

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.
REPLY ARGUMENT**

July 30, 2010

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A. PRELIMINARY MATTERS

1. In its submission of July 16, 2010 (“Board Staff Submissions”), Board Staff organized their comments on FNEI’s rate case into the following topics/issues:
 - Status of Board Directives
 - Operating Revenue Forecast
 - Operations, Maintenance and Administration
 - Cost of Capital
 - Charge Determinant Forecast
 - Harmonized Sales Tax
2. Energy Probe organized their argument of July 19, 2010 in the same order as Board Staff Submissions. Consequently, and for ease of reference, FNEI has organized this Reply Argument in a way that corresponds to the order of topics/issues in the Board Staff Submissions.
3. Before replying to submissions on the first issue (i.e., Status of Board Directives), FNEI would like to point out three minor points relating to pages 2 and 3 of Board Staff Submissions:
 - There is a typographical error in the fifth paragraph on page 2. FNEI’s application was filed on February 26, 2009 (not 2007).
 - In the sixth paragraph on page 2, Board Staff is correct that by its Decision and Order dated April 27, 2010, the Board made FNEI’s current rates interim. FNEI would simply like to make it clear that the rates were made interim as of March 1, 2010.
 - In the first line on page 3, the Board Staff Submission states that final reply is due by July 29, 2010. However, pursuant to the Board’s letter dated July 21, 2010 in this proceeding, this Reply Argument is due July 30, 2010.

B. STATUS OF BOARD DIRECTIVES

4. FNEI has read the very lengthy submissions of Board Staff and Energy Probe regarding the Board Staff Directives, as well as the submissions of Energy Probe under Cost of Capital (which tie into the same issues). The issue at the heart of these submissions is: What is the appropriate basis for determining FNEI's cost of capital to be included in FNEI's revenue requirement (and provincial transmission rates)? This would be a non-issue if FNEI were a typical for-profit utility. FNEI would use a deemed capital structure, propose a cost of debt (based on actual and/or deemed debt rates) and calculate a return on equity ("ROE") using the Board-approved return rate.
5. FNEI is, however, a non-profit corporation.
6. According to Board Staff and Energy Probe, the fact that FNEI is non-profit means that the traditional method of determining cost of capital is inappropriate. At the core of this belief, and underlying all of Board Staff's and Energy Probe's submissions is one critical assumption: That once FNEI has built up sufficient reserves to appropriate carry on business (capital, operating and insurance reserves), then FNEI can no longer continue to earn revenues in excess of its costs or it will lose its non-profit status.
7. This assumption is completely wrong.
8. FNEI can always earn revenues in excess of its costs, provided such excess revenues are not paid out as dividends, but rather are spent in a manner consistent with FNEI's corporate objectives (as set out in its Letters Patent). As noted in the response to Board Staff IR #8, FNEI has received professional advice on this point, and is in no way concerned about losing its non-profit status merely by continuing to earn revenues in excess of costs.
9. The belief that FNEI must earn, in effect, a 0% ROE once any reserve accounts established by FNEI are fully funded, is incorrect as a matter of law.
10. Once that false assumption is dispelled, the question is: What is it about FNEI's non-profit status that makes the standard methodology for establishing cost of capital no longer appropriate? Does the methodology lead to rates that are not just and reasonable?

FNEI's answer to these questions is that the standard methodology (referred to as the ROE Approach in Board Staff Submissions) is entirely appropriate for establishing FNEI's cost of capital to be included in revenue requirement. FNEI submits that the traditional ROE Approach is straightforward and results in an appropriate cost of capital for all Ontario utilities (including FNEI) and that FNEI's non-profit status does nothing to change that.

