

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.

**ARGUMENT ON BEHALF OF
ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")**

July 19, 2010

**FIVE NATIONS ENERGY INC.
2010 TRANSMISSION RATES
EB-2009-0387**

**ENERGY PROBE RESEARCH FOUNDATION
ARGUMENT**

How these Matters came before the Board

- 1. On February 26, 2010, Five Nations Energy Inc. (the “Applicant” or “FNEP”) filed an Application seeking approval for 2010 transmission rates and related matters.**
- 2. The Board issued its Notice of Application and on March 24, 2010. Energy Probe filed a Notice of Intervention on April 6, 2010.**
- 3. The Board issued Procedural Order No. 1 and Interim Rate Decision on April 27, 2010 determining that the current Uniform Transmission Rates, as they relate to the Applicant, will be made interim as of March 1, 2010, to coincide with the filing date of the Applicant’s rate application.**
- 4. Energy Probe filed Interrogatories for EB-2009-0387 on May 5, 2010; the Applicant filed its Responses on June 4, 2010.**
- 5. Also on June 4, 2010, the Applicant requested that Responses to Board staff interrogatories 21(a), 22(b) and (c), and 23(a), (b) and (c) be treated as confidential. The Responses in question all contain information related to charge determinants. No party objected to the request for confidentiality; the Board agreed in its Decision on Confidentiality and Procedural Order No. 3, issued June 23, 2010, that the Responses are of a commercially sensitive nature and will remain confidential.**

6. In Procedural Order No. 3, the Board reserved its decision on whether to hold an oral hearing with respect to reply argument from the Applicant until receipt of arguments from FNEI, Board staff and intervenors. The Board has tentatively reserved July 29 and July 30, 2010 for that oral hearing.

Submissions

7. Energy Probe was greatly assisted in this matter by the opportunity to review the submissions of Board staff, filed July 16, 2010, and is in general agreement with them, subject to the following additional submissions.

8. The submissions of Energy Probe are organized in the same format as Board staff's for the convenience of the Board.

Status of Board Directives

9. As noted in Board staff's submissions, the Board in its decision in FNEI's last rate application (RP-2001-0036), directed the company to provide a report discussing alternate ways of computing revenue requirement than that of using the customary ROE approach used with share capital utilities.

10. FNEI, in this latest Application, has not submitted the requested report and is again requesting that its revenue requirement be computed by using the ROE approach.

11. Energy Probe submits that FNEI's request should be denied for the following reasons:

- i) The Applicant has had lots of time since the Board issued its direction on the matter in 2003 to prepare the report. It appears to have ignored the Board's directive and, in Energy Probe's submission, should not be rewarded for this omission by the Board acceding to its request to use the ROE approach in calculating its rates for this Application.

- ii) Using the ROE approach in the previous rate application could be justified on the basis that the Applicant was in the start up phase and there was little historical information available on which to base alternative methods of rate setting. Ten years have now elapsed since that initial rate application. Using the ROE approach again in this Application will serve to prolong and legitimize its use such that it will be come increasingly difficult for the Board to abandon it in future rates applications.**

- iii) The Board has authority to make exceptions to its rate setting policies but, if it does so without persuasive reasons, it invites applicants to request variations based on their preference. Energy Probe submits that FNEI has not provided persuasive reasons for using the ROE over alternative approaches such as the TIER method.**

Is FNEI's design and current practice for reserves appropriate?

12. Energy Probe supports Board Staff's submissions on this subject and has no additional submissions to make.

What is an appropriate methodology for establishing revenue requirement for a non-profit, non-share capital utility?

13. Energy Probe supports Board Staff's submission on the principle of and the method for establishing operating and capital reserves. However, Energy Probe does not agree, as Board Staff does, with the position taken by FNEI on the TIER approach.

14. FNEI argues in its evidence and Argument-in-Chief that the TIER approach used for Rural Electric Cooperatives and local publicly owned systems in the United States is not appropriate for determination of its revenue requirement. The reasons advanced for this are summarized in Paragraph 23 of the Applicant’s Argument-in-Chief.

“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.”

Analysis of Reasons for not using TIER

15. In response to Energy Probe IR 7, which requested an explanation for why the TIER mechanism was not appropriate, FNEI in its response simply reiterated the factual circumstances surrounding TIER application in the United States. However, it failed to explain why those facts supported a conclusion that the mechanism was not appropriate for FNEI. In Energy Probe’s submission, FNEI has not provided persuasive evidence or argument to substantiate its position that TIER is not a suitable methodology for computing revenue requirement.

Regulation by the OEB

16. Energy Probe submits that the fact that FNEI is regulated by the OEB is not relevant to whether the TIER mechanism is appropriate for determining its revenue requirements. The relevant consideration is whether or not the method provides a good means of determining whether its revenue requirement is sufficient to sustain its business without overcharging its customers.

17. Because FNEI is debt financed, it seems to Energy Probe that a method that focuses on the ability of the business to cover its interest costs is better suited than a method such as ROE that is intended to ensure a fair standard of return for investors.

Source of debt financing

18. The source of FNEI's debt is, in Energy Probe's submission, also irrelevant to the issue of whether the TIER method is appropriate. Whether the debt be private or public, the principle concern should be that the interest cost used to determine revenue requirement be sufficient to recover the Applicant's costs. That is a standard feature of the Board's review of a utility's cost of capital and, therefore, not an issue.

