ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION

FIVE NATIONS ENERGY INC.

2016 REVENUE REQUIREMENT

EB-2016-0231

August 23, 2017

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Background

Five Nations Energy Inc. (FNEI) filed a cost of service application with the Ontario Energy Board (OEB) on July 27, 2016 (completed November 25, 2016) under section 78 of the *Ontario Energy Board Act*, *1998*, seeking approval for changes to its transmission revenue requirement effective January 1, 2016. FNEI recovers its approved revenue requirement through Ontario's Uniform Transmission Rates (UTRs).

FNEI requested approval of a base revenue requirement of approximately $7.84 million, which reflects an increase of about $1.51 million (24%) compared to FNEI's most recently OEB-approved 2010 base revenue requirement of $6.33 million.[1]

FNEI is a non-profit, non-share capital, federally-incorporated corporation that is licenced by the OEB to own and operate transmission facilities along the western coast of James Bay. FNEI's transmission line serves the three First Nation communities of Attawapiskat, Fort Albany and Kashechewan, as well as the DeBeers Victor Diamond Mine.

FNEI was incorporated in 1997 by the three First Nation communities of Attawapiskat, Fort Albany and Kashechewan. The three members of FNEI are the Attawapiskat Power Corporation, the Fort Albany Power Corporation and the Kashechewan Power Corporation, each of which in turn is controlled by its respective First Nation. FNEI's Board of Directors contains representation from not only its three member First Nations, but also has representation from Moose Cree First Nation and Taykwa Tagamou First Nation, because FNEI's assets pass through the traditional territories of these two First Nations.[2]

As there was no settlement conference scheduled for this proceeding, all issues advanced to an oral hearing which was held on July 6 and 7, 2017.

OEB Staff Submission Summary

OEB staff will make submissions on all of the issues that were established by the OEB in the Decision and Order on the Proposed Issues List in the following sections.[3] For ease of reference relative to FNEI's argument-in-chief, OEB staff also organized its submission on the basis of the OEB-approved Issues List.

[1] EB-2016-0231, Argument-in-Chief, p. 4.
[2] EB-2016-0231, Exhibit 1, Tab 1, Schedule 2, pp. 1-2.
[3] EB-2016-0231, Decision and Order on the Proposed Issues List, Schedule A.

OEB staff will provide a brief summary of its main arguments below (the rationales for the arguments are found in the relevant sections of the submission):

- The effective date should be January 1, 2017. The proposed 2016 test year should be converted to a 2017 test year. The final 2017 test year revenue requirement should be based on 2016 actual amounts (rate base, OM&A, depreciation, etc.) with certain proposed adjustments to account for the best available information and an Incentive Regulation Mechanism-based (IRM) inflationary adjustment. The 2017 revenue requirement should be established at $6.72 million (Sections 1.3 and 9.1).

- The OEB should approve a four-year IRM plan for FNEI (2017-2020) with 2017 being considered the first year of the term (Sections 1.3 and 9.1).

- The incremental input tax credit amount of $0.045 million should be refunded to ratepayers in 2018 (Section 1.1).

- The 2017 rate base amount should be established at $33.79 million (a reduction of approximately $1.98 million relative to 2016 proposed). This reflects the use of 2016 actual rate base and the disallowance of the recovery of a portion of the Timmins head office costs (Section 2.3).

- FNEI should use the performance scorecard as designed and proposed in Section 3.1.

- The charge determinant forecast should be based on the 2014-2016 historical average of peak demand (Section 4.1).

- The 2017 base OM&A budget (excluding depreciation and prior to the 2017 IRM adjustment) should be set at $3.79 million (a reduction of approximately $0.55 million relative to 2016 proposed). This reflects the use of 2016 actuals and adjustments for: (a) an additional electrician; (b) the removal of the costs related to the one-time 10% salary increase; (c) a reduction of the conservation budget; (d) a reduction to regulatory expenses; and (e) a reduction to certain maintenance activities (Section 5.1).

- The 2017 base depreciation expense (excluding the 2017 IRM adjustment) should be established at approximately $1.38 million (an increase of about $0.09 million relative to 2016 proposed). This reflects the use of 2016 actual depreciation and the removal of a portion of the Timmins head office costs from rate base (Section 5.3).

- The OEB should approve the introduction of a Financial Viability Revenue Rider (FVRR) set at $0.61 million and the discontinuance of the Reserve Fund Framework. This results in a reduction to the 2016 proposed return component of the revenue requirement of about $0.7 million (Section 6.3).

- The OEB should not apply any restrictions with respect to the use of funds arising from the FVRR (Section 6.6).

- The OEB should approve a Forgone Revenue Deferral Account (Section 7.1).

A numerical summary of the proposed changes to FNEI's revenue requirement is found in the table below (with a reference to the section where the relevant argument can be found).[4] The revenue requirement amounts found in the "OEB Staff Submission" column reflect best effort estimates as not all of the amounts can be calculated precisely at this time (i.e. depreciation).

