ONTARIO ENERGY BOARD

IN THE MATTER OF a cost of service application made by Five Nations Energy Inc. with the Ontario Energy Board under section 78 of the *Ontario Energy Board Act,* 1998, S.O. 1998, c. 15 (Schedule B), seeking approval for changes to its transmission revenue requirement to be effective January 1, 2016

EB-2016-0231

ARGUMENT IN CHIEF

OF

FIVE NATIONS ENERGY INC.

AUGUST 4, 2017

Osler, Hoskin & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario, Canada M5X 1B8
Richard J. King
Jeff St. Aubin

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ARGUMENT IN CHIEF OF FIVE NATIONS ENERGY INC.

OVERVIEW

Five Nations Energy Inc. ("**FNEI**") applied to the Ontario Energy Board (the "**OEB**"), pursuant to Section 78 of the *Ontario Energy Board Act, 1998*,[1] for the approval of its revenue requirement in this proceeding (EB-2016-0231). FNEI submitted a transmission rates application to the OEB on July 27, 2016, which was amended on November 25, 2016 (as amended, the "**Application**"). The Application was in substantial compliance with Chapter 2 of the OEB's *Filing Requirements for Electricity Transmission Applications*, dated February 11, 2016 (the "**Filing Requirements**").

Following the submission of the Application, Energy Probe was granted intervenor status by the OEB and an interrogatory process was conducted, with interrogatories being received by FNEI from both OEB staff ("**Board Staff**") and Energy Probe. An oral hearing was then held on July 6-7, 2017 (the "**Hearing**"), following which FNEI responded to undertakings from the Hearing (each an "**Undertaking**").

In the Application, FNEI requests that the OEB approve FNEI's proposed revenue requirement of $7,839,200, effective January 1, 2016. This revenue requirement will then be adjusted through 2017-2020 in accordance with an incentive rate-setting proposed by FNEI that will take into account inflation, productivity, and a stretch factor, while permitting FNEI to advance Z-factor claims to address unforeseen events. This incentive rate-setting plan is similar in structure to that employed by electricity distributors regulated by the OEB. FNEI would file an annual application to adjust its revenue requirement in accordance with this plan.

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[1] RSC 1998, c 15 (Sched B).

FNEI believes that the proposed revenue requirement of $7,839,200 is reasonable and fair, as are the underlying cost elements: OM&A, depreciation, rate base, and cost of capital.

With respect to the effective date of January 1, 2016, it was not feasible for FNEI to file its Application at an earlier time, but this delay should not deprive FNEI of its entitlement to earn a fair return. The granting of the requested effective date will have no impact on Ontario ratepayers, and the OEB has in the past required transmitters to make payment as between themselves to recognize revenue requirements adjusted after January 1 in rate-setting year.

A critical issue for FNEI in this proceeding is its entitlement to earn revenues in excess of its costs (referred to herein as an "**ROE**"). The importance of this aspect of the decision is a recurrent theme throughout the Application, interrogatory responses, Hearing, and Undertakings. At its essence, FNEI requires both an ROE and its not-for-profit status, as the former permits FNEI to comply with its debt covenants, while the latter allows FNEI to pursue its corporate objectives without the pressure to distribute dividends. The loss of either element would be damaging to FNEI; however, the loss of either element is not necessary, and would be an error at law. FNEI is entitled to earn an ROE in the same manner as every other electricity transmitter in Ontario, and the receipt of an ROE would not jeopardize FNEI's not-for-profit corporate status.

An issue related to FNEI's entitlement to earn an ROE is its right to distribute excess revenues for the corporate purposes that FNEI was established for, specifically, to promote economic and social welfare in the communities of Attawapiskat, Kashechewan, and Fort Albany. In this regard, FNEI should be treated in the same manner as other electricity transmitters in Ontario, each of whom are free to determine for themselves whether excess revenues will be retained, reinvested, or distributed to shareholders. FNEI's use of such funds are properly restricted by the federal legislation that governs FNEI's status as a not-for-profit corporation and further restrictions in the context of electricity rate regulation are inappropriate.

FNEI respectfully requests that the OEB reconsider the position it adopted in FNEI's previous rate application (EB-2009-0387), wherein the OEB held that FNEI was not entitled to earn an ROE and could not distribute excess revenues for its corporate purposes.

To provide structure and ease of reference, this Argument in Chief is organized on the basis of the proposed issues list, which was circulated by the OEB on June 13, 2017.

1.0 GENERAL

1.1 Has Five Nations Energy responded appropriately to all relevant OEB directions from previous proceedings?

FNEI compliance with the OEB directives from the last FNEI rate application (EB-2009-0387) is addressed in the Application at Exhibit 1, Tab 5, Schedule 18. The most significant OEB direction from the previous FNEI rate application was with respect to FNEI filing a reserves policy. FNEI did prepare and submit a draft reserves policy to Board Staff, and subsequently met with senior OEB personnel to discuss the directive. The reserves policy was never finalized or implemented, as FNEI did not receive a response from the OEB. FNEI acknowledges that it did not actively pursue the finalization of the reserves policy with the OEB, as the policy is unworkable for FNEI. The reserves policy and its relationship to FNEI's ability to earn revenues in excess of its costs is a critical issue for FNEI in this Application and is addressed more fully in Sections 6.3, 6.5, and 6.6.

With respect to the other two directives: (i) FNEI acknowledges that it did not establish a deferral account to track the input tax credit for the reasons discussed at the Hearing, and (ii) FNEI did file the Master Service Agreements between FNEI and each of Attawapiskat Power Corporation, Kashechewan Power Corporation, and Fort Albany Power Corporation.

1.2 Are all elements of Five Nations Energy's proposed 2016 revenue requirement reasonable?

FNEI has applied for a revenue requirement of $7,839,200 which is an increase of $1,512,100 (23.9%) more than the revenue requirement of $6,327,100 approved by the OEB in FNEI's last rate application (EB-2009-0387).

FNEI considers the proposed 2016 revenue requirement to be reasonable. In order to assess the reasonableness of the proposed 2016 revenue requirement, it is necessary to consider the individual cost components that are addressed elsewhere in this Argument in Chief. Specifically:

a) OM&A, which is addressed at Section 5.0;

b) rate base, which is addressed at Section 2.3;

c) depreciation expense, which is addressed at Section 5.3; and

d) cost of capital, which is addressed at Section 6.0.

1.3 Is the proposed effective date of January 1, 2016 appropriate?

FNEI should be entitled to earn a fair return on its invested capital, and it would appear that the only question regarding the appropriateness of January 1, 2016 as the effective date relates to the timing of FNEI's Application.

FNEI filed its Application on July 16, 2016 and subsequently amended the Application on November 25, 2016. The preparation of an application is a significant undertaking for any transmitter and FNEI was not in a position to file its Application at an earlier date due to a number of factors, including the:

a) acquisition of 80 kilometres of transmission line from Hydro One Networks Inc. ("**HONI**") in October 2015;

b) replacement of FNEI's Chief Executive Officer in late January 2016;

c) release of new Filing Requirements in February 2016;

d) requirement for FNEI to strictly comply with the Filing Requirements (regardless of the issuance of new Filing Requirements noted in (c) above), despite such requirements being ill-suited to a small transmitter;

e) proposal of FNEI to file a five-year IR Plan for the first time; and

f) the small size of FNEI and the administrative burden of preparing the Application.