Amount of debt financing compared to other utilities

19. FNEI claims that it "is not more heavily debt financed than other utilities". In Energy Probe IR 7 (c) they were asked:

"What funding other than debt does FNEI have? What other utilities is it comparing itself to in the statement on lines 10-11?"

20. FNEI replied "None" to the first question and did not answer the second question relating to the other comparable utilities.

21. Energy Probe concludes from that response that FNEI is 100% debt financed which, in Energy Probe's submission, makes FNEI more similar to the utilities in the United States that use TIER than to utilities in Ontario that are not so heavily debt financed and use ROE.

22. Energy Probe further submits that the company's claim that it "is not more heavily debt financed than other utilities" is not supported by any evidence so cannot be used to support a conclusion that TIER is not appropriate.

23. In Paragraph 21 of the Applicant's Argument-in-Chief, the company points out that if the TIER method were applied to its revenue requirement, the result would be a TIER of 2.5, which falls within the acceptable range of 2.0 to 2.8. Energy Probe submits that this is good evidence that the method yields an appropriate

result. This, in Energy Probe's submission, should persuade the Board that the TIER methodology is appropriate in FNEI's case.

If FNEI's revenue requirement is established using the Reserves approach, what reserves should FNEI establish?

24. Energy Probe supports the submissions of Board Staff and has no additional submissions to make on this subject.

Operating Revenue Forecast

25. Energy Probe supports the submissions of Board Staff and has no additional submissions to make on this subject.

Operations Maintenance and Administration

26. Energy Probe supports the submissions of Board Staff and makes the following additional submissions.

27. Board staff points out the shortcomings of FNEI's tendering and service agreements with related entities and recommends improvements in those practices. Energy Probe agrees with Board Staff's analysis and recommendations on the issue and points out that other elements of FNEI's tendering practices are similarly lacking in the customary controls used to ensure that fair value is received from contractors.

28. FNEI's responses to Energy Probe IRs 10, 11, 12, 15 and 16 demonstrate that significant amounts of consulting and construction work have been awarded without competitive tendering.

29. Energy Probe submits that without competitive tendering it is difficult to determine whether the price quotations FNEI received for the work were reasonable. Without that evidence questions arise about the prudence of the expenditures.

30. Energy Probe submits that the Board should require FNEI to develop purchasing procedures that result in competitive bidding on its contracted work as much as possible given its circumstances.

Cost of Capital

31. Board Staff's submissions on this subject are premised on the assumption that the ROE approach will be maintained for setting of 2010 rates.

32. Energy Probe disagrees with this approach and submits that the Board should use an alternate approach for the following reasons:

- i) The ROE approach assumes investor equity and seeks to provide a return on that equity sufficient to allow the company to attract investment to operate its business. Not for profit utilities like FNEI do not have investors and, therefore, have no need to demonstrate any return on equity because they are not trying to attract investment capital.**

- ii) For profit utilities regulated by the Board are subject to taxes or payments in lieu (PILs) on their earnings. Not for profit utilities do not pay taxes or PILs because they do not ordinarily have any earnings that would attract tax. If not for profit utilities are permitted to earn the equivalent of ROE in their rates without paying PILs an inequity arises. Setting rates by a mechanism other than ROE will avoid the appearance that a not for profit utility is getting the benefit of a return on equity without the attendant requirement to pay taxes.**

iii) Consistent and understandable application of Board policy is necessary for regulatory certainty. Applying the ROE methodology to FNEI, which has no share capital, is inconsistent with the underlying objective of the methodology to provide investors with a fair return on their investment. Deviating from that principle in this application may invite other applicants to request variations from Board policy without well founded reasons.

iv) Other approaches are available to the Board to ensure that FNEI receives sufficient revenue from rates to operate its transmission business. The TIER approach is one example. Another would be to allow sufficient interest in the revenue requirement to cover the cost of FNEI debt and then set targets for the operating and capital reserve funds as separate elements of revenue requirement that could be adjusted at each rate setting application.

33. Energy Probe further submits that FNEI has not provided an explanation of why it prefers not for profit status when the evidence clearly indicates that it wants to earn profits. If it wishes to be treated the same as its for profit counterparts in revenue requirement there is a simple solution – become a for profit utility. In that event there would be no issue about using the ROE approach nor would there be a debate over whether it should be able, as a not for profit entity, to collect excess revenues in its transmission rates and deploy them for the general benefit of its members' communities.

34. One way of resolving the issues raised by this Application is for the Board to predicate the use of the ROE approach on FNEI converting to a for profit structure.

35. The previous submissions notwithstanding, if the Board decides to continue using the ROE approach without requiring FNEI to convert to a for profit structure, Energy Probe supports the position and recommendations made by Board Staff in its submissions

Charge Determinant Forecast

36. Energy Probe supports the submissions of Board Staff on this subject and has no additional submissions to make.

Harmonized Sales Tax

37. Energy Probe supports the submissions of Board Staff on this subject and has no additional submissions to make.

Compliance with Board Directives

38. Energy Probe notes that the time since the Applicant's last rates application has been almost ten years. Because of this, Energy Probe submits that the Board should consider putting time constraints on any directives it might include in its decision.

Costs

39. Energy Probe submits that it participated responsibly in this proceeding. Energy Probe requests the Board award 100% of its reasonably incurred costs.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

July 19, 2010

Peter Faye

Counsel to Energy Probe Research Foundation