FNEI Supplementary Response to IR 33(e)(iii) and (iv), (f) and (g)

7-Staff-33(e)

(iii) FNEI's debt coverage ratio is a factor of: (i) the ratio of principal to interest in any loan repayment obligation; and (ii) net income. As a loan matures, principal makes up a greater portion of any loan repayment, and as a consequence net income plays a larger role in impacting the debt coverage ratio. The effect of that is to lower the debt coverage ratio, pushing FNEI closer to the ratio required in its Credit Agreement.

For example, using the application information for 2017 test year, eliminating the ROE component ($1.315 million) would result in: (i) actual ROE of -0.4%; (ii) a current liquidity ratio of 0.898; and (iii) a debt coverage ratio of 1.48 to 1.0.

This would technically be onside the 1.2 to 1.0 debt coverage ratio required by the Credit Agreement. However, the debt coverage ratio is a snapshot in time. Using the numbers in the application, assuming everything else remains equal, removing the $1.315 million from FNEI's revenue requirement will put FNEI offside its debt coverage ratio by 2021.

(iv) FNEI's position has been clearly stated in our evidence. Concern about removing an ROE component of our revenue requirement is not limited to the impact on FNEI's debt coverage ratios. That is one concern, but not the only concern. FNEI's objection with any reserves policy is first and foremost, that it is based on the legally incorrect notion that non-profit corporations cannot earn a profit, and it would prohibit FNEI from meeting its corporate objectives. The Board's concept of how a reserves policy might be framed (as set out in Appendix A "Accounting for the Reserves" in FNEI's last rates decision) had a number of difficulties: (a) it was impossible to implement because it was based on the incorrect premise that net income was cash; and (b) was completely inflexible in that it sought to micro-manage FNEI's operations in a way that the OEB does not micro-manage any other Ontario utility. FNEI does not believe it prudent to operate a business via accumulating significant funds in reserve accounts.

FNEI has multiple corporate objectives – one objective is the reliable transmission of electricity, and another objective is the generation of revenue in excess of costs for the purposes of benefiting the communities served. In this manner, FNEI is no different than any other transmitter of electricity in Ontario, as such entities have the dual-objectives of transmitting electricity and generating a profit for their owners. However, the reserves policy denies FNEI its legal right to pursue any objective not related to the transmission of electricity. To treat FNEI in this manner is not consistent or justified, nor is it supportable at law or on the principles of fairness.

It is impossible for FNEI to be certain whether or not a reserve fund designed in the manner proposed in 7-Staff-33(e)(iv) would be sufficient to satisfy FNEI's lenders. However, even if such a reserve fund were to be acceptable to FNEI's lenders, the overall approach of the reserves policy would remain unacceptable to FNEI. Further, the inability of FNEI to earn an ROE would be a material change to the business of FNEI and we assume that this would increase FNEI's cost of borrowing, which would not be in the best interest of ratepayers.

7-Staff-33(f)

As a preface to this response, FNEI again reiterates that it is opposed to, and considers it inappropriate, to be denied the ability to earn an ROE as part of its revenue requirement. As a result, it is also opposed to any OEB-mandated reserves policy. On that understanding, FNEI has nevertheless agreed to make best efforts to answer this question.

(i) FNEI has no suggested other reserve accounts.

(ii) through (x) FNEI has incorporated the items requested in (ii) through (ix) in an "updated" reserves policy (which was requested in item (x). Please see below.

UPDATED RESERVES POLICY

Insurance Reserve Fund

Definition, Purpose and Use: The Insurance Reserve Fund would be used as a form of self-insurance coverage on FNEI's transmission line poles and wires (because FNEI's stations are covered by a purchased policy). FNEI would utilize funds from this Insurance Reserve Fund to cover costs associated with events that would typically be covered by insurance.

Insurance Reserve Cap: $4 million. This amount is what FNEI's senior lenders have stipulated as a covenant in its current Credit Agreement.

Usage and Maintenance of Fund: The Insurance Reserve Fund is fully funded. No withdrawal may be made from the Insurance Reserve Fund until two conditions are satisfied: (a) FNEI's transmission line/pole assets have suffered an event of significant damage requiring repair that would normally trigger an insurance claim; and (b) FNEI's Board of Directors has passed a resolution to notify FNEI's senior lenders of the withdrawal of funds from the Insurance Reserve Fund. FNEI would then replenish the Insurance Reserve Fund at a high priority level.