Notwithstanding that FNEI was not able to reasonably file the Application at an earlier date, FNEI should remain entitled to earn a fair return on its invested capital throughout 2016, during which time FNEI's forecasted revenue deficiency was $1,512,098 and FNEI's actual ROE was only 0.87%.

To deny FNEI an effective date of January 1, 2016 would result in the denial of FNEI's right to earn a fair return. By way of example, the acquisition of the 80 kilometres of transmission line alone increased FNEI's rate base by 17% for the 2016 calendar year. Moreover, establishing the effective date at January 1, 2016 would provide FNEI with a fair return for 2016, without any impact on Ontario transmission rates.

1.4 Were Five Nations Energy's customer engagement activities sufficient to enable customer needs and preferences to be considered in the formulation of its proposed spending?

FNEI is highly engaged with its customers. A full description of FNEI's customer engagement activities are set out in the Application.[2] This level of organic engagement is possible because FNEI only has four customers[3] and three of them are local distribution companies in the communities served (the "**Power Corporations**") and are the "owners" of FNEI.[4] Representatives of the Power Corporations routinely serve on the FNEI Board, which provides a direct connection between FNEI and these customers at the executive level. Similarly, FNEI provides technical services to these Power Corporations,[5] which provides a direct connection at the technical level.

One example of customer needs being identified and addressed through customer engagement is the additional feeders that FNEI installed in Attawapiskat and Kashechewan to support community development.[6] These projects demonstrate that FNEI understands and is responsive to community needs.

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[2] Application at Exhibit 1, Tab 2, Schedule 1.

[3] Attawapiskat Power Corporation, Kashechewan Power Corporation, Fort Albany Power Corporation, and the DeBeers Mine.

[4] The term "owners" provides an accurate description of the corporate organizational structured (included in the Application at Exhibit 1, Tab 5, Exhibit 13, Appendix II), however, these entities are more correctly referred to as "members", given that FNEI is a non-share capital not-for-profit corporation.

[5] Pursuant to Maintenance Services Contracts, which FNEI filed as part of its IR to 6-Staff-27(a).

[6] Application at Exhibit 2, Tab 2, Schedule 1.

2.0 TRANSMISSION SYSTEM PLAN AND RATE BASE

2.1 Does the Transmission System Plan adequately address customer needs and preferences?

Given FNEI's small size, and its operational personnel's intimate knowledge of the FNEI system, FNEI does not require what might be thought of as a conventional transmission system plan. FNEI's transmission system planning is constant and ongoing. Customer needs and preferences are a direct input into FNEI's transmission system planning. FNEI has a uniquely close relationship with each of its four customers, addressed in Section 0 above, and this provides FNEI with regular and direct feedback on customer needs and preferences.

None of FNEI's customers anticipate material increases in capacity, and their primary concern is with respect to system reliability, which is why FNEI's strategic plan is grounded in the principle of minimizing outages and providing reliable transmission of electricity.[7]

In addition to serving as an input to FNEI's transmission system planning, customer needs and preferences are considered by FNEI through the evaluation of potential capital projects. Specifically, FNEI addresses the potential impact on customers when preparing a summary of each proposed material project[8] and the body that approves a capital project, whether it be the FNEI Board or Finance Committee, considers whether the project is responsive to customer needs.[9]

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[7] Application at Exhibit 2, Tab, 1, Schedule 1 (Section 2.0).

[8] Application at Exhibit 2, Tab, 1, Schedule 1 (Section 3.0).

[9] Application at Exhibit 2, Tab, 1, Schedule 1 (Section 3.0).

FNEI's proposed capital projects demonstrate that customer needs and preferences, and the related focus on system reliability, are the driving force behind FNEI's transmission system planning. These capital projects are addressed in Section 2.2.

2.2 Is the level of proposed capital expenditures appropriate and adequately taking into consideration factors such as customer preferences, system reliability and asset condition?

FNEI's actual capital spending in 2016 was $2.361 million,[10] which is $241,000 (11.4%) more than the forecasted 2016 capital budget of $2.120 million.[11]

The capital projects proposed by FNEI are focused on system reliability, which simultaneously addresses the primary customer preference (for reliability) and takes into account asset condition. The proposed capital projects include:

a) the bus isolation project for a total cost of approximately $4 million, of which $1.614 million was spent in 2016 and it is forecast that $1 million will be spent to complete the project in 2017.[12] This project which will significantly improve system reliability by reducing maintenance related outages (explained in more detail in Section 2.3(ii)) by the time periods set out in FNEI's response to Undertaking J1.5. This project is directly tied to ensuring that FNEI can meet its Customer Delivery Point Performance Standards;

b) the transformer stone replacement project for a total cost of approximately $650,000, of which $45,696 was spent in 2016 and it is forecast that $150,000 will be spent to complete

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[10] FNEI response to Board Staff interrogatory 2-Staff-17(c).

[11] FNEI response to Board Staff interrogatory 2-Staff-17(c).

[12] FNEI response to Board Staff interrogatory 2-Staff-17(a).

the project in 2017.[13] This project is necessary from a health and safety perspective to ensure that the proper project step and touch voltages are maintained;[14]

c) the installation of diesel back-up generators at the fibre shelters for a total cost of $258,538, of which $145,470 was spent in 2016 to complete the project.[15] This project was necessary because battery back-up is insufficient to operate the heating and cooling systems, which are required to maintain the fibre equipment at the proper temperatures to remain operational during a power outage;

d) replacement of the batteries in the control room at each of FNEI's transformer stations, which is necessary as the existing assets reach the end of their useful life;

e) twinning the transmission line from Kashechewan to Attawapiskat, which will significantly enhance system reliability;

f) replacement of the brush clearing equipment, which is nearing the end of its useful life; and

g) replacement of the fibre optic system, which is nearing the end of its useful life.

Each of these projects will improve the reliability of the FNEI transmission system, either by replacing assets that will become unreliable or unusable due to age, or by directly modifying the

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[13] FNEI response to Board Staff interrogatory 2-Staff-17(a).

[14] FNEI response to Board Staff interrogatory 2-Staff-17(h).

[15] FNEI response to Board Staff interrogatory 2-Staff-17(a).

system in a manner that improves redundancy (twinning the line) or permits routine maintenance to be performed in a manner that does not require the loss of service (the bus isolation project).

The capital projects listed above at paragraphs (d)-(g) are only under consideration at this point in time and will not be undertaken in 2017, so detailed budgets are not available. Of these projects, the twinning of the transmission line from Kashechewan to Attawapiskat would be a significant capital project with costs in the anticipated range of $35 million.[16]

2.3 Is the proposed 2016 rate base reasonable?

FNEI's actual rate base for 2016 was $35.868 million, which is an increase of $7.180 million (25.1%) over the 2010 OEB approved rate base of $28.688 million (EB-2009-0387).

The FNEI rate base is reasonable, due in part to the fact that FNEI's rate base is significantly undervalued as a result of the manner in which FNEI was initially funded. At that time, the federal government contributed $33 million, which FNEI treated as akin to a customer contribution. If this contribution had been distributed to the communities or the Power Corporations, and <u>then</u> to FNEI, FNEI's initial rate base would have been $33 million higher than it was recognized at that time.

