operating agreement with HONI, as well as FNEI bringing new assets into service and increasing the complexity of its system.

36. The cost increases in Station Buildings and Fixtures Expenses ($NIL in Board-approved 2001 versus $104,200 in 2010 test year) is due to the fact that no amounts were budgeted for this account in FNEI's initial rate application. However, in 2002, it became apparent that non-capitalized costs related to station building and yard maintenance should be recorded in this account. In 2010, more maintenance work than normal is planned.

37. The cost increases in Transformer Station Equipment – Operating Labour ($NIL in Board-approved 2001 versus $189,200 in 2010 test year) is due to the fact that no accounts were budgeted for this account in FNEI's initial rate application. However, in 2004, FNEI began using the services of local utility workers in each of the three communities for minor station work. By this time, local personnel in the communities had been sufficiently trained to carry out this work.

38. With respect to maintenance, FNEI's expenses are primarily made up of those in Account 4916 (Maintenance of Transformer Station Equipment) and Account 4930 (Maintenance of Towers, Poles & Fixtures). In the 2010 test year, the amounts in these two accounts total $468,000.

39. The cost increases in Maintenance of Transformer Station Equipment ($143,000 in Board-approved 2001 versus $348,000 in 2010 test year) and the cost increase in Maintenance of Towers, Poles & Fixtures ($57,000 in Board-approved 2001 versus $120,000 in 2010 test year) are harder to predict. Costs increase and decrease by significant amounts on a year-to-year basis, which reflect the fact that some maintenance expenditures are unplanned, and the fact that even planned maintenance expenditures can be "lumpy". Also, given the remote location of FNEI's assets and the high cost to mobilize equipment and personnel, maintenance expenditures on FNEI's system tend to be particularly "lumpy" because FNEI will carry out unplanned maintenance in areas where equipment and personnel have already been mobilized to deal with an emergency matter (i.e., FNEI takes advantage of having the equipment and crews in place). Overall, however, one would expect maintenance work on the system (unplanned and planned) to increase generally as the assets age (i.e., in 2001, FNEI's assets were all new).

40. With respect to administration, FNEI's expenses are made up primarily of those in Account 5605 (Executive Salaries and Expenses), Account 5610 (Management Salaries and Expenses), Account 5630 (Outside Services Employed) and Account 5655 (Regulatory Expenses). In the 2010 test year, the amounts in these four accounts total $1.719 million (as compared to $864,000 in Board-approved 2001).

41. The cost increase in Executive Salaries and Expenses ($160,000 in Board-approved 2001 versus $665,500 in 2010 test year) is due to the hiring of a Chief Executive Officer, and more frequent meetings of the Board of Directors and FNEI's members (which includes significant travel costs).

42. The cost increase in Outside Services Employed ($230,000 in Board-approved 2001 versus $503,300 in 2010 test year) has been due to the fact that FNEI has carried out more capital projects than anticipated in 2001 (which has continued to require external technical and financial support). The $503,300 forecast for the 2010 test year is lower

than the actual amounts expensed to this account in 2004, 2005, 2006, 2007 and 2008. The decrease in expenses in this account in 2010 (as compared to these earlier years) is part of FNEI's short-term plan to bring some of these services in-house.

43. As for Regulatory Expenses, the amount forecast in the 2010 test year ($343,000) is actually lower than the Board-approved 2001 amount ($350,000) but more than any actual amounts expensed to this account since 2002. The actual amounts expensed to this account in the years 2002 through 2009 vary from a low of $210,000 in 2005 to a high of $312,000 in both 2006 and 2009. The amounts in this account fluctuate directly with the amount of external legal advice sought by FNEI (e.g., financing in 2006, and rate application in 2009 and 2010).

44. FNEI submits that the OM&A expenses included in its Application are reasonable, and any variances from previous years have been appropriately and fully explained in the evidence.

F. OPERATING REVENUE

45. FNEI is forecasting operating revenue of $5.078 million for 2010, consisting almost entirely of transmission service revenue from the IESO. The forecasted 2010 transmission service revenue was based on FNEI's estimate of 2009 transmission service revenues (estimated in fourth quarter 2009, at the time work began on FNEI's Application).

46. In forecasting 2010 transmission revenues, FNEI proposed to keep the 2009 transmission revenues flat (i.e., no increase in the 2010 test year) because the IESO predicted virtually no demand growth in Ontario from 2009 to 2010.

