June 24, 2013

FFPC
FORT FRANCES POWER CORPORATION

Kristin Walli
Board Secretary
Ontario Energy Board
PO Box 2319
2300 Yonge Street, 26th Floor
Toronto, Ontario M4P 1E4

Re. Consultation Report and Stakeholder Consultation Meetings in May Defining and Measuring Performance of Electricity Distributors (EB-2010-0379)

Please accept this correspondence as the formal comments of Fort Frances Power Corporation ("FFPC") on the issues addressed in the report prepared by Board Staff's expert consultant ("PEG") entitled, "Empirical Work in Support of Incentive Rate Setting in Ontario" (the "PEG Report").

Throughout the PEG Report, PEG underscores the importance of ensuring "apples to apples" benchmarking across distributors (see, for example, pages 37-38 of the PEG Report). For the purpose of benchmarking, PEG has grouped FFPC along with 17 other distributors which PEG has identified as having small output, small area, and below average customer growth (Peer Group E, Table 23 of the PEG Report).

FFPC is concerned that, given the unique circumstances of FFPC described in this letter, it might not be possible to make such an "apples to apples" comparison of FFPC to other distributors. FFPC has a unique feature which inflates its legal and administrative expenses relative to other distributors. In particular, FFPC is the custodian of a 1905 Agreement which greatly benefits residents of the Town of Fort Frances. To maintain that benefit, FFPC is required to incur significant legal and administrative expenses on an ongoing basis. FFPC is concerned that, by ignoring this unique circumstance applicable to FFPC, FFPC might appear to be less efficient than others in its peer group when the costs are entirely unrelated to efficiency, and are in fact prudently and effectively incurred to the benefit of customers.

As the Board is aware, the residents of the Town of Fort Frances are beneficiaries of a 1905 Agreement entered into between the Town and the local pulp and paper mill. The 1905 Agreement obligates the mill owner, or more precisely today, the owner of the generation assets on the Rainy River (today, H2O Power LP ("H2O")), to provide to the Town of Fort Frances, in perpetuity, 4,000 horsepower (2.984 Megawatts) at $14 per horsepower per annum (0.21416 cents per kilowatt hour) "for municipal purposes and for public utilities" [*Fort Frances v Boise Cascade Canada Ltd*., [1983] 1 SCR 171 at 184].

The 1905 Agreement is filed as a physical bilateral contract with the IESO and represents a financial obligation of H2O. Essentially, for 2.984 Megawatts, which represents approximately 25% of the power purchases of FFPC, H2O pays to the IESO the additional costs of power above 0.21416 cents per kilowatt hour, and the IESO credits FFPC for that amount. FFPC in turn credits its customers who, in effect, pay a blended commodity rate reflecting the benefit of the 1905 Agreement. The amount of the benefit currently exceeds $2.2 million annually.

Costs associated with maintaining the benefits of the 1905 Agreement are not insignificant. The accounting and billing for the benefits of the 1905 Agreement is labour-intensive. Further, given the value of the 1905 Agreement to the residents of the Town of Fort Frances, and the corresponding cost to the owner of the generation assets on the Rainy River, the 1905 Agreement is under constant attack from the owner of the generation assets. Finally, the existence of the 1905 Agreement and the manner in which it reduces the price for power paid by the residents of the Town of Fort Frances relative to other ratepayers in the Province often requires that FFPC be given unique and specific treatment by government policy, regulation and legislation so as to preserve its benefits.

The specific cost elements associated with maintaining and enforcing the 1905 Agreement are best dealt with in FFPC's cost of service rebasing application. For present purposes, FFPC will explain the nature of the costs it incurs with respect to the following categories:

1. Ensuring regulatory and policy changes do not negate the benefit of the 1905 Agreement;

2. Enforcing the 1905 Agreement as against the various owners, from time to time, of the generation assets tied to the 1905 Agreement; and

3. Working with the IESO and the owner of the generation assets and internally to ensure that residents obtain a blended rate which reflects the financial benefit of the 1905 Agreement to which they are entitled.