The FNEI rate base is also reasonable in light of the capital projects that have been the primary drivers of the rate base increase. These key projects include the:

a) construction of FNEI's new head office in 2013;

b) commencement of the bus isolation project in 2014; and

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[16] FNEI response to Board Staff interrogatory 2-Staff-17(d).

c) acquisition of 80 kilometres of transmission line from HONI in 2015.

Each of these projects is addressed in the following subsections.

(i) Head Office

FNEI constructed a new head office in Timmins, which was substantially completed in 2013 at a cost of $4,856,255. A new office was required because FNEI had significantly outgrown its previous office. The decision to construct, as opposed to leasing or purchasing an existing building, was driven by the lack of suitable facilities in the Timmins area. The new office accommodates all operations and management staff, as well as providing for the receipt, storage, maintenance, and testing of equipment.

The head office was over-budget, but as explained at the Hearing, FNEI took prudent steps to examine alternatives, ensure competitive bids were received, and manage costs. The fact that the actual cost was greater than anticipated was due to local economic and workforce dynamics beyond FNEI's control.

At the request of Board Staff during the interrogatory process, FNEI provided various permutations of the square footage, land area and staffing related to the previous and new head offices.[17] At the Hearing, Board Staff compared these metrics to those of other utilities that had constructed office buildings.[18] However, these other utilities are not direct comparators to FNEI with respect to building construction because:

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[17] FNEI response to Board Staff interrogatory 2-Staff-16(f)-(t).

[18] OEB Staff Compendium at Tab 15.

a) the small size of the FNEI office building prevents a meaningful comparison, as FNEI could not achieve the economies of scale associated with the construction of a larger facility. Specifically:

   i. the average square footage of these other facilities is more than <u>16 times</u> the size of the FNEI head office;[19] and

   ii. the square footage of the smallest of these other facilities is almost <u>5 times</u> the size of the FNEI head office;[20]

b) the small number of FTEs working at the FNEI office building prevents a meaningful comparison, as certain areas of a building must be of a given size regardless of a large change in the number of employees (e.g. hallways, washrooms, lobbies, boardrooms). Specifically:

   i. the average number of FTEs at these other facilities is more than <u>20 times</u> the number of FTEs at the FNEI head office;[21] and

   ii. the smallest number of FTEs at these other facilities is more than <u>4 times</u> the number of FTEs at the FNEI head office;[22] and

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[19] ((92,000 + 104,000 + 79,000 + 36,172 + 351,000 + 91,828) / 6) / 7500 = 16.75

[20] 36,172 / 7500 = 4.82

[21] ((250 + 117 + 150 + 40 + 622 + 62) / 6) / 10 = 20.69 (for the purposes of these calculations it has been assumed that FNEI has 10 FTEs. This number is greater than the actual number of FTEs, but reflects a portion of the additional staff that FNEI intends to hire. More information regarding these hires is included in Section 5.2(1)).

[22] 40 / 10 = 4

c) even if the size of the buildings and the number of FTEs were comparable, any such comparison would still fail to take into account the higher construction costs of building a facility in Timmins.

The comparison as between FNEI's office building and the buildings of other utilities provides an appealing and deceptively simply means of confirming the reasonableness of the costs incurred, but such an approach is flawed. It would be equally disingenuous for FNEI to tout that the cost of the FNEI head office is reasonable simply because it is more than 80% less than the average cost of these other facilities.[23] A more nuanced and sensible assessment is required, and FNEI believes that the costs incurred are reasonable when considered in the proper context.

(ii) Bus Isolation Project

In 2014 FNEI commenced a project to upgrade the transformer station in each of the communities by splitting the bus system on both the high and medium voltage sides of the transformers and installing additional disconnects. The total cost of this project is expected to be approximately $4 million, comprised of $2.975 million spent by the end of 2016[24] and an anticipated expenditure of $1 million in 2017.[25]

This project provides a separate parallel pathway for electricity to flow, which allows equipment to be isolated for maintenance purposes without disrupting service to customers. It is expected that the bus isolation project will significantly enhance system reliability by reducing service outages

[23] 1 – (4.9 / ((27.7 + 26.5 + 18.0 + 10.9 + 66.0 + 14.5) / 6)) = 0.82

[24] FNEI Undertaking Response J1.6.

[25] FNEI response to Board Staff interrogatory 2-Staff-13(a).

related to scheduled maintenance. The detailed breakdown of the bus isolation reduction to maintenance outages was submitted by FNEI in its response to Undertaking J1.5. As mentioned earlier, this project will permit FNEI to meet its Customer Delivery Point Performance Standards.

(iii) Acquisition of 80 Kilometres of Transmission Line

FNEI purchased 80 kilometres of transmission line, running north from Moosonee, from HONI on October 15, 2015, at a cost of $4,896,221.75 plus $636,508.83 in harmonized sales tax. FNEI had originally sold this portion of transmission line to HONI in 2000, but the intention had always been that FNEI would reacquire this asset when it could afford to do so. The reacquisition provided FNEI with complete ownership of the transmission system within the communities' traditional territory, and it also was more efficient from an overall maintenance perspective, as both FNEI and HONI were separately maintaining parallel transmission facilities prior to the reacquisition.

2.4 Is the proposed 2016 working capital allowance amount reasonable and was the methodology used to calculate the working capital allowance appropriate?

FNEI's proposed working capital allowance of 3.55% of OM&A was determined on the basis of a lead/lag analysis, as required by Section 2.5.3 of the Filing Requirements. Navigant Consulting Ltd. performed this lead/lag analysis and it is included in the Application.[26] This was not challenged during the Hearing.

[26] Application at Exhibit 3, Tab 1, Schedule 12.

3.0 PERFORMANCE SCORECARD

3.1 Is Five Nations Energy's proposal regarding its Performance Scorecard reasonable?

In the Application, FNEI indicated that, to the best of FNEI's knowledge, no electricity transmitter performance scorecard (a "**Scorecard**") had been developed, but that HONI had proposed a Scorecard as part of its transmission rate application (EB-2016-0160). FNEI did not propose to adopt the HONI Scorecard, but indicated that FNEI was amenable to a Scorecard that was narrower in scope.[27]

During the interrogatory process, FNEI included a modified version of the HONI Scorecard that included only those metrics that are applicable to FNEI.[28]

Following the Hearing, FNEI provided an undertaking response that included an explanation for each of the measures from the HONI Scorecard that FNEI would exclude from the FNEI Scorecard.[29]

The answers and information provided by FNEI throughout the proceeding demonstrate a willingness to implement a Scorecard, but uncertainty regarding the appropriate form for a transmitter of FNEI's size. Part of the challenge is that the HONI Scorecard and the FNEI Scorecard are at opposite ends of the transmitter spectrum, which necessitates significant revision in order to develop the FNEI Scorecard. FNEI remains committed to this process and simply

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[27] Application at Exhibit 4, Tab 1, Schedule 1.

[28] FNEI response to Board Staff interrogatory 4-Staff-20(c).

[29] FNEI Undertaking Response J1.7.

requests that the OEB take into consideration the reasons provided by FNEI that certain metrics are not appropriate for FNEI's Scorecard.