11. At the end of the day, FNEI carries on its operations like any other commercial, for-profit utility, it just does not pay dividends (but will instead take excess revenues and spend it on activities that “promote the social, economic and civic welfare and development of the Attawapiskat, Fort Albany and Kashechewan First Nations”, as per FNEI's Letters Patent).
12. As noted in the response to Board Staff IR #8, there is nothing unusual about non-profit corporations operating in a competitive or commercial environment. The two cases cited in the response to Board Staff IR #8 involved a logging corporation that competed against for-profit corporations, and an insurance organization that offered commercial insurance to its members. Both were non-profit.
13. FNEI's view is that its status as a non-profit corporation is immaterial from a rate regulation perspective. The question of whether FNEI's activities are consistent with its corporate objectives (as set out in its Letters Patent) is not an issue to be determined by this Board. Indeed, FNEI's status as a non-profit has only two implications for the Board's jurisdiction as it relates to rate regulation: (a) FNEI does not (as a non-profit) pay income taxes, so there is no income tax expense included in FNEI's revenue requirement (i.e., a benefit to Ontario transmission customers); and (b) the Board must ensure that FNEI's spending of its excess revenues does not put the utility in a compromised position that ends up putting inappropriate costs on transmission ratepayers.
14. With respect to (b), this means that FNEI should spend its “excess revenues” in the three communities (even though they may be consistent with FNEI's corporate objectives) if such spending compromises FNEI's ability to appropriately carry on its transmission business. This is exactly the same scrutiny the Board applies to dividend payments of for-profit utilities.

15. The question of whether FNEI's spending of its excess revenues falls within the corporate objectives of FNEI's Letters Patent is not a matter for the Board to determine as part of its rate-setting jurisdiction, but rather for FNEI's corporate and tax advisors. What is a matter for the Board is to ensure that the quantum of such spending by FNEI does not compromise its ability to meet its capital or other operating requirements efficiently or with inappropriate cost consequences for transmission ratepayers.
16. Because FNEI operates in exactly the same way as other electric utilities in Ontario, and because there is nothing to preclude FNEI from earning excess revenues, FNEI submits that there is no basis for determining that the traditional methodology for calculating cost of capital is inappropriate for FNEI, or somehow results in unjust or unreasonable rates.
17. In fact, utilizing the ROE Approach to set FNEI's cost of capital has two very important advantages: (a) it is straightforward and familiar to the Board; and (b) ensures consistency of treatment across Ontario transmitters.
18. The "Reserve Approach" as a method of determining FNEI's cost of capital is more complicated, particularly in respect of determining an appropriate Capital Reserve cap. If FNEI were a for-profit entity, we would not be having a discussion about setting up reserves, determining appropriate caps for (and policies governing) reserves. Instead, FNEI would simply earn revenues and run its business in accordance with its best business judgment. FNEI does not believe that the form of corporate vehicle adopted by a utility should change a utility's ability to exercise its best business judgment. The differences between a for-profit corporation and a non-profit corporation that operates in a commercial manner are not as significant as Board Staff and Energy Probe would suggest.
19. Because of that, FNEI submits that using the traditional methodology to set FNEI's cost of capital is appropriate. Under FNEI's proposal, it would use revenues to carry on its operations (as it has for the past eight years), maintain an Insurance Reserve (which is fully funded) and establish reserves for capital and operating purposes based on its own business judgment.

20. FNEI does not propose to set any “caps” on its capital or operating reserves because it might 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.
21. For all of the above reasons, FNEI submits that establishing FNEI’s cost of capital (for inclusion in FNEI’s revenue requirement) on the basis of the traditional “ROE Approach” is appropriate.
22. Before leaving this issue, FNEI notes that Board Staff agrees with FNEI’s submission that the TIER mechanism is an inappropriate method to setting FNEI’s cost of capital, so FNEI will not revisit its submissions made in Argument-in-Chief.