Table 1 – Revenue Requirement

Category ($M)	Proposed	OEB Staff Submission	Variance ($)	Variance (%)	Section Reference
Effective Date	Jan. 1, 2016	Jan. 1, 2017			1.3
Rate Base	$35.78	$33.79	-$1.99	-5.6%	2.3
OM&A (Excl. Depreciation)	$4.34	$3.79	-$0.55	-12.7%	5.1
Depreciation	$1.29	$1.38	$0.09	7.1%	5.3
LT Debt	$1.02	$0.97	-$0.05	-5.3%	6.2
ST Debt	$0.02	$0.02	$0	0.1%	6.2
Return Component	$1.32	$0.61	-$0.70	-53.2%	6.3
Total (Service RR)	**$7.99**	**$6.78**	**-$1.21**	**-15.2%**	
Other Revenue	$0.15	$0.15	$0	-2.6%	4.2
Total (Base RR)	**$7.84**	**$6.63**	**-$1.21**	**-15.4%**	9.1
Total (Base RR) - IRM Update (Final 2017 Revenue Requirement)	**$7.84 (no update)**	**$6.72**	**-$1.12**	**-14.3%**	9.1

[4] A more detailed version of this table is provided at Appendix A; and minor variances in the calculations are due to rounding.

OEB staff also notes that FNEI states, at multiple points in its pre-filed evidence, interrogatory responses and argument-in-chief, that changes to its revenue requirement have no impact on Ontario transmission rates. OEB staff acknowledges that FNEI's entire revenue requirement is not material to the setting of the UTRs, since the revenue requirement from which the UTRs are derived is comprised of the combined revenue requirements for rate-regulated transmitters across Ontario, including Hydro One Networks Inc. (HONI). However, OEB staff submits that it is still important to give careful consideration to requests made by FNEI with respect to its revenue requirement by ensuring the prudence and appropriateness of the underlying costs.

1.0 General

1.1 Has FNEI responded appropriately to all relevant OEB directions from previous proceedings?

In the following section OEB staff will make submissions on the following two issues: (a) FNEI's compliance with the OEB's direction to record incremental input tax credits in a deferral account; and (b) FNEI's compliance with the OEB's direction to establish certain reserve funds.

Incremental Input Tax Credit

The OEB's decision with respect to FNEI's 2010 revenue requirement application stated:

> the Board directs that, beginning July 1, 2010, FNEI shall record in a deferral account, the incremental input tax credit it receives on revenue requirement items that were previously subject to PST and which become subject to HST. Tracking of these amounts will continue in the deferral account until the effective date of FNEI's next rate application. While the actual amounts recorded in such an account may well be small as FNEI contends, there is insufficient evidence at this point to determine whether the administrative costs outweigh the benefits. As a result the Board finds that in order to ensure consistency across regulated utilities, a deferral account is appropriate.[5]

FNEI stated that it tracked the incremental tax credit for a period of six months and determined the applicable amount to be approximately $5,000 during this period. Therefore, FNEI did not establish a deferral account on the basis that such an amount was well short its materiality threshold.[6]

[5] EB-2009-0387, Decision and Order, pp. 14-15.
[6] EB-2016-0231, Exhibit 1, Tab 5, Schedule 18, OEB Directive 2.

In response to an interrogatory from OEB staff, FNEI noted that its estimate of the total incremental tax credit amount during the 2010-2016 period was about $0.09 million.[7] Therefore, in a manner consistent with the treatment of other regulated utilities, 50% of that amount (or $0.045 million) would be eligible for refund to ratepayers as part of the current proceeding.

At the oral hearing, FNEI confirmed that the $0.09 million reflects a reasonable proxy of the amount of the incremental input tax credit that would have been recorded in the deferral account had it been established. FNEI deferred to the OEB with respect to whether 50% of the recorded balance ($0.045 million) should be refunded to ratepayers in the current proceeding based on the OEB's decision on FNEI's 2010 revenue requirement application.[8]

OEB staff submits that 50% of the incremental tax credit amount (being $0.045 million) that would have been recorded in the deferral account had it been established should be refunded to ratepayers as part of the current proceeding. This is in accordance with the OEB's decision in FNEI's 2010 revenue requirement proceeding[9] and consistent with the treatment that has been applied to other regulated utilities with respect to incremental input tax credits.

OEB staff submits that while the amount is small (as FNEI originally argued in its 2010 revenue requirement proceeding), the OEB was clear in its decision[10] that while the amounts may be small there was an expectation that amounts would be recorded for refund in the deferral account on a principled basis to ensure consistency with other regulated utilities. The amount should be refunded to ratepayers through an adjustment to FNEI's 2018 revenue requirement (as discussed in Section 9.1).

Reserve Fund Framework

The OEB's decision with respect to FNEI's 2010 revenue requirement application stated, "the Board is very concerned that FNEI's current Operating fund and Capital reserve remain unfunded. In the Board's view, reserves provide a cushion against unplanned expenses and therefore FNEI must maintain sufficient operating and capital reserves."[11]

[7] EB-2016-0231, Interrogatory Responses, 1-Staff-11.
[8] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 65.
[9] EB-2009-0387, Decision and Order, pp. 14-15.
[10] EB-2009-0387.
[11] EB-2009-0387, Decision and Order, p. 21.

In its decision, the OEB further directed that the Insurance Reserve was appropriate as configured but made specific findings related to the Operating Reserve and the Capital Reserve.

The OEB approved the recovery of revenue in excess of costs amounting to 9.5% to be used to fund Operating and Capital reserves (and directed FNEI to refer to these amounts as Internally Generated Funds).

