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May 20, 2011

BY EMAIL & COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Dear Ms. Walli:

Board File No. EB-2010-0138
Niagara Peninsula Energy Inc. – 2011 Cost of Service Application
Energy Probe – Final Argument

Pursuant to the Decision on Partial Settlement and Procedural Order No. 3, issued May 16, 2011, please find attached the Final Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2010-0138 proceeding for the consideration of the Board.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

Original signed by

David S. MacIntosh
Case Manager

cc: Brian Wilkie, Niagara Peninsula Energy (By email)
Suzanne Wilson, Niagara Peninsula Energy (By email)
James Sidlofsky, Borden Ladner Gervais LLP (By email)
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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 Niagara
Peninsula Energy Inc. for an order approving just and
reasonable rates and other charges for electricity
distribution to be effective May 1, 2011.

**ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")**

ARGUMENT

MAY 20, 2011

**NIAGARA PENINSULA ENERGY INC.
2011 RATES REBASING CASE
EB-2010-0138**

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A - INTRODUCTION

This is the Argument of the Energy Probe Research Foundation ("Energy Probe") related to the setting of 2011 rates for Niagara Peninsula Energy Inc. ("NPEI") on the two unsettled issues from the Settlement Agreement ("Settlement Agreement") dated May 4, 2011. These unsettled issues are the long term debt rate on the affiliate debt and the effective date of rates. Both of these issues are noted in Appendix A to the Settlement Agreement.

B - LONG TERM DEBT RATE

NPEI has requested an overall weighted long term debt rate of 6.36% (Exhibit 5, page 3, Table 5-1). Within this weighted average cost of long term debt are two debt instruments held by affiliates of NPEI. These two instruments are long term notes payable to the City of Niagara Falls (\$22,000,000) and to Niagara Falls Hydro Holding Corporation (\$3,605,090). Both have a fixed interest rate of 7.25%, which was the Board's deemed long-term interest rate at the time of issuance, which was April 1, 2000 (Table 5-1). However, it should be noted that the promissory notes shown in Appendix A to Exhibit 5 are actually dated September 26, 2000 and July 24, 2001. As NPEI indicates on page 3 of Exhibit 5, these two long term notes payable were approved by the Board in Niagara Falls Hydro's 2006 EDR application.

Both long term notes have maturity dates of April 1, 2020 and are payable upon demand. In addition, both notes may be revised or changed at the option of the debt issuer and on one year's prior written notice (Exhibit 5, page 3, lines 13-16).

Based on these facts, NPEI states that its view is that both of these affiliate notes should be classified as embedded debt and the fixed rate of 7.25% should be reflected in the calculation of the weighted average cost of long term debt for 2011 (Exhibit 5, pages 3-4). Energy Probe respectfully disagrees.

In the EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities dated December 11, 2009 ("Board Report") the Board found that there were certain circumstances where the deemed long term debt rate would act as a proxy or ceiling for what would be considered to be a market based rate. The two relevant circumstances in regard to this proceeding are the following (taken from pages 53 and 54 of the Board Report):

1. For affiliate debt (i.e., debt held by an affiliated party as defined by the Ontario Business Corporations Act, 1990) with a fixed rate, the deemed long-term debt rate at the time of issuance will be used as a ceiling on the rate allowed for that debt.

2. For debt that is callable on demand (within the test year period), the deemed long-term debt rate will be a ceiling on the rate allowed for that debt. Debt that is callable, but not within the period to the end of the test year, will have its debt cost considered as if it is not callable; that is the debt cost will be treated in accordance with other guidelines pertaining to actual, affiliated or variable-rate debt.

Energy Probe submits that NPEI appears to be relying on the first of these two circumstances. In particular, NPEI claims that the two affiliate notes are embedded debt, with fixed rates and have been approved by the Board in the 2006 EDR proceeding.

On the other hand, Energy Probe submits that the second of the two circumstances noted above is one that is relevant in this proceeding. Energy Probe agrees that if the affiliate debt is not callable within the test year period, then the second circumstance defaults to the first circumstance and the NPEI interpretation would be appropriate. Energy Probe submits, however, that the affiliate debt instruments are both callable on demand in the test year period and the first circumstance noted above is not relevant for NPEI.

Energy Probe submits that the evidence in this proceeding is clear. Both affiliate notes are callable on demand; they are NOT callable on demand with one year's notice, as claimed by NPEI.

In part (c) of Energy Probe Interrogatory #29, it was asked for the specific wording in the promissory notes shown in Appendix A that indicated that these notes are callable with one year's notice. The response provided is replicated below:

"The phrase "either upon demand by the City or on April 1, 2020 (the Maturity Date)" which is the last sentence of the first paragraph combined with paragraph four "At the option of the City, on one year's prior written notice to WiresCo, the Maturity Date and any of the terms of the Promissory Note may be revised, changed or restated by the City in consultation with WiresCo. The same wording is in the HoldCo Promissory note."