C. OPERATING REVENUE FORECAST

23. Board Staff submits that FNEI’s forecast of Transmission Services Revenue for the 2010 Test Year (\$4.978 million) is too low. FNEI’s forecast was based on FNEI’s projected 2009 Transmission Services Revenue (at the time FNEI filed the application in this proceeding), and assumed no growth in transmission revenues from 2009 to 2010. As Board Staff notes, FNEI filed its 2009 Audited Financial Statements with the Board during the course of this proceeding, which showed FNEI’s actual Transmission Services Revenue to be marginally higher (\$5,023,982).
24. Board Staff Submissions contained a table (on page 15) showing:
 - FNEI’s actual Transmission Services Revenue in each year from 2002 through 2009;
 - FNEI’s average annual Transmission Services Revenue from 2002 through 2009;
 - FNEI’s average annual Transmission Services Revenue from 2006 through 2009 (i.e., since De Beers was connected to the FNEI system);
 - FNEI’s average annual Transmission Services Revenue from 2007 through 2009 (i.e., the last three years); and,

- FNEI's annual Transmission Services Revenue using a linear trend methodology from 2002 through 2009.

Board Staff submits that a more reasonable forecast for FNEI's Transmission Services Revenue for the 2010 Test Year is \$5.28 million (which is basically equivalent to the annual average of the last three years, and the result using the linear trend methodology – i.e., the last two methods on the table noted above).

25. Energy Probe supported the submissions of Board Staff on the Operating Revenue Forecast issue, and had no additional comments to make.
26. Neither Board Staff nor Energy Probe take issue with FNEI's forecast of Other Revenues of \$0.1 million.
27. FNEI believes that its original forecast of \$4.978 million in Transmission Services Revenue for the 2010 Test Year remains valid, for the reasons set out below.
28. First, we should point out that the effect of De Beers on FNEI's transmission revenues is basically irrelevant. FNEI's revenues are tied to the entire provincial transmission demand and do not fluctuate based on the transmission demand of FNEI's customers (except to the extent that FNEI's four customers can impact the entire provincial demand). Put another way, any new transmission revenues generated by De Beers' Victor Diamond Mine will be revenues shared by all four rate-regulated transmitters in proportion to their share of the provincial transmission revenue requirement (i.e., Hydro One Networks Inc. would receive approximately 96.5% of such revenues, and FNEI would receive 0.4% of such revenues). The impact of De Beers' consumption, or that of any other FNEI customer, on FNEI's Transmission Services Revenue is irrelevant.
29. Second, FNEI is of the view that historical data on Transmission Services Revenues (which relate directly to provincial transmission demand) is of limited utility. FNEI's forecast was based on the best IESO forecast data available on electricity demand. The IESO data predicts an increase in Ontario electricity demand of 0.4% for 2010 (as compared to 2009) and an increase of 0.8% in 2011 (as compared to 2010). Further, FNEI's actual Transmission Services Revenue for the period from January to April 2010

shows a 2% decrease over FNEI's actual Transmission Services Revenue same period in 2009, as follows:

Month	FNEI Revenues (2009)	FNEI Revenues (2010)
January	\$457,055.67	\$459,391.72
February	\$438,252.57	\$441,921.81
March	\$432,041.43	\$401,075.15
April	\$381,525.62	\$370,605.56
TOTAL	\$1,708,875.29	\$1,672,994.24

See Board Staff IRs #19 and #20(e) and (f)