The OEB also established caps for both the Operating Reserve and the Capital Reserve. The Operating Reserve was capped at an amount equal to the sum of the highest six months of OM&A expenses incurred by the utility over the previous two years of operation. The Capital Reserve was capped at $275,000.

The OEB directed FNEI to file a reserves policy within three months of the date of the decision. The OEB also set out a number of accounting rules regarding the operation of the Operating and Capital reserves. The OEB stated that any deviation from those rules would be strictly on consent of the OEB and acquired in advance.[12]

Finally, the OEB also ordered that once both reserves were fully funded, FNEI would file an application for a revised revenue requirement and stated that, "under no circumstances shall the Company collect any funds in excess of revenue requirement once the Reserves are fully funded."[13]

As discussed in FNEI's argument-in-chief the reserves policy was never finalized.[14] OEB staff has suggested a new approach to the treatment of cost of capital for FNEI in Section 6.3.

1.2 Are all elements of FNEI's proposed 2016 revenue requirement reasonable?

OEB staff submits that certain changes to FNEI's proposed 2016 revenue requirement are appropriate and necessary. These changes are discussed in the remainder of the submission.

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

OEB staff submits that the proposed effective date of January 1, 2016 is not appropriate. Instead, an effective date of January 1, 2017 should be approved.

[12] EB-2009-0387, Decision and Order, pp. 20-24 and Appendix A.
[13] EB-2009-0387, Decision and Order, p. 24.
[14] EB-2016-0231, Argument-in-Chief, p. 4.

OEB staff notes that FNEI's current revenue requirement as originally approved in FNEI's 2010 rates proceeding[15] was declared interim effective January 1, 2016.[16]

OEB staff notes that FNEI originally filed its application on July 16, 2016, and after that version of the application was deemed incomplete, it was another four months later, on November 25, 2016, that a complete application was filed. This was over 10 months after the requested effective date and 18 months after the expected filing date. In the OEB's 2014 Filing Requirements for Electricity Distribution Rate Applications, the filing deadline for a January 1 effective date is the end of April in the year prior to the test year.[17] The OEB's general policy has been that late applications filed after the commencement of the rate year for which the application is intended to set rates should be converted to the following rate year. This general policy was formalized in the 2016 Filing Requirements for Electricity Distribution Rate Applications.[18] OEB staff submits that a request for an effective date that precedes the filing date should not be approved.

FNEI argued that it was not in a position to file its application at any earlier date due to a number of factors. These factors include: (a) the acquisition of 80 kms of line from HONI in October 2015; (b) the replacement of FNEI's CEO in late January 2016; (c) the release of new OEB filing requirements in February 2016; (d) the requirement for FNEI to strictly comply with the Filing Requirements; (e) FNEI's IR Plan proposal; and (f) the small size of FNEI and the administrative burden of preparing the application.[19]

FNEI was aware of the need to file its application well in advance of the proposed effective date and the possibility of revising the application to include the 80 km purchase, before submitting it to the OEB.[20] FNEI had a fairly accurate estimate of the cost of reacquiring the 80km of line in 2014 (estimated at $5 million[21] and the actual purchase price was $4.9 million[22]) and could have used that estimate as a placeholder for the final cost in its application. This would have made it possible for an application to be filed in late 2014 or early 2015, and in any event, no later than late April 2015, the filing deadline for electricity distributors seeking a January 1 rate year. The other factors identified by FNEI and noted above were largely in FNEI's control.

[15] EB-2009-0387.
[16] EB-2015-0368, Decision and Interim Order, p. 3.
[17] Filing Requirements for Electricity Distribution Rate Applications, Chapter 2 – Cost of Service, July 18, 2014, p. 3.
[18] Filing Requirements for Electricity Distribution Rate Applications, Chapter 2 – Cost of Service, July 14, 2016, p. 4.
[19] EB-2016-0231, Argument-in-Chief, pp. 5-6.
[20] EB-2016-0231, Interrogatory Responses, 2-Staff-13(b), Appendix at p. 8.
[21] EB-2016-0231, Interrogatory Responses, 2-Staff-13(b), Appendix at p. 8.
[22] EB-2016-0231, Exhibit 2, Tab 2, Schedule 1, p. 1.

As discussed in Section 6.3, OEB staff does not agree that FNEI should be permitted to earn a return on equity. However, even if the OEB were to determine that an ROE is appropriate in this case, OEB staff cannot support a request for an ROE for 2016, in light of the late filing of this application.

OEB staff submits that the appropriate effective date in the context of when the application was filed is January 1, 2017. This reflects a conversion of the proposed test year beginning January 1, 2016 to a test year beginning January 1, 2017 in accordance with the OEB's general policy with respect to the late filing of applications (as formalized in the 2016 Filing Requirements for Electricity Distribution Rate Applications).[23]

OEB staff submits that, as will be discussed in more detail throughout the submission, the 2017 test year revenue requirement should be established in two stages.

1) The base 2017 revenue requirement should be established using actual 2016 revenue requirement (with certain specific adjustments) as this reflects the best available information on the record.

2) The final 2017 revenue requirement should be established by applying an IRM-based inflationary adjustment to the base 2017 revenue requirement to provide FNEI with sufficient funds in 2017 to effectively manage inflationary pressures on its costs.