The promissory notes are both shown in Appendix A to Exhibit 5. As noted in the response provided above, the last sentence of the first paragraph indicates that these notes are callable on demand. There is no timeframe associated with the ability to call the loan.

The fourth paragraph deals with specific aspects of the notes that can be changed or restated by the City (or by Holdco depending on the note) in consultation with NPEI with one year's prior written notice to NPEI. The specific aspects that may be revised, changed or restated are noted in paragraph four and include the maturity date and any of the terms of the promissory note.

Energy Probe submits that the promissory notes are clear. They are both callable on demand. This callable feature can be revised, changed or restated at the option of the City (or Holdco) in consultation with NPEI with one year's prior written notice to NPEI from the City (or Holdco). This could include, for example, stipulate that the note is callable on demand with a specific time period for written notice.

This means that at the current time, the callable feature cannot be changed by the City (or Holdco) within the test year, since no evidence has been provided that one year's written notice has been provided to NPEI. This also means that both notes remain callable on

demand in the test year. There is no notice period required related to the callable feature noted in the first paragraph of the notes.

Energy Probe submits that the evidence in this proceeding is very clear. The affiliate loans are callable within the test year. As a result, the second circumstance from the Board Report requires the deemed long term debt to be used as a ceiling on the rate allowed for that debt.

Energy Probe submits that the deemed long term debt rate of 5.32% contained in the Board's March 3, 2011 letter related to the cost of capital parameter updates for 2011 cost of service applications for rates effective May 1, 2011 should be applied as the ceiling on the affiliate debt.

For clarity, Energy Probe submits that this rate should be applied to the affiliate long term debt even if the Board determines that an effective date later than May 1, 2011 is approved by the Board.

Energy Probe has estimated that the weighted average cost of long term debt would be 5.16% based on replacing the 7.25% shown for the two affiliate debt instruments with the Board's deemed rate of 5.32% in Table 5-1 in Exhibit 5.

Applying the weighted overall long term debt rate of 5.16% to the deemed long term debt component of \$66,957,906 (pages 75 and 95 of the Settlement Agreement) would result in a reduction in the deemed long term debt interest cost of slightly more than \$800,000. Energy Probe notes that this is a significant amount and represents nearly 28% of the revenue deficiency resulting from the settlement agreement of \$2,869,242 (page 96 of the Settlement Agreement).

C - EFFECTIVE DATE FOR RATES

Energy Probe submits that the Board should not approve an effective date for rates for NPEI of May 1, 2011.

By way of a letter dated June 29, 2010 to all electricity distributors, transmitters and other interested parties related to the "Update to Chapter 2 of the Filing Requirements for Transmission and Distribution Applications (EB-2010-0001) the Board reminded distributors that cost of service application for 2011 rates to be effective May 1, 2011 were expected to be received no later than August 27, 2010.

NPEI filed a letter dated August 16, 2010 indicating that it would not be able to meet the August 27, 2010 deadline. It further indicated that it would submit its 2011 cost of service application by November 30, 2010. NPEI filed their application and evidence on November 26, 2010, three months beyond the Board's deadline.

Based on the late filing by NPEI, Energy Probe submits that the effective date should be the beginning of the month following the issuance of the Decision in this proceeding. This is consistent with the Board's findings in the EB-2009-0146 Decision dated November 25, 2010 for Renfrew Hydro Inc. In that Decision, the Board went on to state at page 6:

"The preparation and filing of a cost of service rebasing application is a core activity for a distributor – the setting of rates is the foundation upon which the distributor conducts its business. Further, customers are entitled to expect that rates will be set on a prospective basis, with limited recourse to the collection of revenue deficiencies accumulated during the period of interim rates".

Energy Probe notes that the Board has made similar cost of service Decisions for Ottawa River Power Corporation (EB-2009-0165 dated December 15, 2010) and for Hearst Power Distribution Company Limited (EB-2009-0266 dated February 15, 2011).

Energy Probe submits that an effective date of the beginning of the month following the issuance of the Decision in this proceeding for NPEI would ensure that rates would be set on a prospective basis for customers and these customers would not be subject to recovery of the deficiency accumulated during the period of interim rates.

D - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs.

Recognizing the size of Niagara Peninsula Energy Inc., Energy Probe has attempted to minimize its time on this application, while at the same time ensuring a thorough review.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

May 20, 2011

Randy Aiken

Consultant to Energy Probe