30. The IESO's demand forecast appears to indicate that the key factor driving the forecast is industrial demand (which appears to have largely accounted for the drop in transmission revenues in 2008 and 2009). The IESO notes in its 18-Month Outlook (an excerpt of which is attached to Board Staff IR#19) that although provincial electricity demand is expected to grow modestly over 2010 and 2011 (i.e., the 0.4% and 0.8% mentioned above), peak demands are expected to decline due to conservation programs, the growth in embedded generation, and the introduction of time-of-use meters. Since transmission revenues in Ontario are tied directly to peak demand (coincident and non-coincident), this further argues for a conservative forecast of FNEI's Transmission Services Revenue for the 2010 Test Year.
31. Thus, FNEI submits that its original forecast of \$4.978 million in Transmission Services Revenue for the 2010 Test Year remains valid, because: (a) historical levels of FNEI's Transmission Services Revenue are of limited utility because Transmission Services Revenue fluctuate based on factors beyond FNEI's control; and (b) the IESO's demand forecast represents the best information available to forecast Transmission Services Revenue, and the IESO is forecasting very modest provincial demand growth and a decline in peak demand.
32. At the end of the day, not much turns on which forecast of FNEI's Operating Revenue is more accurate or plausible. If FNEI's forecast is used, FNEI's forecasted revenue deficiency is \$1.488 million, and if Board Staff's suggested forecast is used, FNEI's

forecasted revenue deficiency is \$1.186 million. In either case, the deficiency is material and a new revenue requirement for FNEI is needed.

D. OPERATIONS, MAINTENANCE AND ADMINISTRATION (“OM&A”)

33. Board Staff submits that, in general, the level of FNEI’s OM&A expenses are reasonable. However, Board Staff does make submissions on four OM&A issues: (a) International Financial Reporting Standards (“IFRS”) costs; (b) tendering and service agreements with related entities; (c) fibre optic line operating and maintenance costs; and (d) charitable donations and sponsorships.
34. Energy Probe’s submissions on FNEI’s OM&A expenses is confined to the issue of FNEI’s tendering and service agreements with related entities.
35. FNEI’s reply submissions on each of the four OM&A issue are set out below.

(a) IFRS Costs

36. Board Staff accepts FNEI’s position that it would be appropriate for FNEI to adopt IFRS, even though the Board’s Report on IFRS indicates that entities such as FNEI may not be required to otherwise adopt IFRS.
37. FNEI’s rationale for wanting to adopt IFRS are set out comprehensively in its evidence and in its response to Board Staff IRs (and summarized by Board Staff at pages 17 and 18 of the Board Staff Submissions). FNEI will not repeat its evidence on this point in this Reply Argument.

(b) Tendering and Service Agreements with Related Entities

38. The Board Staff Submissions argue that FNEI ought to have service agreements with each of the local distribution companies (“LDCs”) in Attawapiskat, Fort Albany and Kashechewan. These LDCs (because of the proximity of LDC lineworkers to FNEI’s main assets, and the excessive costs of mobilizing workers from outside the region to address maintenance issues) perform maintenance work for FNEI. To date, FNEI has not procured these services pursuant to any competitive tendering process, nor does FNEI have any service agreements governing the maintenance work.

39. Board Staff indicates that service agreements should be put in place because in the absence of any agreement, disputes could arise as to pricing, accusations of non-performance, liability or other terms. Board Staff submits that establishing these service agreements should be a priority for FNEI.
40. Energy Probe goes further, and indicates that the Board should require FNEI to develop competitive bidding for its contracted work as much as possible, given FNEI's unique circumstances. Energy Probe states that without competitive tendering it is difficult to determine whether FNEI's costs for this maintenance work are reasonable.
41. FNEI acknowledges the positions of both Board Staff and Energy Probe, and the rationale supporting their positions. FNEI agrees with Board Staff that service agreements between FNEI and the three LDCs are required, for the precise reasons outlined by Board Staff. FNEI plans to put in place these service agreements with the LDCs in short order, and FNEI believes that it can have these agreements in place before the end of calendar year 2010 (since they would largely codify the existing unwritten arrangements that have prevailed between the parties).
42. The concerns of Energy Probe about the prudence of pricing under the maintenance contracts with the LDCs should be alleviated by the establishment of service agreements. The fact is that the LDCs are the only companies in these communities that can provide the maintenance services to FNEI. Thus, any competitor would have to fly into the communities (which is not only prohibitively expensive, but cannot be done on a timely basis as compared to LDC workers). In addition, FNEI has always procured the maintenance services from the three LDCs on a "cost plus 15%" basis, where "cost" is comprised of: (a) non-unionized labour costs of \$28 to \$36 per hour; (b) equipment rental costs; and (c) minimal materials costs, since FNEI usually supplies these materials. These terms, combined with zero travel costs, make these arrangements far better than anything FNEI could achieve through a competitive tendering process. Again, having service agreements in place with the LDCs will make the pricing transparent to the Board and should ensure that Board and intervenors have a basis for assessing the prudence of such costs in the future.