OEB staff submits that the 2017 test year should also be considered the first year of FNEI's IRM term (2017-2020 – 4 years total – with the original proposed 2016 rebasing year forgone) as it will reflect both FNEI's rebased costs and the first IRM-based adjustment.

OEB staff also submits that a 4-year rate setting term is appropriate in this case as OEB staff has proposed that a FVRR be applied to FNEI, which represents a new method for the treatment of cost of capital for a not-for-profit utility. OEB staff believes that a shortened rate setting term (4-years instead of the standard 5-years) is prudent in the context of this new proposal.

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

[23] Filing Requirements for Electricity Distribution Rate Applications, Chapter 2 – Cost of Service, July 14, 2016, p. 4.

OEB staff submits that FNEI's customer engagement activities were sufficient to enable customer needs and preferences to be considered in the formulation of its past and future spending.

OEB staff notes that FNEI is in a unique situation in that it has only four customers, and three of those customers are the LDCs that operate in the communities served by FNEI. These three customers are also the members (or "owners") of FNEI as a non-share capital not-for-profit corporation.[24] Due to this situation, OEB staff submits that FNEI has the opportunity to directly communicate with its customers on a regular and ongoing basis. This allows FNEI to address the concerns of its customers immediately as they arise. OEB staff also submits that FNEI is in regular contact with its fourth customer (DeBeers) and works directly with that customer to ensure that its needs are addressed.

As an illustrative example, as noted in FNEI's argument-in-chief, FNEI's customers identified the need for additional feeders in the communities of Attawapiskat and Kashechewan in order to support development and FNEI was able to respond to that request in short order.[25]

Overall, OEB staff submits that FNEI's customer engagement activities, which largely occur organically due to the corporate structure of the utility and the small number of customers, are sufficient for the purposes of enabling customer needs and preferences to be considered in FNEI's spending.

2.0 Transmission System Plan (TSP) and Rate Base

2.1 Does the TSP adequately address customer needs and preferences?

OEB staff submits that FNEI's TSP adequately addresses customer needs and preferences given the limited number of future capital projects that have been discussed in evidence. However, OEB staff does have some concerns with respect to the proposed project which would twin FNEI's transmission line from Kashechewan to Attawapiskat (the "twinning project"). These concerns are discussed in more detail in Section 2.2. OEB staff will also make submissions regarding necessary efforts that should be required for the next rebasing application to enhance FNEI's TSP in Section 2.2.

As discussed previously, FNEI is in a unique situation whereby it only has four customers and three of those customers are the LDCs that operate in the communities served by FNEI. As evidenced by FNEI, the needs of its customers are a direct input in

[24] EB-2016-0231, Exhibit 1, Tab 2, Schedule 1.
[25] EB-2016-0231, Argument-in-Chief, p. 7.

its transmission system planning due to the close relationship that it has with its customers.[26]

As set out in FNEI's argument-in-chief, none of FNEI's customers anticipates material increases in capacity, and the primary concerns of FNEI's customers is with respect to system reliability. Therefore, FNEI's strategic plan is grounded in the principle of minimizing outages and providing reliable transmission of electricity.[27] OEB staff submits that this is the appropriate approach given the information provided to FNEI by its customers.

OEB staff agrees with FNEI that it has appropriately considered customer needs and preferences as the capital projects that it is considering undertaking in the near future are largely related to maintaining system reliability.[28]

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?

OEB staff will make submissions on two main issues in the following section: (a) proposed capital expenditures (2017 and beyond); and (b) necessary enhancements to the TSP and capital expenditure evidence for the next rebasing.

Proposed Capital Expenditures (2017 and beyond)

OEB staff submits that it has no concerns with the following capital projects: (a) the bus isolation project ($1 million remaining to be spent in 2017); (b) the transformer stone replacement project ($0.15 million remaining to be spent in 2017); (c) the installation of diesel backup generators at the fibre shelters (approx. $0.1 million remaining to be spent in 2017);[29] (d) replacement of batteries in the control room at each of FNEI's transformer stations (approx. $0.1 million during IRM term); (e) replacement of brush clearing equipment ($0.25 million during IRM term); and (f) replacement of fibre optic system ($0.25 million during IRM term).[30] OEB staff submits that these projects are reasonable as they address system reliability concerns, health and safety concerns, and replace assets that are nearing their end of useful life.

However, OEB staff does have a concern with the twinning project. FNEI stated that the project is forecast to cost approximately $35 million, which would reflect an approximate

[26] EB-2016-0231, Exhibit 1, Tab 2, Schedule 1.
[27] EB-2016-0231, Argument-in-Chief, p. 8.
[28] EB-2016-0231, Argument-in-Chief, pp. 8-9.
[29] These projects (a to c) are discussed at EB-2016-0231, Exhibit 2, Tab 2, Schedule 1, pp. 13-17.
[30] The projects (d to f) are preliminary and discussed at EB-2016-0231, Interrogatory Responses, 2-Staff-17(d) and EB-2016-0231, Oral Hearing Transcripts, Vol. 1, pp. 78-79.

doubling of FNEI's rate base. FNEI stated that, while the asset would not likely come into service during the proposed IRM term (ending December 31, 2020) it plans to undertake detailed engineering for this project during the IRM term.[31]

OEB staff submits that there is no evidence of the need for this project in the current proceeding. While FNEI has not sought any direct approvals with respect to this project as part of the current proceeding, OEB staff submits that the OEB should caution FNEI that any significant spending (beyond very preliminary estimating of the costs) prior to explicit OEB approval would be at FNEI's risk. OEB staff submits that it may be possible for FNEI to seek approval through an incremental capital module (ICM), (which FNEI could undertake to file during the IRM term following the current proceeding), or through an advanced capital module (ACM) in a subsequent revenue requirement proceeding.