Role of Board of Directors and Management: See above. In the event that the Insurance Reserve Fund is drawn down, FNEI Management will recommend a plan for replenishment (acceptable to FNEI's lenders) taking into account cash and other needs of the company in the short- to medium-term. FNEI Management would likely then bring that plan to FNEI's Board of Directors for approval.

Investment Policy: Due to the need for amounts in this Reserve Fund to be available on short notice, any amounts in this Reserve Fund would be retained in an interest bearing bank account.

Reporting Obligations: The balance held in the Insurance Reserve Fund (as well as any withdrawals or replenishments) shall be reported on FNEI's quarterly financial statements. The OEB would be advised of any Insurance Reserve Fund balance as part of any rate application filing by FNEI.

Operating Reserve Fund

Definition, Purpose and Use: The Operating Reserve Fund would be used to fund operations, maintenance and administration ("OM&A") expenditures. This fund may be the most "fluid" of the three reserve funds for the following reason. While rates will generate cash for FNEI on a relatively steady basis, FNEI's OM&A expenditures are often quite "lumpy" (more than other utilities) because of the climatic and geographic environment in which FNEI operates. The James Bay lowlands area is almost completely inundated during the spring, summer and fall months. As a result, most of the major maintenance activities on the transmission line can only be done during the winter months. This has resulted in the annual maintenance budget for the transmission line being expended in two or three months. This impacts the cash flows and can result in cash shortages during this time. Consequently, withdrawals from this Operating Reserve Fund can occur in one of two circumstances: (a) in order to overcome the disconnect between OM&A expenditures and FNEI's cash flows; and (b) in the event of a significant unplanned OM&A expense.

Operating Reserve Cap: The methodology for establishing this cap established by the Board in the FNEI 2010 Transmission Rates decision would put this cap at $2,575,856. It is based on the total of the highest six months OM&A costs in the preceding two years. FNEI has no alternative method to offer. The amount would be adjusted annually by FNEI, at the time of the finalization of the annual audited financial statements.

Usage and Maintenance of Fund: The funding and draw down of moneys in this Fund would be at the discretion of FNEI Management.

Role of Board of Directors and Management: There is no role for FNEI's Board of Directors with respect to this Fund, given that it is used to deal with common and frequent OM&A expenses as they arise. FNEI's Management would be free to draw on this Fund to maintain a minimum amount (acceptable to FNEI Management) in its operating account.

Investment Policy: Amounts in the Operating Reserve Fund will be invested in some combination of an interest bearing bank account or short term GIC or money market funds with a maximum investment period of 90 days, as management deems advisable from time to time.

Reporting Obligations: The balance held in the Operating Reserve Fund (as well as any withdrawals or replenishments) shall be reported on FNEI's quarterly financial statements. The OEB would be advised of any Insurance Reserve Fund balance as part of any rate application filing by FNEI.

Capital Reserve Fund

Definition, Purpose and Use: The Capital Reserve Fund will be used to fund capital expenditures that are part of FNEI's capital plan (i.e., as assets depreciate) as well as unplanned capital expenditures that are not covered by insurance.

Capital Reserve Cap: $1,795,000. This methodology was established by the Board in the FNEI 2010 Transmission Rates decision. FNEI would adjust this annually based on forecasted annual capital expenditures.

Usage and Maintenance of Fund: FNEI Management would, after each quarterly financial statement is approved by the Board of Directors, transfer an amount from the Capital Reserve Fund to an operating bank account that is equal to the amount of capital expenditures in the previous quarter. Also at the end of the quarter, FNEI Management would determine whether any surplus cash is available to replenish the Capital Reserve Fund.

Role of Board of Directors and Management: FNEI's Board of Directors approves a capital budget for each calendar year that would inform the amount of any annual capital reserve.

Investment Policy: Same as Operating Reserve Fund.

Reporting Obligations: The balance held in the Capital Reserve Fund (as well as any withdrawals or replenishments) shall be reported on FNEI's quarterly financial statements. The OEB would be advised of any Insurance Reserve Fund balance as part of any rate application filing by FNEI.

7-Staff-33(g)

FNEI assumes that an "alternative test year revenue requirement" means replacing the ROE amount of $1,315,000 with annual amounts to fund the Capital Reserve and Operating Reserve (given that the Insurance Reserve Fund is fully funded). On that basis, the alternative test year revenue requirement would be:

OM&A	$4,336.0
Depreciation and Amortization	$1,293.3
Interest on Debt	$1,044.7
Capital Reserve Fund	$1,795.0 (based on test year capex)
Operating Reserve Fund	$ 858.6 (based on a three year funding plan)
TOTAL REV. RQMT.	**$9,327.6**