4.0 OPERATING AND OTHER REVENUES

4.1 Is Five Nations Energy's 2016 charge determinant forecast reasonable?

FNEI has sought to provide a charge determinant forecast that best correlates with the reasonable expectations of future demand. Although FNEI was directed in its last rate application (EB-2009-0387) to use a linear trend method, the resulting figures appeared inordinately high. FNEI therefore proposes the use of the three year historical average peak demand figures as the charge determinants. As explained in detail in the Application,[30] FNEI believes that this is a more accurate forecast, based on FNEI's knowledge of its four customers and their anticipated demand.

4.2 Is Five Nations Energy's 2016 other revenue forecast reasonable?

FNEI's other revenue was for 2016 was forecasted to be $150,000 (based on $60,000 in miscellaneous service revenue, plus $90,000 in interest and dividend income).[31] FNEI's actual other revenue for 2016 was $146,058 (based on $90,829 in miscellaneous service revenue, plus $56,304 in interest and dividend income, less a loss of $1,075 on the disposal of a utility asset).[32]

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[30] Application at Exhibit 5, Tab 1, Schedule 3.

[31] Application at Exhibit 1, Tab 3, Schedule 2.

[32] FNEI response to Board Staff interrogatory 1-Staff-7.

5.0 OPERATIONS, MAINTENANCE AND ADMINISTRATION (OM&A) COSTS

5.1 Is the level of proposed 2016 OM&A expenses reasonable and adequately taking into consideration factors such as customer preferences, system reliability and asset condition?

FNEI's proposed OM&A expense to be included in its 2016 revenue requirement is $4.336 million. FNEI's actual OM&A in 2016 was $3.916 million,[33] which is:

a) $561,000 (16.7%) more than the $3.355 million approved by the OEB in FNEI's last rate application (EB-2009-0387); and

b) $420,000 (9.7%) less than the forecasted 2016 OM&A of $4.336 million.

The primary drivers of the increase in FNEI's OM&A, as between 2010 and the 2016 test year, were:

a) inflation;

b) additional staff and adjustments to employee compensation;

c) the acquisition of 80 kilometres of transmission line from HONI;

d) increased load dispatching costs; and

e) the right-of-way clearing program.

Each of these drivers is addressed in the following subsections.

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[33] FNEI response to Board Staff interrogatory 6-Staff-25(a).

(i) Inflation

The increase in All-items CPI in Ontario between the effective date of the FNEI's last rate application (EB-2009-0387, effective March 1, 2010) to the proposed effective date for this Application (January 1, 2016) was 9.97%. This level of inflation would increase the $3.355 million approved by the OEB in 2010 by $334,500.[34]

(ii) Additional Staff and Compensation Adjustments

This driver of OM&A costs is addressed in Section 5.2.

(iii) Acquisition of 80 Kilometres of Transmission Line

The acquisition of the 80 kilometres of transmission line from HONI, the details of which are set out in Section 2.3, increased the length of transmission line for which FNEI performed maintenance from 369 kilometres to 449 kilometres. FNEI estimates that the additional maintenance expense related to this increase in the transmission line maintenance length will be at least $50,000 per year.[35]

(iv) Increased Load Dispatching Costs

FNEI's actual load dispatching costs (Account 4810) in 2016 were $349,660,[36] which is an increase of $142,360 (68.7%) more than the load dispatching costs in 2011 of $207,300.[37] The increase in these costs were related to (i) telecommunications expenses related to the fibre optic

[34] Application at Exhibit 6, Tab 1, Schedule 1 (Section 4.1).

[35] Application at Exhibit 6, Tab 1, Schedule 1 (Section 4.3).

[36] FNEI Undertaking Response J1.9.

[37] As noted in the Application at Exhibit 6, Tab 2, Schedule 1, Page 2, the OEB approved OM&A amount in 2010 was on an envelope basis, not an account-by-account basis, which is why the account specific figures used as a basis for comparison are from 2011, as opposed to 2010.

system ($70,700), and (ii) an increase in FNEI's Operating Services Agreement with HONI ($91,100).[38]

The increase in the HONI fees took place in 2016 and are related to HONI (i) providing services to FNEI in relation to the additional 80 kilometres of transmission line acquired by FNEI, and (ii) migrating to a new cost model base on per-unit costs of operating the Ontario Grid Control Centre per kilometre of transmission line and per Network Management System point monitored.[39]

(v) Right-of-Way Clearing Program

FNEI's maintenance costs related to poles, towers, and fixtures (Account 4930) in 2016 were $545,000, which is an increase of $279,000 (104.9%) more than the same maintenance account costs in 2011 of $266,000.[40] The increase in these costs is related to the commencement of the annual right-of-way clearing work in 2013, which has an annual cost of approximately $450,000.[41]

5.2 Are the proposed 2016 human resources related costs (wages, salaries, benefits, etc.) including employee levels appropriate?

In the Application, FNEI had forecasted that employee compensation in 2016 would be $1.041 million,[42] which represented an increase of $675,709 (185.0%) more than employee compensation in 2010 of $365,294.[43]

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[38] Application at Exhibit 6, Tab 2, Schedule 1 (Section 2.1).

[39] Application at Exhibit 6, Tab 2, Schedule 1 (Section 2.1).

[40] As noted in the Application at Exhibit 6, Tab 2, Schedule 1, Page 2, the OEB approved OM&A amount in 2010 was on an envelope basis, not an account-by-account basis, which is why the account specific figures used as a basis for comparison are from 2011, as opposed to 2010.

[41] Application at Exhibit 6, Tab 2, Schedule 1 (Section 2.2).

[42] Application at Exhibit 6, Tab 2, Schedule 2.

[43] FNEI response to Board Staff interrogatory 6-Staff-25(m).

FNEI's actual employee compensation for 2016 was $907,375,[44] which was $133,625 (12.8%) less than the amount proposed. Notwithstanding that the actual expenses incurred during 2016 were less than anticipated, FNEI is still seeking a revenue requirement based on the proposed 2016 employee compensation figures, as the proposed hires of 2016 that were deferred are still required.

The two primary drivers of the increases to employee compensation have been the hiring of additional staff and a compensation adjustment. Each of these are addressed in the following subsections.

(i) Additional Staff

During the period of 2014 to 2016, FNEI increased its staff by hiring two substation electricians and one apprentice.[45] These personnel were necessary to minimize staff-turnover and to provide FNEI with access to a dedicated team with internalized expertise, as adequate service is difficult and expensive to obtain through third parties.[46]

FNEI still intends to hire one more substation electrician and one more apprentice, which will further increase staffing costs by approximately $200,000. It is for this reason that the reduced staffing expenses incurred in 2016 are not appropriate the appropriate basis for this application.

(ii) Compensation Adjustments

On January 1, 2016, FNEI implemented a one-time salary increase of 10% applicable to all staff. This salary increase was necessary to allow FNEI to remain competitive as an employer by offering

[44] FNEI response to Board Staff interrogatory 6-Staff-25(m).

[45] Application at Exhibit 6, Tab 2, Schedule 1 (Section 2.1).

[46] FNEI response to Board Staff interrogatory 6-Staff-25(f).

compensation comparable to other utilities in the electricity sector. FNEI anticipates that the long-term benefit of paying its employees at industry standard levels will assist in the retention of these individuals for a longer period of time, which will preserve institutional knowledge.

At the Hearing, the point was made that the Board has in the past found OPG's compensation levels too high. The implication here is that FNEI should not move its salary levels to match what the OEB considers to be unreasonable. With respect, that is somewhat absurd. FNEI has to retain its employees. FNEI does not set the market for wages in the energy sector in Timmins, but is definitely impacted by the market. What would intervenors and Board Staff have FNEI do? Keep its salaries low, invest in training employees, and then have them leave? That is not sensible.