Necessary Enhancements to the TSP and Capital Expenditure Evidence

OEB staff recognizes that FNEI is small transmitter and a TSP similar to that which is filed by HONI is not feasible, nor is it appropriate. OEB staff also notes that this is first TSP filed by FNEI. Therefore, a certain level of flexibility with respect to the TSP is reasonable in this proceeding. However, there are certain items that are set out in Chapter 2 of the OEB's *Filing Requirements for Electricity Transmission Applications*, dated February 11, 2016 (the Transmission Filing Requirements), that FNEI should adhere to when filing the next iteration of its TSP.

OEB staff submits that FNEI should be required to file the same information that it filed as part of the current proceeding. This would include its investment planning process (including a strategic plan and information regarding how regional planning was considered) and an updated and detailed asset management plan (including an up-to-date inventory of assets). The detailed asset management plan will be necessary for the OEB to ensure that sufficient investment has been made in FNEI's capital assets during the IRM term in the context of OEB staff's submission with respect to the use of revenues for fulfilling FNEI's non-transmission corporate objectives discussed at Section 6.6.

In addition to the information that has been filed as part of the current proceeding, FNEI should also be required to file incremental evidence as discussed in the following paragraphs.

First, OEB staff submits that, as set out at section 2.3.4 of the Transmission Filing Requirements, FNEI should be directed to file, in its next rebasing application, a summary of five future years of proposed capital expenditures (including the proposed

[31] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 79.

test year).[32] In the current proceeding, FNEI provided only two future years including the test year (i.e. 2016-2017). OEB staff submits that the OEB must have a five-year forecast in order for it to be able to adequately consider the appropriateness and pacing of future capital plans.

Second, OEB staff notes that no benchmarking was filed as part of the current proceeding. The consequence of this lack of benchmarking is addressed in OEB staff's submission with regard to a change to the proposed stretch factor (from 0.3% to 0.6%) that should be applied to FNEI as part of its IRM plan (see Section 9.1).

OEB staff's proposal on future benchmarking requirements is meant to encompass both capital cost benchmarking and operational cost benchmarking.

As discussed in the Transmission Filing Requirements and reiterated in the Rate Handbook[33], benchmarking is a key component of rate-setting under the *Renewed Regulatory Framework for Electricity* (RRFE). While the RRFE was designed to specifically address electricity distributors, the Filing Requirements attempted to integrate the core RRFE concepts into the rate application process for transmitters.[34]

OEB staff understands that not all of the benchmarking that is set out in the Transmission Filing Requirements will be achievable by FNEI. However, some forms of benchmarking should be required while others should at least be attempted by FNEI on a best efforts basis.

OEB staff submits that FNEI should be required, at a minimum, to provide internal program-based benchmarking (which compares FNEI's own cost performance over time to demonstrate continuous improvement). This type of internal benchmarking is useful as a directional indicator of productivity and can assist the OEB in assessing FNEI's future capital spending proposals, and in determining an appropriate stretch factor to apply to FNEI in the absence of external benchmarking. This is a type of benchmarking that FNEI can undertake as it does not require relevant external comparators.

With respect to external program-based benchmarking (which compares FNEI's cost performance against other transmitters), OEB staff understands that this type of benchmarking may be difficult due to FNEI's unique customer count, customer makeup, and geography. However, OEB staff submits that FNEI should be required to undertake this type of benchmarking on a best efforts basis. If FNEI cannot complete this type of

[32] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.3.4, p. 16.
[33] Handbook for Utility Rate Applications, October 13, 2016, pp. 2-4.
[34] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.0, p. 1.

benchmarking, it should provide evidence explaining its inability to do so, including (but not limited to) evidence of its efforts to determine appropriate comparator utilities.

Finally, OEB staff notes that no sector-wide productivity study has been completed for the Ontario transmitters at this time. However, OEB staff submits that the OEB should direct FNEI to take into consideration any HONI productivity study that may be published prior to FNEI's next rebasing application. For the purposes of the current proceeding, OEB staff notes that the lack of availability of a productivity study is reflected in OEB staff's submission at Section 9.1 with respect to the acceptance of the proposed productivity factor (which is based on the same factor as is used by the OEB for electricity distributors).

2.3 Is the proposed 2016 rate base reasonable?

For the 2017 rate base amount, OEB staff submits that FNEI's proposed 2016 rate base should be reduced by approximately $1.98 million from the proposed rate base amount of $35.78 million[35] to $33.79 million (a reduction of 5.6%) for the reasons that follow. OEB staff has organized its argument into the following categories: (a) 2016 actual rate base; (b) historic capital projects entering rate base; and (c) working capital allowance.