43. With respect to Energy Probe's suggestion that FNEI develop competitive bidding for its contracted work "as much as possible given its circumstances", FNEI does not object to competitive tendering when it makes sense but wishes to retain discretion to determine when it should sole-source and when it should run a competitive tendering process. Apart from its maintenance service arrangements with the LDCs, FNEI has tended to sole-source work to companies that have previously worked in these communities, and/or previously provided goods/services to FNEI. This is because FNEI considers this experience to be absolutely critical – not only from the perspective of having worked in harsh geographic and climatic conditions, but also: (a) understanding the logistics of moving materials/equipment in remote areas; and (b) in the case of longer-term projects, having personnel residing in the communities that have an understanding of the socio-economic and cultural conditions in the communities.
44. FNEI understands the value of competitive tendering when it comes to providing evidence about the prudence of costs, and tenders where FNEI considers it advisable. FNEI particularly understands the importance of tendering where goods/services are procured from non-arm's length parties. However, given the unique circumstances in which FNEI operates, FNEI wishes to retain its discretion to determine when sole-sourcing might make most sense.

(c) **Fibre Optic Line Operating and Maintenance Costs**

45. Board Staff's submission on this point is not entirely clear, but appears to suggest that the Board direct FNEI to provide an analysis of the ongoing operating and maintenance costs of FNEI's new fibre optic system (as compared to the dial-up telephone system that the fibre optic system replaced). FNEI had been asked to provide this comparison in Board Staff IR #33, but responded that FNEI did not have sufficient operating experience with the fibre optic system to provide a meaningful analysis. FNEI also stated (as pointed out in the Board Staff Submissions) that such an analysis was of little value because the fibre optic system provided FNEI with far superior operating control over the transmission system (real-time as opposed to dial-up every thirty minutes), metering communication and the ability to monitor stations for security and public safety. While FNEI anticipates that there will be operational cost savings (because there should be fewer trips to the

communities from Timmins to determine equipment status), the real rationale for converting to the fibre optic system was better operational control, and added system safety and security.

46. To be frank, part of FNEI's concern with providing such a cost comparison is that the Board will look at the operating cost comparison solely for the purpose of determining whether the capital cost of the fibre optic system was warranted. While there will be operational cost savings associated with the fibre optic system (as opposed to the old dial-up telephone system), FNEI does not expect that such cost savings would reach the level of the capital cost of the fibre optic system. In FNEI's submission, an operating cost comparison of the two systems only tells half the story – with the other half, of course, being the benefits of the system (as outlined in FNEI's evidence and IR responses, and summarized above).
47. In order to assist the Board in determining whether to direct FNEI to provide such an analysis, FNEI can advise the Board that the current plan is to lease the spare fibre strands (i.e., the "overbuild") to Western James Bay Transmission Network ("WJBTN") for \$50,000 annually. The plan is to waive this fee for an initial period (potentially three years) in order to allow WJBTN to attract a client base (and revenue stream) that would allow them to pay the annual fee. In addition, FNEI expects that it would take at least three years of operational experience to obtain useful data as to cost savings provided by the fibre optic network.

(d) Charitable Donations and Sponsorship Amounts in Account 5410

48. Board Staff recommends that the Board deny \$31,225 of the \$86,000 forecast to be spent in this account, on the basis that the \$31,225 historically has not been spent on programs that provide assistance to customers in paying their electricity bills and assistance to low income customers (as per the Board's Filing Requirements).
49. FNEI acknowledged that the \$31,225 was not spent on such programs, but rather on sponsorship of cultural events (Creefest), local scholarships and other sponsorship of educational events.