Actual staffing costs in 2016 increased $87,623 (as compared to 2015 staffing costs) as a result of the salary increase.[47]

5.3 Is Five Nations Energy's proposed depreciation expense for 2016 appropriate?

FNEI's depreciation expense for 2016 was $1.473 million,[48] which is an increase of $286,000 (24.1%) over the 2010 OEB approved depreciation of $1.187 million (EB-2009-0387).

FNEI calculates depreciation for each asset on a straight-line basis in accordance with IFRS.[49] FNEI does not use the half-year rule, but rather calculates depreciation on a monthly basis

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[47] FNEI Undertaking Response J1.10.

[48] FNEI response to Board Staff interrogatory 1-Staff-7(a).

[49] Application at Exhibit 6, Tab 3, Schedule 1.

commencing on the date that the asset goes into service.[50] The depreciation rates used by FNEI are set out in the Application.[51]

5.4 Are the amounts proposed to be included in the 2016 revenue requirement associated with annual fees for land use appropriate?

In 2016 FNEI was required to pay (i) $30,000 to the Ministry of Natural Resources and Forestry, pursuant to a land use permit for locating assets on Crown land, and (ii) $56,000 to the three First Nations (Attawapiskat, Kashechewan, and Fort Albany), pursuant to subsection 28(2) of the *Indian Act*,[52] to locate assets on reserve lands.[53] FNEI understands these to be below the levels paid by other transmitters.

6.0 COSTS OF CAPITAL

6.1 Is Five Nations Energy's proposed capital structure appropriate?

FNEI's proposed capital structure for rate making purposes is 60% debt and 40% equity, which was proposed and approved in FNEI's last rate application (EB-2009-0387). The debt component is comprised of 56% long-term debt and 4% short-term debt. This conforms to the OEB's deemend capital structure. FNEI does not believe that there have been any significant changes in business or financial risk that would require a reassessment.

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50 Application at Exhibit 6, Tab 3, Schedule 1.

51 Application at Exhibit 6, Tab 3, Schedule 3.

52 RSC 1985, c I-5.

53 FNEI response to Board Staff interrogatory 6-Staff-25(b).

6.2 Are Five Nations Energy's proposed long-term and short-term debt rates appropriate?

FNEI has applied a long-term debt rate of 5.11%. This rate is based on the weighted cost of actual debt, pursuant to the *Report of the Board on Cost of Capital for Ontario's Regulated Utilities* (issued December 11, 2009). The calculation of the weighted cost of actual debt is set out in the Application.[54]

FNEI has applied a short-term debt rate of 1.65%. This rate is the OEB-approved deemed short-term debt rate established in the *Cost of Capital Parameter Updates for 2016 Applications* (released October 15, 2015).[55]

6.3 Is Five Nations Energy's proposal to earn a return on equity (ROE) in the same manner as a regulated for-profit utility appropriate?

A critical issue for FNEI is the determination by the OEB of whether FNEI will be permitted to earn an ROE. There are two compelling bases that support FNEI's entitlement to an ROE; one relates to the treatment of FNEI vis-à-vis other for-profit transmitters, while the other relates to the necessity of an ROE to FNEI's continued operation. Each of these bases are addressed below.

(i) FNEI is Entitled to Fair Treatment

A for-profit electricity transmitter in Ontario is permitted to earn a fair return on their invested capital. Given this general approach to establishing the revenue requirement for transmitters in

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[54] Application at Exhibit 7, Tab 1, Schedule 1.

[55] An explanation of the ROE calculation was provided by FNEI in response to Board Staff interrogatory 1-Staff-4.

Ontario, it is difficult to discern why FNEI should be treated any differently simply because it is a not-for-profit corporation.

If the concern is that FNEI should not be entitled to earn a profit because it is a not-for-profit corporation, then this is simply incorrect as a matter of law. FNEI is organized as a not-for-profit corporation under the *Canada Not-for-profit Corporations Act*,[56] which specifically provides that not-for-profit corporations may earn a profit, with the only restriction being on the use of such profits.[57] The earning of an ROE is therefore permissible for FNEI as a not-for-profit.

Another potential concern, which was expressed by the OEB Panel at the Hearing,[58] is that the granting of an ROE will result in FNEI losing its tax-exempt status,[59] which would result in FNEI ceasing to be a not-for-profit corporation. FNEI has obtained legal advice with respect to this issue and it has been determined that it is unlikely that the receipt of an ROE will affect FNEI's tax status.[60] Furthermore, this concern conflates FNEI's corporate status and tax status. Even if FNEI were to lose its current tax-exempt status as a result of receiving an ROE, which is not expected, this would have no impact on FNEI's not-for-profit corporate status.

Given that FNEI is permitted to earn profit and that the receipt of an ROE will have no impact on FNEI's corporate status, it follows that the status of FNEI as a not-for-profit corporation should

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[56] RSC 1970, c C-32.

[57] *Ibid* at s. 34.1

[58] Hearing Transcript, Volume 2 at page 63.

[59] As set out in the Application at Exhibit 1, Tab 5, Schedule 10, FNEI is exempt from tax as a non-profit organization under paragraph 149(1)(l) of the *Income Tax Act*.

[60] Attached as Appendix I to this Argument in Chief is a memo prepared by FNEI counsel for the purposes of this proceeding, in response to a dialogue with Panel Member Long.

not deprive FNEI of its right to earn a fair return. FNEI is entitled to be treated in the same manner as other transmitters and that is what it respectfully requests.

(ii) FNEI Cannot Continue to Operate Without Excess Revenues/ROE

If FNEI is prohibited from earning excess revenues/ROE, then this could result in FNEI failing to satisfy its debt covenants, which would subject FNEI to the risk of imminent insolvency. The only feasible course of action for FNEI in such circumstances would be to reorganize as a for-profit entity, so as to entitle it to an ROE. The risks of such a reorganization were discussed at length during the Hearing and include not only the administrative burdens and costs of the reorganization itself, but also the subsequent pressure on FNEI, as a for-profit entity, to distribute dividends to its shareholders. It is the view of FNEI that such pressures would pose a serious risk to FNEI and lead to its collapse, either immediately as a not-for-profit corporation that is unable to satisfy its debt covenants, or a short time later as a for-profit corporation unable to prevent the distribution of funds to its shareholders.

(iii) The Importance of the ROE Decision and a Path Forward

FNEI finds itself in an unenviable position in this proceeding, as <u>FNEI requires both its not-for-profit status and an ROE</u>. The not-for-profit status is required to insulate FNEI from the financial pressure of shareholders, while the ROE is necessary to satisfy FNEI's lenders and to allow FNEI to pursue its legitimate corporate objectives beyond the transmission of electricity.

Unfortunately, <u>the OEB decision in FNEI's previous application requires that FNEI choose between retaining its not-for-profit status and earning an ROE</u>. This is completely unnecessary, and results in an untenable situation. If the OEB's past decision stands, and FNEI chooses its not-for-profit status, then it is unable to earn an ROE and will breach its debt covenants. If FNEI chooses to earn an ROE, then according to the OEB it must forsake its not-for-profit status, which will result in FNEI being stripped of the protective cover it requires to continue. Again, this lose-lose situation created by the past decision was, and remains, entirely unnecessary.