2016 Actual Rate Base

On the basis of OEB staff's submission in Section 1.3, the actual 2016 revenue requirement should act as the basis for establishing the base 2017 revenue requirement (with certain specific adjustments). Therefore, the actual 2016 rate base should be used as the starting point for establishing the 2017 rate base as it reflects the most up-to-date information available. FNEI's actual 2016 rate base is $35.87 million (which reflects an increase of $0.09 million above 2016 proposed).[36]

Historic Capital Projects Entering Rate Base

There are a number of capital projects that were placed in service during the 2010-2016 period. OEB staff notes that this is the first proceeding in which the OEB will have an opportunity to determine whether the capital costs associated with these projects were prudently incurred and are properly included in rate base for recovery from ratepayers.

Timmins Head Office

[35] EB-2016-0231, Exhibit 3, Tab 1 , Schedule 1, p. 1.
[36] EB-2016-0231, Interrogatory Responses, 3-Staff-18(e).

FNEI constructed a new head office in Timmins, which was substantially completed in 2013, at a total cost of $4.86 million. FNEI argued that a new office was required because FNEI had significantly outgrown its previous office.[37] OEB staff agrees with FNEI that there was a need for a new head office building. FNEI also stated that 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.[38] OEB staff also agrees with FNEI, based on its evidence[39], that its only real option was to construct its own building as there were no options available during the two year period that it was searching for a suitable office. However, while OEB staff agrees that there was a need to construct a new head office building, OEB staff submits that the total cost of the building was excessive and not entirely prudently incurred. OEB staff submits that $2.08 million should be removed from rate base related to the Timmins head office as this represents a reasonable estimate of the imprudently incurred costs associated with the building.

OEB staff submits that it is clear that FNEI could have constructed a building that fulfilled its needs for significantly less than the total final cost of the building that was actually constructed.

OEB staff notes that according to the minutes of a March, 2011 FNEI Finance Committee meeting, a building with a total cost of $0.41 million was considered for purchase.[40] However, by the time FNEI was in a position to place an offer, the building had already been sold.[41] The building was only a shell and significant renovation work would have been required. However, OEB staff submits that had FNEI been able to purchase that building the total final cost would have been significantly lower than the amount that FNEI seeks to include in rate base related to its Timmins head office.

Another option that is mentioned in the minutes of a July, 2011 FNEI Board of Directors meeting was the purchase of 4 acres of land at a cost of approximately $0.08 million per acre and the purchase of a prefabricated steel building package at a cost of approximately $0.07 million (a total cost of approximately $0.4 million).

OEB staff notes that FNEI did end up purchasing the land discussed at the July, 2011 FNEI Board of Directors meeting. FNEI purchased 5 acres as opposed to the originally discussed 4 acres at a total cost of $0.25 million (or approximately $0.05 million per acre). However, FNEI did not purchase a prefabricated building.[42]

[37] EB-2016-0231, Argument-in-Chief, p. 12.
[38] EB-2016-0231, Argument-in-Chief, p. 12.
[39] EB-2016-0231, Interrogatory Responses, 2-Staff-16(x).
[40] EB-2016-0231, Interrogatory Responses, 2-Staff-13(b), Appendix at p. 1.
[41] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 106.
[42] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 106; and EB-2016-0231, Interrogatory Responses, 2-Staff-13(b), Appendix at p. 2.

The costs of the building that was constructed are broken down in the following table:

Table 2 - Timmins Head Office Costs[43]

Land	$250,644
Engineering & Project Management	$520,233
Construction	$4,085,378
TOTAL	**$4,856,255**

As highlighted in the table above the land costs makeup a very small percentage of the overall cost of the building (5.2%). Therefore, it was the construction costs that were quite expensive.

OEB staff notes that, over time, the cost estimates for the building seemed to increase. Originally, there was an expectation that the cost to develop the land and construct a building would be about $0.95 million (July 2011)[44]; after the purchase of the land an initial estimate was that the building would cost about $2.4 million (2012-2013); and the bids received when FNEI tendered the work ranged between $3.4 million to $5.5 million. FNEI selected the lowest cost bidder.[45] However, the project was completed at a total cost that was higher than the estimate.[46]

OEB staff submits that the range of costs discussed above (specifically, the potential to purchase a much less expensive prefabricated building which could have been constructed on the land that was purchased) suggests that the opportunity existed to construct the building at a much lower cost than the final cost for which FNEI seeks approval in the current proceeding, while maintaining the same functionality required by the utility for the administrative, operational and storage activities to be carried on at that location.[47]

OEB staff submits that it is not appropriate for ratepayers to cover the incremental costs of the Timmins head office that exceeded the necessary functionality, and that the amount to be included in rate base in respect of the head office should be reduced.

In order to quantify that premium, the most appropriate starting point is to consider the costs that were recently incurred by other regulated utilities in the province for the construction of their head office buildings. At Tab 15 of OEB staff's compendium, OEB staff compared the cost of the Timmins Head Office to the costs of these other head