50. In FNEI's submission, the Board's Filing Requirements are overly narrow, and the Board (in exercising its rate-making jurisdiction) should have the flexibility to consider whether any expense in Account 5410 is a legitimate cost of doing business (and therefore recoverable through rates).
51. In the case of the \$31,225 spent by FNEI under Account 5410, FNEI considers this to be money that is extremely well spent. FNEI operates its assets in three communities (three Indian Reserves) and the traditional territories of five First Nation communities (i.e., the traditional hunting, fishing and trapping grounds of these communities and individuals within these communities). FNEI's operations requires them to occupy and access these lands on a continuous basis. Maintaining a positive corporate reputation and profile in these communities, from FNEI's perspective, just makes good business sense and ought to be viewed as a legitimate business cost.

E. COST OF CAPITAL

52. The Board Staff Submissions address four items related to Cost of Capital: (a) short-term debt; (b) Board-deemed interest rates; (c) other unfunded debt; and (d) the phase-in of a debt to equity structure. FNEI will reply to each of these items below.
53. Before making its reply to submissions on these four items, FNEI notes that Board Staff's submissions on cost of capital are premised on the assumption that the Board will use the ROE Approach to setting FNEI's 2010 rates (and not the Reserve approach for rate-setting). Energy Probe ultimately agrees with Board Staff submissions if the Board decides to continue using the ROE Approach, but Energy Probe did argue that use of the ROE Approach for FNEI should be predicated on FNEI converting to a for-profit structure. Because the issue of FNEI's profit is intimately tied to the issues in the Board Directives, FNEI has replied to Energy Probe's argument on this point (as expressed in paragraphs 32 through 34 of Energy Probe's Argument) in Section B of this Reply Argument above. Consequently, the remainder of this Section E of the Reply Argument is devoted to replying to the four items noted above.

(a) **Short-Term Debt**

54. On the issue of short-term debt, the Board states that there is a discrepancy between:
- FNEI's evidence (which states that the Operating Facility from Pacific & Western Bank ("PWB") has an interest rate of "Prime + 250 bps"); and,
 - FNEI's 2006 Credit Agreement (filed in response to Board Staff IR #59) which indicates that the Operating Facility is at the "PW Interest Rate" which is defined as "equal to the Prime Rate less one quarter of one percent (0.25%)".

The former would yield an interest rate of 4.75%, while the latter would yield an interest rate of 2.0% (very close to the Board's current deemed short-term debt rate).

55. The discrepancy is easily explained. FNEI's evidence is correct. Certain provisions of the 2006 Credit Agreement were amended on November 13, 2009 by way of a two-page letter agreement (on PWB letterhead). One of the provisions amended was the definition of "PW Interest Rate", which was changed to mean "a rate per annum equal to the Prime Rate plus two and one half percent (2.5%). Currently the all in rate is 4.75%." This two-page amending letter agreement was included in the response to Board Staff IR #59 (after Schedule K to the Credit Agreement, which was the last page of the Credit Agreement).
56. The interest rate on the PWB Operating Facility was less favourable as of November 2009 than it was in the original Credit Agreement. FNEI submits that this had nothing to do with the financial viability of FNEI, but rather had to do with the economic conditions globally and the impact of these conditions on lending generally.
57. Given the clarification, FNEI submits that applying for a short-term debt rate at FNEI's actual debt rate is appropriate.

(b) **Board-deemed Interest Rates**

58. The Board Staff Submissions contain a Table that demonstrates that if the Board-deemed short-term debt rate (of 2.07%) is used for all of FNEI's short term debt, FNEI's overall return is reduced from \$1.893 million to \$1.863 million (or a \$30,000 decrease). Board

Staff submits that adopting the Board-deemed short-term debt rate would treat FNEI consistently with other electricity transmitters and distributors for rate-making purposes.