See Board Staff IR #19

47. Although the load taken by FNEI's customers has increased fairly significantly over the past few years (and more load growth is expected as De Beers moves towards full production), this has virtually no impact on FNEI's revenues, since variances in FNEI's transmission service revenues are driven primarily by variations in the entire provincial peak loads from year to year.

48. In recent years, FNEI had additional revenues in the form of interest income as well as services provided to De Beers. FNEI is forecasting relatively negligible revenue from these two sources in the test year, given: (a) low interest rates; and (b) the fact that the De Beers work is basically completed.

G. COST OF CAPITAL

49. FNEI is proposing a capital structure of 60% debt and 40% equity, based on the Board's deemed structure. FNEI has used the Board-approved return on equity ("ROE") of 9.85% for its 2010 test year.

50. With respect to debt, FNEI has a Credit Agreement with Manulife and Pacific & Western Bank ("PWB") which provides FNEI with a term credit facility of up to $11 million (at 5.5%), and an operating facility of up to $500,000 (at prime plus 2.5%). FNEI also has a $500,000 operating line with its bank, the Bank of Montreal. FNEI also has an interest-free loan from the Northern Ontario Heritage Fund Corporation ("NOHFC") which dates back to the initial development stage of the FNEI project. The loan is interest-free until October 2010, after which interest at 4% commences.

See Board Staff IR #59

51. FNEI's total cost of capital, described in Exhibit 5, Tab 1, Schedule 1, is $1.893 million.

52. As outlined in Part C of this Argument-in-Chief (Board Directives), FNEI believes that the standard methodology for establishing cost of capital (as opposed to the TIER mechanism) be utilized for FNEI.

H. RATE RECOVERY OF REVENUE REQUIREMENT

53. FNEI's evidence with respect to charge determinant forecasting and the calculation of uniform transmission rates is set out at Exhibit 8, Tab 2, Schedules 1 through 3. In calculating Uniform Transmission Rates, FNEI has used the revenue requirement applied for in this Application (i.e., $6.466 million). As demonstrated in Exhibit 8, Tab 2, Schedule 1, FNEI's application does not result in any change to the current 2010 Uniform

Transmission Rates (established by EB-2008-0272). The Revenue Allocators would, however, change modestly.

54. Board Staff asked a number of questions regarding charge determinants, but FNEI is unclear as to the position Board Staff (or Energy Probe) might take on the issue. Rather than speculate, FNEI will deal with this in Reply Argument.

See Board Staff IRs #21 through 24 (inclusive)

55. It should be noted that FNEI's calculation of the Uniform Transmission Rates (based on the revenue requirement applied for in this Application) does not take into account changes being sought by other Ontario transmitters (e.g., by Great Lakes Power Transmission Inc. in EB-2009-0408).

I. VARIANCE AND DEFERRAL ACCOUNTS

56. FNEI has no deferral or variance accounts, but requested a deferral account as part of this Application to record the revenue requirement deficiencies incurred from January 1, 2010 until FNEI's proposed 2010 revenue requirement is approved by the Board. As noted above, the Board's Interim Decision of April 27, 2010 made rates interim as of March 1, 2010 and declined to make any decision on the deferral account.

57. The purpose of the deferral account request was to ensure FNEI was able to recoup revenues (the "Pre-Decision 2010 Revenues") for the period prior to having FNEI's 2010 revenue requirement determined by the Board.

58. Because the ultimate disposition of FNEI's Application will not result in any change in the provincial Uniform Transmission Rates, if the Board rules that FNEI's 2010 revenue requirement takes effect prior to the date of the Board Decision in this matter, then FNEI would need to obtain its Pre-Decision 2010 Revenues from the other rate regulated transmitters based on the revised revenue allocators. Essentially, the payment of Pre-Decision 2010 Revenues from the other transmitters to FNEI would recognize that the others had (prior to the Decision in this proceeding) received more than their Board-approved share of 2010 transmission revenues and FNEI had received less than their

share. It is FNEI's understanding that this has been done in the past (specifically, for Great Lakes Power Limited, as it then was).

All of which is respectfully submitted this 5th day of July, 2010.

FIVE NATIONS ENERGY INC.

By its Counsel, Ogilvy Renault LLP
Per: Richard J. King