Through this quagmire a path forward does exist for FNEI and it is based on the recognition that a not-for-profit corporation is entitled at law to earn an ROE, for the reasons set out at Section 6.3(i). From this recognition it follows that FNEI should not be prejudiced by the fact that it is organized as a not-for-profit corporation, but rather, FNEI should be entitled to treatment as would any other electricity transmitter in Ontario.

6.4 Is Five Nations Energy's proposed ROE appropriate?

FNEI is requesting that it be allowed to earn an ROE of 9.19%. This rate is the OEB-approved ROE established in the *Cost of Capital Parameter Updates for 2016 Applications* (released October 15, 2015).[61]

6.5 Is it appropriate to add a reserve fund component to Five Nations Energy's cost structure?

A reserve fund component to FNEI's cost structure is unworkable for FNEI. The primary purpose of a reserve fund would be to provide for the accumulation of funds to allow FNEI to operate, and when those levels are reached, to reduce FNEI's revenue requirement. If this approach is

[61] An explanation of the ROE calculation was provided by FNEI in response to Board Staff interrogatory 1-Staff-4.

implemented, then FNEI would not be entitled to earn an ROE, which would result in FNEI's eventual collapse for the reasons set out in Section 6.3.

Even if one were to bifurcate the reserve policy, such that there was no relationship between the accumulation of reserves and a subsequent reduction in FNEI's revenue requirement, the reserve fund policy would still remain inappropriate. In such a scenario, although FNEI would remain entitled to earn an ROE after the reserves were funded, there still remains no justification for treating FNEI in a manner different than other for-profit transmitters that are not subject to such restrictions.

Reserve funds, whether related to a revenue adjustment or not, are also problematic for FNEI because the accumulation of significant reserves may jeopardize FNEI's eligibility to qualify for its tax exemption as a not-for-profit under the *Income Tax Act*.[62] The loss of this status would be to the detriment of Ontario rate-payers generally, as the requirement to pay taxes would necessitate that FNEI reapply to the OEB for a corresponding increase to its revenue requirement.

6.6 Is Five Nations Energy's proposal to use revenues in excess of costs to meet other non-transmission related corporate objects (i.e. funding community projects) appropriate?

The purposes to which FNEI may apply any revenues in excess of its costs are not relevant to determining whether FNEI is entitled to earn such revenue. The right to earn a fair return is a settled point in law and the basis upon which the return is determined is the service rendered by a

[62] RSC 1985, c 1 (5th Supp).

utility and the related costs. The determination is in no way related to the manner in which the utility chooses to apply its excess revenues.

The question being asked goes even further than asking a for-profit utility to explain why it would reinvest, retain, or distribute excess revenue. The question looks at the end-use of the excess revenue, as opposed to the entitlement to earn it, and is in fact analogous to asking how the shareholder of a for-profit utility will spend the funds they receive by way of a dividend.

The OEB decision in FNEI's previous rate application erred in considering the use to which excess revenues would be applied. In that decision the OEB specifically held:

> It is important to address at this point FNEI's proposal to use the Reserves or "excess earning" to support the social, economic and civic welfare and development activities in the three First Nations communities. The Board rejects this proposal. The Board stresses that amounts included in revenue requirement in excess of costs are for building reserves necessary to ensure the sustainable operation of the utility in its role as a transmitter of electricity pursuant to its license and for no other purpose. The Company is specifically prohibited from using any funds to support the social, economic, and civic welfare and development activities in the First Nations communities. As laudable as these activities may be, they are not the responsibility of the utility as a licensed electricity transmitter and the ratepayers of the utility should not be funding them.[63]

The position adopted by the OEB in 2010 fails to withstand scrutiny. If Ontario ratepayers should not be funding the social, economic and civic welfare and development in the three First Nations Communities, then why should Ontario ratepayers be funding the dividends received by a shareholder of a for-profit transmitter?

[63] OEB Decision and Order in EB-2009-0387, dated November 1, 2010, at 23.

Further, it is illuminating to consider a scenario in which the excess revenues earned by a for-profit utility are designated for precisely the same purposes that FNEI would apply its excess revenues. In these circumstances, a for-profit transmitter, or a shareholder recipient of its dividend, could choose to direct the excess revenues to the benefit of a community, yet this use of the funds would not impair the for-profit transmitter's entitlement to earn an ROE. The OEB position that "[a]s laudable as these activities may be … the ratepayers of the utility should not be funding them",[64] is simply irreconcilable with the accepted reality of this alternative scenario.

Based on the foregoing, the ultimate use of funds cannot be relevant to determining the entitlement of a utility to earn a fair return. Besides being incorrect at law, such an approach is also not applied by the OEB to for-profit utilities. The implication would appear to be that FNEI is subject to differential treatment because it is a not-for-profit. Accordingly, the question is not how FNEI will apply any excessive revenues, but whether it is entitled to earn them, which is addressed in Section 6.3.

7.0 DEFERRAL/VARIANCE ACCOUNTS

7.1 Are the proposed new deferral and variance accounts appropriate?

The only deferral account that FNEI requested in its Application is to track revenue requirement deficiencies from the proposed effective date of January 1, 2016 until such time that FNEI's revenue requirement in this proceeding is approved.[65] A draft accounting order for this account was provided by FNEI as Undertaking J2.3.

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[64] OEB Decision and Order in EB-2009-0387, dated November 1, 2010, at 23.

[65] Application at Exhibit 8, Tab 1, Schedule 1.

At the request of Board Staff, FNEI also provided a draft accounting order to track expenses incurred on account of Z-Factor expenses.[66]

8.0 COST ALLOCATION

8.1 Is the cost allocation to rate pools proposed by Five Nations Energy appropriate?

FNEI allocates its revenue requirement to the Uniform Transmission Rate asset pools on the same basis as HONI.[67]

9.0 INCENTIVE RATEMAKING

9.1 Is Five Nations Energy's proposed 5 year Incentive Ratemaking Plan appropriate (including, but not limited to, its proposals related to inflation, productivity, and stretch factors, Z-Factor claims and deferral account treatment)?

FNEI is proposing a multi-year incentive rate-setting plan ("**IR Plan**") that will annually adjust the 2016 revenue requirement on the basis of an inflation factor, productivity factor, and stretch factor. The IR Plan would also permit FNEI to bring forward Z-factor claims, in relation to unforeseen events, for Board consideration and approval. This approach is set out in the Application is similar to that employed by electricity distributors.[68]

The proposed IR Plan also includes a trigger mechanism for a regulatory review if FNEI's earnings fall short of or exceed an annual ROE deadband of 300 basis points, based on FNEI's annual audited financial statements. [69]

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66 FNEI Undertaking Response J2.4.

67 Application at Exhibit 9, Tab 1, Schedule 1.

68 Application at Exhibit 10, Tab 1, Schedule 1.

69 Application at Exhibit 10, Tab 1, Schedule 1.

FNEI anticipate filing an annual rate application during the IR term and proposes a filing deadline of October 15th.[70]

10.0 BILL IMPACTS

10.1 Are the bill impacts resulting from Five Nations Energy's application appropriate?

FNEI's Application would have no impact on Ontario rate-payers, as there is no change to the network, line connection, or transformation connection charge, as per the calculations set out in the Application.[71]

All of which is respectfully submitted.