Costs Related to Preserving the 1905 Agreement in the Face of Regulatory and Policy Changes

At pages 49-50 of the PEG Report, PEG makes an apt comment about costs related to regulatory changes and the difficulty of capturing company-specific cost pressures, as follows:

> A surprising finding of our cost model was the coefficient on the trend variable. This coefficient was estimated to be 0.014%. This implies that, even when input prices, outputs, and other business condition variables remain unchanged, costs for the Ontario electricity distribution industry still increased by an average of 1.4% per annum between 2002 and 2011. This is counter to the usual finding in cost research, where the coefficient on the trend variable is negative. One factor that could be contributing to these upward cost pressures is government policy implemented over the sample period. Another possibility is that there are cost pressures for a sizeable portion of the industry due to company-specific factors, rather than industry-wide policies, but it is difficult to capture these company-specific cost pressures in measurable business condition variables.

No doubt all distributors incur significant costs associated with regulation and changing government policy. However, in the experience of FFPC, it is forced to incur costs for proceedings and negotiations solely related to the 1905 Agreement, which other distributors do not. In the words of the PEG Report, FFPC appears to have a company-specific cost burden to maintain the 1905 Agreement.

In order to appreciate the time and expense that is required to support the 1905 Agreement, we can consider a few of the major regulatory changes that have required extensive work by FFPC:

- In 1999, Fort Frances Public Utilities Commission was required to apply for and obtain an Order of the Board exempting it and FFPC from Section 2.2.2 of the *Standard Supply Service Code*. If FFPC had not obtained this exemption, FFPC would have been required to meet all of its power needs through the IMO (as it then was) at market rates. By incurring the legal expenses to secure the exemption, FFPC retained the ability to obtain 25% of its power purchases at the low rate 0.21416 cents per kilowatt hour and pass on that benefit to its customers, allowing them to retain the lowest electricity rates in the Province.

- In 2002, Bill 210 required distributors to charge their standard supply customers at a fixed commodity rate of 4.3 cents per kilowatt hour. Regulation 339/02 filed under Bill 210 specifically exempted FFPC from this requirement so as to permit FFPC to continue to offer its customers the lower, blended rate consisting of power purchased from the IMO at 4.3 cents and power acquired from the owner of the generation assets on the Rainy River at 0.21416 cents. However, further regulations filed on Christmas Eve of that year, and in particular the revocation of Ontario Regulation 342/02, required all LDCs to pay the spot market price. As the Regulations stood at that time, FFPC was obliged to purchase power at spot prices and was not entitled to settlement payments under Ontario Regulation 435/02 (as were other LDCs) on an apparent theory that the 1905 Agreement would provide a blended commodity rate to the Town residents not to exceed 4.3 cents per kilowatt hour. This policy was objectionable to FFPC for two reasons. First, the residents of the Town had been paying *less* than 4.3 cents per kilowatt hour for power, and therefore a policy implemented to reduce the cost of power to Ontario consumers would increase the cost of power to Town residents. Second, the policy opened up the 1905 Agreement to the risk of challenge by the owner of the generating assets. In 1983 the Supreme Court of Canada [*Fort Frances v Boise Cascade Canada Ltd*., [1983] 1 SCR 171] had confirmed that the perpetual right to call for the delivery of power at the low rate of 0.21416 cents is "for municipal purposes and public utilities" and that the Town cannot call for power "for commercial purposes". Any diversion of the benefits of the 1905 Agreement from municipal purposes to the Province might have opened the Agreement to challenge, which no doubt the owner of the generation assets on the Rainy River would seize upon. Negotiations with the Province, including face-to-face meetings between FFPC counsel and then Minister of Energy John Baird and his staff were required to get the proper legislative exemptions in place to preserve the benefits of the 1905 Agreement.