59. As clarified in (a) above, FNEI's actual short-term debt rate is 4.75% and as a result, FNEI believes that it is more appropriate than the Board-deemed short term debt rate.
60. In the alternative, FNEI submits that at a minimum the amount of short-term debt with the fixed 4.75% interest rate (i.e., the \$500,000 Operating Facility) should be included in costs (with the remaining unfunded debt at the deemed rate) to ensure that FNEI is allowed to recover its actual costs. This calculation was carried out by FNEI in response to Board Staff IR #60(b) and results in a weighted cost of short-term debt (\$500,000 at 4.75% and the remainder at the Board-deemed rate of 2.07%) of 3.24%. The resultant overall return for FNEI with this weighted cost of short-term debt is \$1.875 million.

(c) **Unfunded Debt**

61. The Board Staff Submissions on this issue make two points. The first paragraph of Board Staff Submissions (at the top of page 24) indicates that FNEI has unfunded debt in the amount of \$647,500, but that only \$500,000 of this is covered by the BMO line of credit. Board Staff states that FNEI was unable to "provide any information with respect to the applied for \$147,500 tranche of unfunded debt". Board Staff derives the \$647,500 figure by subtracting \$500,000 (representing the PWB Operating Facility) from FNEI's short-term debt (which is calculated at \$1,147,500 in FNEI's evidence at Exhibit 5, Tab 1, Schedule 2, page 3).
62. The explanation of how unfunded debt is calculated is straightforward. FNEI's short-term debt cost is a calculation (i.e., it is calculated by taking 4% of FNEI's rate base). In other words, because FNEI is applying for a cost of capital based on a deemed capital structure, the amount of short-term debt is a plug calculation (as is the amount of long-term debt and the amount of common equity). This is normal practice.
63. The second point made by Board Staff on the topic of unfunded debt is to reiterate Board Staff's view that FNEI's unfunded short term debt should be prescribed by the Board's *Cost of Capital Report*. FNEI has already replied to this submission.

64. The only new point raised by Board Staff on this point is to highlight that portion of the *Cost of Capital Report* which indicates that the new deemed short-term debt rate was developed for use in the electricity transmission sector (and not just the electricity distribution sector). However, in FNEI's view, the fact remains that a portion (\$500,000) of FNEI's short-term debt has an actual short-term debt rate of 4.75% and FNEI should be permitted to recover its actual costs.

(d) Transition to Deemed 60/40 Capital Structure

65. Neither Board Staff nor Energy Probe take issue with FNEI making the transition directly to a 60/40 debt-to-equity split, as per FNEI's application. Consequently, FNEI has no reply submissions on this point.

F. CHARGE DETERMINANT FORECAST

66. Board Staff submits that the Board may wish to consider whether the 2010 charge determinant forecast submitted with FNEI's application should be increased to better reflect historical trends and actual experience. Board Staff considers the charge determinant forecast determined by utilizing the linear trend method to be a more reasonable estimate of 2010 charge determinants.
67. Energy Probe supported the submissions of Board Staff on this issue, and had no additional comments to make.
68. Board Staff asked a number of questions regarding charge determinants, which considered a number of different scenarios for estimating FNEI's 2010 charge determinants.
69. FNEI takes no issue with submissions of Board Staff and Energy Probe as to the most appropriate method for estimating FNEI's 2010 charge determinant forecast.

G. HARMONIZED SALES TAX

70. Board Staff submits that the Board may wish to consider establishing a deferral account to track any savings in OM&A expenses and capital expenditures that might arise as a

result of harmonizing the provincial sales tax (“PST”) and goods and services tax (“GST”). Board Staff notes that the Board has consistently directed LDCs who filed a 2010 rate application to establish a deferral account for this purpose.