DATED at Toronto, Ontario, this 4th day of August, 2017.

FIVE NATIONS ENERGY INC.

By its counsel, Osler, Hoskin & Harcourt LLP
Per: Richard J. King

[70] FNEI response to Board Staff interrogatory 10-Staff-36(a).

[71] Application at Exhibit 11, Tab 1, Schedule 1.

Appendix I

Legal Memorandum

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Memorandum

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To: Five Nations Energy Inc.

Date: August 4, 2017

From: Osler, Hoskin & Harcourt LLP

Subject: Five Nation Energy Inc. ("**FNEI**")
Non-Profit Status and Tax Exemption

Matter No: 1159580

Five Nations Energy Inc. ("**FNEI**") submitted a transmission rates application to the Ontario Energy Board ("**OEB**") on July 27, 2016, which was amended on November 25, 2016 (EB-2016-0231, the "**Application**").

The Application included a request by FNEI that it be entitled to earn a return on equity ("**ROE**") as part of its base transmission revenue requirement. This request was in response to a prior unfavourable OEB decision on this issue in 2010 (EB-2009-0387, the "**2010 Decision**"). In the 2010 Decision, the OEB held that FNEI was not entitled to earn an ROE *per se*. Instead, the OEB permitted FNEI to earn revenues in excess of costs for the purpose of funding certain reserve accounts, which when fully funded would trigger an adjustment to FNEI's revenue requirement that would eliminate these excess revenues. In the 2010 Decision, the OEB rejected the use of FNEI's reserve funds (or revenues in excess of costs) for the purposes of supporting the social, economic, and civic welfare and development activities in Attawapiskat, Kashechewan, and Fort Albany.

An oral hearing in relation to the Application was held by the OEB on July 6-7, 2017 (the "**Hearing**"), which was presided over by Allison Duff (Presiding Member), Christine Long (Member), and Ellen Fry (Member) (collectively the "**OEB Panel**"). At the Hearing, the OEB Panel asked FNEI to consider filing either or both of: (i) the original legal opinion provided to

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FNEI in relation to not-for-profit corporations, which formed the basis for the evidence at Exhibit 7, Tab 2, Schedule 1 of the Application, and (ii) a legal opinion regarding whether allowing FNEI to earn an ROE would jeopardize the not-for-profit status of FNEI.

This memorandum has been prepared at the request of FNEI, for the purposes of filing with the OEB, to address the following issues:

1. whether allowing FNEI to earn an ROE would jeopardize FNEI's current tax exemption;

2. if the earning of an ROE did cause FNEI to lose its current tax exemption, whether FNEI would automatically be subject to the payment of income taxes under the *Income Tax Act* (Canada) (the "**ITA**")[1]; and

3. whether FNEI's non-profit status would be jeopardized by either: (a) earning an ROE; or (b) losing its current tax exemption.

Other related issues (e.g., FNEI's reasons for wanting to retain its not-for-profit status) are properly dealt with as matters for evidence and argument, and are not discussed in this legal memorandum.

<u>ANALYSIS</u>

1. FNEI's Current Tax Exemption (Non-Profit Organizations)

FNEI currently files its income tax return under paragraph 149(1)(l) of the ITA, pursuant to which FNEI is exempt from taxation on the basis that it qualifies as an non-profit organization ("**NPO**").

Paragraph 149(1)(l) provides that a not-for-profit club, society, or organization (including a corporation) will be exempt from taxation so long as it: (i) is not a charity, (ii) is organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any

[1] RSC 1985, c. 1 (5th Supp.). All statutory references herein are to the provisions of the ITA unless otherwise noted.

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other purpose except profit, and (iii) no part of its income is payable or otherwise available for the personal benefit of its members.

Considerations (i) and (iii) are not controversial with respect to FNEI as it is not a charity, and by virtue of its corporate status and as a factual matter, its income is not paid, payable, or otherwise made available for the personal benefit of its members.[2]

Condition (ii) has two requirements, specifically FNEI must be both organized **and** operated exclusively for a purpose other than profit. With respect to the first requirement, the case law emphasizes the importance of looking to the entity's objects as described in the Letters Patent (or other incorporation documents) in determining whether an entity is organized for the purpose of profit.[3] FNEI's Letters Patent include the objects of providing electrical power to several First Nation communities, and encouraging self-sufficiency and socially beneficial initiatives within the communities. These objects do not have a profit purpose and, instead, fall within scope of "social welfare" and "civic development" for the purposes of paragraph 149(1)(l).

This is in contrast to entities where the Letters Patent on their face indicate a for-profit purpose that does not, itself, have an element of social welfare or civic development and consequently does not satisfy the requirements of paragraph 149(1)(l).[4] In addition, subsections 17(2) and

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2 In addition, subsection 34(1) of the *Canada Not-for-profit Corporations Act*, SC 2009, c 23 ("**CNFPCA**") provides that FNEI is prohibited from distributing income directly or indirectly to its members except in furtherance of its activities or as otherwise permitted by the CNFPCA. Subsection 17(2) of the CNFPCA further provides that a corporation shall not carry on any activities in a manner contrary to its articles. When read together, these provisions prohibit FNEI from distributing income to its members except for the purposes set out in its Letters Patent.

3 In *Gull Bay Development Corp v R*, [1984], 2 FC 6040 84 DTC 6040 at 24 (FCTD) the Court held that a nonshare logging corporation was a not-for-profit organization within the meaning of 149(1)(l) stating that, "the letters patent make no reference to any business operations whatsoever. I believe that this is a substantial distinction." See also *L.I.U.N.A. Local 527 Members' Training Trust Fund v. The Queen*, 92 DTC 2365 at 2378 (TCC), where the Court dealt with the first requirement in condition (ii) as follows: "That the fund was organized for a purpose other than profit is incontrovertible. Its sole purpose as stated in the trust agreement is the training of members of the union".

4 See *Woodward's Pension Society v MNR*, [1962] SCR 224, where the Supreme Court of Canada found that the corporate objectives of providing funds for the payment of pensions first required that the business of trading securities earned a profit. See also *Otineka Development Corp. v Canada*, [1994] 1 CTC 2424 [*Otineka*] where the Tax Court of Canada denied a 149(1)(l) claim based in part on the fact that the corporation's sole purpose was to earn profit on real estate in order to fund community programs.

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34(1) of the CNFPCA further bolster the FNEI's position for tax purposes that FNEI is not organized for the purpose of profit.[5]

With regard to the second requirement in condition (ii), the courts have pointed out that it is implicit in the legislative scheme surrounding paragraph 149(1)(l) that NPOs can in fact sometimes earn a profit without thereby losing their tax-exempt status. Paragraph 149(1)(l) exempts an organization from tax on *net* income (taxable income generally being the excess of operating income over expenses and other allowable deductions) and the exemption would be unnecessary if it could only ever apply to organizations that never earn positive net income (i.e., profit).[6]

We are aware that the CRA has taken the position that an entity will not meet the requirements of paragraph 149(1)(l) where its accumulated funds exceed its current needs.[7] The CRA has also indicated that large reserve funds will not be considered "incidental profits" and, instead, the entity will be viewed as having two purposes: (i) a social welfare purpose and (ii) a for-profit purpose,[8] such that the entity will not qualify under paragraph 149(1)(l) because it is not organized and operated *exclusively* for social welfare, civic development, or any other purpose except profit. In this way, the 2010 Decision poses some risk to FNEI of running afoul of the CRA's administrative position because) an accumulation of funds is an inevitable result if FNEI is not permitted to distribute excess revenues for its corporate purposes, which it is prohibited from doing by the 2010 Decision.