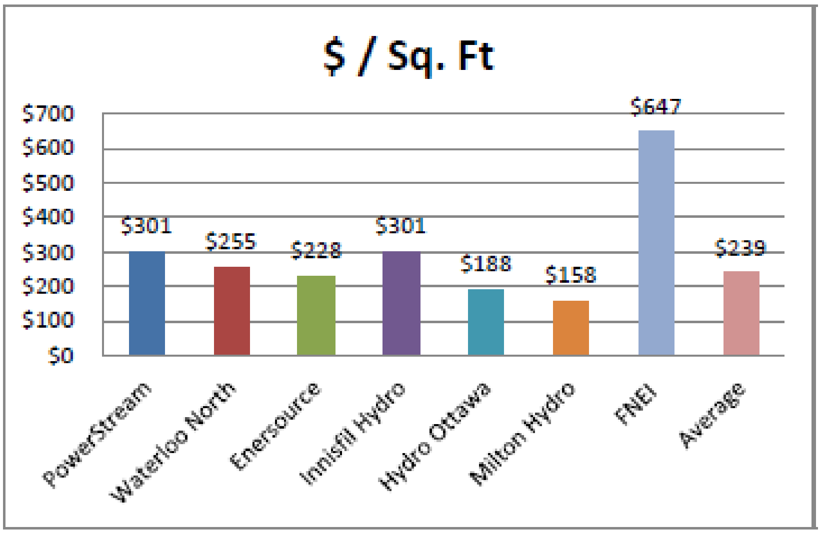
[43] EB-2016-0231, Interrogatory Responses, 2-Staff-16(p).
[44] EB-2016-0231, Interrogatory Responses, 2-Staff-13(b), Appendix at p. 2.
[45] EB-2016-0231, Interrogatory Responses, 2-Staff-16(x).
[46] EB-2016-0231, Argument-in-Chief, p. 12.
[47] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 109-111.

offices. OEB staff has reproduced the overall cost comparison and the cost per Sq. Ft. comparison from Tab 15 of the OEB staff compendium in the table and chart below:

Table 3 - Head Office Comparison

	PowerStream	Waterloo North	Enersource	Innisfil Hydro	Hydro Ottawa	Milton Hydro	FNEI	FNEI
	EB-2008-0244	EB-2010-0144	EB-2012-0033	EB-2014-0086	EB-2015-0004	EB-2015-0089	EB-2016-0231	EB-2016-0231
Function	Admin	Admin / Ops	Admin	Admin/Ops	Admin / Ops	Admin / Ops	Admin / Ops	Admin / Ops
In-Service Date	2008	2011	2012	2014	2016	2015	2013	2013
Total Cost	$27.7 M	$26.5 M	$18.0 M	$10.9 M	$66.0 M	$14.5 M	$4.9 M	$4.9 M
Total Square Feet	92,000	104,000	79,000	36,172	351,000	91,828	7,500	7,500
FTEs	250	117	150	40	622	62	9 (Current)	11 (Expected)
$ / Sq. Ft	$301	$255	$228	$301	$188	$158	$647	$647
$ / FTE	$110,800	$226,496	$120,000	$265,854	$106,109	$235,772	$539,583	$441,477

Chart 1 – Head Office Comparison ($ / Sq. Ft.)



OEB staff will focus on the cost per Sq. Ft. metric as it is the most relevant metric for determining the premium that was likely incurred with respect to constructing FNEI's head office. FNEI's building cost was $647 / Sq. Ft., which is $408 more expensive than the average and $346 / Sq. Ft. above the highest cost comparator.

OEB staff agrees with FNEI that the comparators used in the table are not perfect. There are economies of scale present when constructing larger buildings, which were not available to FNEI given the size of its building. In addition, FNEI argues that the cost of building in Timmins is higher[48]. Recognizing these differences, OEB staff submits that the OEB should deem that only $370 / Sq. Ft. to be recoverable from ratepayers. The remainder should be removed from rate base. The amount of the disallowance is equal to the amount that was self-financed by FNEI as will be discussed in further detail

[48] EB-2016-0231, Argument-in-Chief, pp. 13-14.

below. However, the $370 / Sq. Ft. that OEB staff proposes should be allowed by the OEB still represents an approximate 55% premium relative to the average cost in the sample and a premium of approximately 23% above the highest cost building in the sample, which recognizes the difference between FNEI's building and the other buildings included as part of the comparison.

Overall, this results in a recoverable amount for the Timmins head office of about $2.78 million (a decrease of approximately 43% from the proposed amount of about $4.86 million). Therefore, on the basis of OEB staff's submission $2.08 million should be removed from rate base. OEB staff submits that the $2.08 million that it proposes be removed from rate base reflects a reasonable proxy of the premium that was paid by FNEI for its building beyond what was required to fulfill its needs for space for administrative, operational and storage functions.

OEB staff acknowledges that this is a significant reduction. However, OEB staff submits that minimal harm to FNEI will arise from a finding to remove $2.08 million from rate base for the following reason.

OEB staff notes that with the reserve fund framework discussed at Section 1.1 of the submission not having been finalized, FNEI earned significant net income, over the 2010-2016 period, beyond what the OEB's Decision and Order in EB-2009-0387 contemplated. On a deemed net income basis, the reserve funds would have been fully funded by the end of 2011[49] and the return component (or internally generated funds) included as part of FNEI's revenue requirement (which was designed to generate about $1.09 million of revenue each year[50]) would have been removed for the years 2012-2016. On an actual basis, FNEI generated approximately $8.29 million of incremental net income beyond the amount necessary to fund the Operating and Capital reserves.[51] OEB staff submits that it is difficult to determine exactly how much less net income would have been generated on an actual basis had FNEI applied to the OEB to remove the return component (or internally generated funds) included as part of its revenue requirement (as there likely would have been changes to both revenues and costs). However, FNEI agreed that the reduction to net income on a deemed (or notional basis) would have been $4.4 million during the 2012-2015 period (4 years at $1.09 million per year).[52] Adding 2016 net income to that calculation (i.e. 2012-2016), the reduction to net income on a deemed (or notional basis) would have been about $5.5 million.