71. Board Staff also notes that: (a) FNEI typically does not have any OM&A expenses that are subject to PST (because most of FNEI’s expenses are PST exempt); and (b) FNEI did have substantial PST amounts on capital expenditures in 2009 (\$167,096).

See FNEI Response to Board Staff IRs #10 and #27

72. Energy Probe supported the submissions of Board Staff on this issue, and had no additional comments to make.
73. As noted in FNEI’s responses to Board Staff IR #10(d) and #27(e), FNEI is not opposed to the establishment of a deferral or variance account to record any PST savings on FNEI’s OM&A expenses and capital expenditures. However, as pointed out in FNEI’s response to Board Staff IR #27(e), FNEI was unsure as to how any amounts in a variance account would be administered.
74. Unlike LDCs that have direct billing and collection relationship with their customers, FNEI (as a transmitter) does not have any such relationship. FNEI receives payment for the transmission services it provides from the IESO, based on FNEI’s share of the provincial transmission revenue requirement. Because FNEI’s revenues are tied to province-wide transmission revenues (and province-wide electricity demand), presumably any rebate of PST savings would have to be made to all provincial transmission customers (as opposed to the four transmission customers served by FNEI). As a result, there would have to be a mechanism for FNEI to allocate any PST savings to all provincial transmission customers. The simplest way to do this would be to bring forward any amounts in a PST deferral/variance account at FNEI’s next cost-of-service proceeding, and dispose of any amounts recorded in such account in a future FNEI test year (i.e., reduce FNEI’s revenue requirement in a future test year). FNEI understands that this is how HONI’s Tax Rate Changes Account will work.
75. FNEI does not object to establishing a deferral/variance account similar to HONI’s Tax Rate Changes Account, but would raise a couple of issues: (a) the importance of

recognizing that FNEI does not come in for rate applications as frequently as HONI; and (b) whether the administrative burden and costs associated with FNEI establishing (and the Board regulating) any deferral account is worthwhile.

76. With respect to the first issue, the issue is an administrative one, and stems from the fact that it is likely that FNEI will continue to wait a few years before coming to the Board with a new rate application. As a result, FNEI could not (for example) bring forward a PST deferral/variance account for disposition (with \$100,000 in PST savings recorded in the account) in the year 2015, and have FNEI's revenue requirement in 2015 reduced by \$100,000 because it could be 2020 before FNEI is back in with a rate application. Further, FNEI submits that it does not make sense to have the clearance of a PST deferral/variance account drive the timing of (potentially more frequent) FNEI rate applications.
77. With respect to the second issue, as noted by Board Staff, FNEI's OM&A expenses typically do not attract PST, and although PST paid on capital expenditures by FNEI has been significant in recent years, FNEI's capital expenditures are expected to be a very small fraction of what they have been in recent years.
78. In the response to Board Staff IR #10(c), FNEI's PST on capital expenditures in the past three years was \$17,815 in 2008 and \$167,096 in 2009 (it was \$0 in 2007). However, FNEI's capital expenditures in recent years were significant compared to FNEI's capital expenditures forecasted for Test Year 2010:
- **\$4.2 million** in actual capital expenditures in 2006
 - **\$4.8 million** in actual capital expenditures in 2007
 - **\$9.4 million** in actual capital expenditures in 2008
 - **\$2.9 million** in actual capital expenditures in 2009
 - **\$275,000** in forecasted capital expenditures in Test Year 2010
79. Consequently, FNEI submits that any PST savings accrued in a deferral or variance account would likely be miniscule, and potentially nothing. That having been said, if the Board considers it appropriate and worthwhile to have FNEI establish a deferral/variance account, and the administrative issue associated with disposing of any amounts recorded

in such a deferral/variance account can be overcome, then FNEI has no issue with the establishment of such an account.

All of which is respectfully submitted this 30th day of July, 2010.

FIVE NATIONS ENERGY INC.



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