- In 2004, Ontario Regulation 429/04 was enacted under section 25.33 of the *Electricity Act, 1998* (the "Global Adjustment Regulation"). FFPC worked with the Ministry to ensure that the Global Adjustments Regulation, and subsequent amendments to it, would be consistent with the 1905 Agreement and the Supreme Court of Canada decision. However, accounting for the Global Adjustment vis-à-vis customers eligible for the credit under the 1905 Agreement was complex, and true-ups with the IESO resulted in the inadvertent return of the benefit of the global adjustment cost savings on 2.984 Megawatts to the IESO. FFPC had to undertake extensive discussions with the IESO, OEB, OEFC and OPA regarding implementing accounting changes in order to reverse the error and once again ensure that the residents of the Town received all the benefit to which they are entitled under the 1905 Agreement.

Attacks on the 1905 Agreement by various owners of the generation assets on the Rainy River

It is not surprising that the owner of the generation assets, which now incurs a cost in the neighbourhood of $2.2 million annually under the 1905 Agreement, would attempt to attack it on every occasion. The most notorious attack was the legal attack by Boise Cascade which resulted in the Supreme Court of Canada decision confirming the perpetual right. There have been other attacks, while less public, which have required time and effort on behalf of FFPC management and the advice of counsel. Threats to negate the 1905 Agreement have taken various forms, including threats to shut down the generation assets on the Rainy River. FFPC management must be vigilant and incur prudent legal expenses in such battles.

Administration related to the 1905 Agreement

Administration of the 1905 Agreement is time-consuming. Approximately 30% of the work load of Lori Cain, Financial and Regulatory Officer at FFPC, is devoted to the day-to-day administration of the Agreement. This does *not* include extraordinary efforts on Lori's part which result from OEB and Ministry of Finance audits because of the Agreement. For example, the Ontario Energy Board requested audits of FFPC's Group 1 and Group 2 RSVA accounts, which alone consumed 9 months of Lori's time. Recently, the Ministry of Finance requested an HST audit. These audits were the result of FFPCs unique accounting requirements which make FFPC appear anomalous when compared to other LDCs. In addition, approximately another 0.2 Full Time Equivalent is devoted by general administration towards the day-to-day administration of the Agreement. A conservative estimate is that 0.5 FTEs are required to manage the $2.2 million dollars annually across FFPC's customer base of approximately 3800 customers.

The day-to-day tasks involved with the administration of the Agreement include the following:

- **Agreement value determination**. Data must be extracted from the IESO's daily settlement statement to distinguish between Agreement and non-Agreement related charges. A monthly invoice must be prepared for H2O to receive recovery of Agreement-related charges from H2O. Further, all of the data must be compiled and incorporated into monthly and annual financial statements for FFPC's Board of Directors and auditors.

- **Review of regulations**. FFPC must constantly scan issues for applicability or conflict with the Agreement, including IESO charges, regulatory methodology and reporting, financial budgeting and reporting, customer billing, benefits, such as the Ontario Clean Energy Benefit, and taxation issues.

- **Adjustments to conform to regulatory reporting formats.** In order for FFPC to conform to regulatory reporting formats, FFPC must adjust all integrated regulatory and financial data by extraction of balances related to the Agreement.

- **Calculation and implementation of credits and rebates**. FFPC must calculate and provide the benefits of the Agreement to its customers in the form of monthly credits and annual rebates, including the issuance of rebate cheques which must be mailed to former FFPC customers.

- **Billing and customer communications**. FFPC must integrate the special accounting for the 1905 Agreement into its billing process and calculation algorithms. It must also process customer inquiries regarding the Agreement, as well as draft and publish periodic announcements related solely to the administration of the Agreement.

Conclusion

FFPC cannot speak to any company-specific cost pressures borne by other distributors. However, FFPC asks the Board to consider that, because of the unusual legal and administrative costs related to the 1905 Agreement, which to date have resulted in tremendous benefit to Fort Frances consumers, it might not be possible to compare "apples to apples" when considering the efficiency of FFPC.

Yours truly,

FORT FRANCES POWER CORPORATION

Per: *Original Signed By*

Joerg Ruppenstein, President and CEO

Davis: 14193141.1