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5 Subsections 17(2) and 34(1) of the CNFPCA provide that an entity cannot act outside of its corporate objectives and it cannot pay or otherwise make payable income to its members for their personal benefit in a way that would be contrary to the corporate objectives.

6 See *Canadian Bar Insurance Assn v R*, 99 DTC 653 (TCC) at para 34: "if the simple act of earning income from any source disqualified a person from relying on the exemption, then the exemption itself would be redundant and meaningless."

7 Canada Revenue Agency, Interpretation Bulletin IT-496R, "Non-Profit Organizations" (2 August 2001) at para 9.

8 See Canada Revenue Agency, Interpretation View 2012-0439951I7, "Non-Profit Organization Project" (10 November 2012) and Canada Revenue Agency, Interpretation View 2011-0426231I, "Non-Profit Organization Project" (20 June 2012).

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Apart from the potential issues raised by the 2010 Decision, FNEI should not be considered to be operated for a profit purpose; rather, it operates to provide communities with electricity and promote socially beneficial initiatives. Any excess revenues it may earn (including in the form of an ROE) is incidental to these purposes and, pursuant to FNEI's corporate objects, is to be used for additional social welfare purposes. FNEI has filed annually on the basis of paragraph 149(1)(l) and, as noted in the Hearing, CRA has not taken issue with FNEI's filings. As such, FNEI is careful to monitor its business and ITA developments to ensure that it stays within the exemption afforded by paragraph 149(1)(l). We understand that OEB has expressed a concern that if it characterizes some of FNEI's revenue requirement as an ROE and allows FNEI to report an ROE, that this could have an adverse implication for FNEI's ability to qualify as a NPO. The characterization of the revenue by the OEB should not be relevant to the tax treatment of FNEI. As noted above, the only requirements of FNEI to qualify for tax-exempt status do not address the characterization of funds, but regard profit generally.[9] If it should turn out to be the case that FNEI earns a profit in a year and has a positive ROE in the same year, its status under 149(1)(l) will be determined under the applicable law, as summarized above and the mere use of term "ROE" will not be determinative.

On the basis of the foregoing, assuming that it continues to operate for the purposes for which it was established, FNEI should continue to qualify under paragraph 149(1)(l) even if it is entitled to an ROE and earns some measure of profit.

2. Other Income Tax Exemptions

Although we have concluded that FNEI should be tax-exempt under paragraph 149(1)(l), an entity may be exempt from tax under more than one provision in subsection 149(1). In this regard, FNEI potentially also may qualify for tax exemption under paragraph 149(1)(d.6).

The potential eligibility of FNEI for tax exemption under paragraph 149(1)(d.6) is derived from its corporate structure. FNEI's three members are the three local distribution companies

[9] For additional discussion on what is considered "profit" please see generally *BBM Canada v MNR*, 2008 TCC 341 at paras 21-42.

(Attawapiskat Power Corporation, Kashechewan Power Corporation, and Fort Albany Power Corporation) (collectively the "**LDCs**"). The members of each LDC are in turn the First Nation Band in their respective communities (collectively the "**Bands**"). A chart illustrating this ownership structure was included in the Application at Exhibit 1, Tab 5, Schedule 13, Appendix II.

The tax exemption originates with the Bands, which are each eligible for a tax exemption pursuant to paragraph 149(1)(c), on the basis that they are a public body performing a function of government.[10]

The LDCs are clearly eligible for a tax exemption, pursuant to paragraph 149(1)(d.5), on the basis that they are each 100 per cent owned by one of the Bands, which are public bodies performing a function of government.

FNEI may be eligible for a tax exemption, pursuant to paragraph 149(1)(d.6), on the basis that it is 100 per cent owned by the LDCs, which are themselves eligible for a tax exemption pursuant to paragraph 149(1)(d.5), although a detailed analysis of FNEI's eligibility to qualify for a tax exemption under paragraph 149(1)(d.6) has not been undertaken. However, this tax exemption is not dependent upon FNEI's not-for-profit status.

3. Tax Treatment Not Determinative of FNEI's Status as a Not-for-Profit Corporation under the CNFPCA

FNEI's status as a not-for-profit corporation under Canadian federal corporate law is a product of the basis for its incorporation. FNEI's entitlement to benefit from an exemption from taxation as an NPO is a separate question, arising under tax legislation. As described below, although not expected to occur, FNEI can lose the benefit of this favourable tax treatment without affecting its status as a not-for-profit corporation under corporate law.

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[10] See e.g. *Otineka, supra* note 4 where the Tax Court of Canada found that the Opaskwayak Cree Nation, through its elected Chief and Band Council in the powers that they exercise and by the services that it provided to its members, is a municipality and thus performs a function of government. The services included education, social services, and employment and training – many of which overlap with services provided in each of Attawapiskat, Kashechewan, and Fort Albany.

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As a matter of corporate status, FNEI was incorporated as a not-for-profit corporation without share capital under the *Canada Corporations Act*[11] and was subsequently continued on the same basis under the *Canada Not-for-profit Corporations Act*.[12]

The CNFPCA specifically provides that not-for-profit corporations may earn a profit – the only restrictions are on the use of such funds, not on their receipt. Subsection 34(1) of the CNFPCA specifically provides:

> … no part <u>of a corporation's profits</u> or its property or accretions to the value of the property may be distributed, directly or indirectly, to a member, a director or an office of the corporation, except in furtherance of its activities or as otherwise permitted by this Act.
>
> (emphasis added)

Even in the event that the CRA refused to treat FNEI as a NPO under the ITA, therefore, such action by the CRA would have no impact on the not-for-profit status of FNEI under the CNFPCA, as this is part of its corporate "constitution". This distinction has been expressly recognized by the CRA, which distinguishes its tax treatment of a corporation from a corporation's ability to meet the requirements of the CNFPCA.[13]

Given that FNEI's status as a not-for-profit corporation under the CNFPCA will not be affected by (i) the treatment of FNEI for tax purposes under the ITA, or (ii) the earning of an ROE, it follows that the granting of an ROE by the OEB will not jeopardize FNEI's not-for-profit corporate status, regardless of potential tax implications.

<u>SUMMARY OF CONCLUSIONS</u>

1. FNEI has been considered eligible for treatment as a non-profit organization by the CRA for tax purposes while having earned an ROE, in substance if not in name. Canadian courts have also held that the earning of a profit does not disentitle an entity from qualifying as a non-profit organization for tax purposes.

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[11] RSC 1970, c C-32.

[12] CNFPA, *supra* note 2.

[13] Canada Revenue Agency, Interpretation Views 2009-0337311E5, "149(1)(l) Organizations" (5 November 2009).

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2. In the event that the CRA takes the position in future that FNEI no longer qualifies as a non-profit organization, for any reason, then FNEI could then explore alternative tax exemptions, which may prevent the loss of non-profit status from having an impact on FNEI's revenue requirement.

3. The not-for-profit corporate status of FNEI would not be jeopardized by its receipt of an ROE. Further, FNEI's not-for-profit status will not be affected by the manner in which FNEI is assessed for tax purposes.

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