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[49] EB-2016-0231, Interrogatory Responses, 1-Staff-12(h).
[50] EB-2016-0231, Exhibit 1, Tab 1, Schedule 2.
[51] EB-2016-0231, Interrogatory Responses, 1-Staff-12(i).
[52] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 73.

OEB staff acknowledges that net income is not the same as cash. However, FNEI did agree that net income does lead to the availability of cash over time.[53] FNEI stated that about $2.08 million of the Timmins head office was self-financed.[54] Therefore, OEB staff submits that $2.08 million of the excess cash that was generated as a result of the return component (or internally generated funds) not being removed once the reserves were fully funded was notionally used to self-finance part of FNEI's head office in Timmins.

OEB staff's submission, if accepted by the OEB, results in the removal from rate base of $2.08 million, which equates to the amount of the building that was self-financed. Therefore, FNEI forgoing the ability to recover the cost of capital on that amount would not significantly harm FNEI as there are no actual costs of debt associated with that portion of the building. In addition, as discussed at Section 6.3, OEB staff's submission on cost of capital is that due to FNEI's not-for-profit status and absence of shareholder equity, FNEI does not require a standard return on capital (and instead requires only certain amounts in excess of its costs to protect the financial viability of the company). Finally, the inability to recover the depreciation costs associated with the proposed disallowance from rate base would also not harm FNEI, as there should be no expectation that FNEI will require funding to build another $4.86 million building in the future.

For all of the above reasons, OEB staff submits that it is appropriate to remove $2.08 million from rate base to reflect FNEI's imprudent spending on its Timmins head office.

Acquisition of 80kms of Transmission Line from Hydro One

FNEI purchased 80 kms of transmission line, running north from Moosonee, from HONI on October 15, 2015 at a cost of about $4.9 million (plus taxes). FNEI stated that it had originally sold this portion of transmission line to HONI in 2000, but always intended to repurchase the line. The reacquisition provided FNEI with complete ownership of the transmission system within the communities' traditional territory.[55] FNEI also stated that it was more efficient from an overall maintenance perspective to have FNEI operate the line as previously HONI and FNEI were maintaining parallel transmission facilities.[56]

OEB staff submits that the acquisition of the noted transmission line from HONI was prudent and the OEB should accept the inclusion of the costs associated with these assets in rate base going forward. OEB staff submits that the operation of parallel transmission infrastructure by a single utility should result in cost efficiencies in the

[53] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 67.
[54] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 115.
[55] EB-2016-0231, Exhibit 2, Tab 2, Schedule 1, p. 1.
[56] EB-2016-0231, Argument-in-Chief, p. 15.

future. OEB staff will discuss the depreciation rate applied to the line by FNEI in Section 5.3 of the submission.

Other Capital Projects

In regard to the Bus Isolation Project (which has a total cost of about $4 million – with $2.98 million spent by the end of 2016 and a future expenditure of about $1 million in 2017), OEB staff has no concerns. At the oral hearing, OEB staff asked a number of questions about the project to determine the effectiveness of the project to minimize planned outages. FNEI provided responses to OEB staff's requests at Undertaking J1.5. OEB staff submits that it is clear from the evidence that the Bus Isolation Project will reduce planned outages.[57] Therefore, OEB staff submits that the costs associated with the project were prudently incurred.

OEB staff also raised some concerns with respect to the Attawapiskat and Kashechewan Feeder Projects at the oral hearing. OEB staff was originally concerned that FNEI was in non-compliance with Section 6.3.2 of the Transmission System Code (which sets out the requirement for the payment of capital contributions). However, after reviewing FNEI's response to Undertaking J1.2, in which FNEI provided economic valuations for those projects, OEB staff is no longer concerned as it appears that no capital contributions were required. OEB staff submits that the costs for these projects were prudently incurred and should be approved by the OEB. However, OEB staff submits that the OEB should advise FNEI that in the future it should complete economic evaluations prior to undertaking projects that are requested by FNEI's customers to meet additional customer load, as projects of this type may require capital contributions.

With respect to the remaining major capital projects that were completed during the historic period (including the purchase of brush clearing equipment; construction of the Fort Albany garage; the relay replacement project; and the emergency communication system project)[58], OEB staff submits that the costs for these projects were prudently incurred and the amounts associated with these projects should be included in rate base.

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 is 3.55% of the OM&A budget. The working capital allowance was determined on the basis of a lead / lag analysis completed by

[57] EB-2016-0231, Undertaking Response J1.5.
[58] EB-2016-0231, Exhibit 2, Tab 2, Schedule 1, pp. 5-12.

Navigant Consulting Limited. OEB staff submits that the proposed working capital allowance is appropriate and should be approved by the OEB. The allowance was derived through a detailed lead / lag study and OEB staff is of the view that 3.55% of the OM&A budget is reasonable. The dollar value of the working capital allowance (but not the percentage) would change from proposed if the OEB accepts OEB staff's proposal to reduce the OM&A budget as discussed in Section 5.1.

Overall, OEB staff's submission results in a 2017 rate base of approximately $33.79 million – a reduction of approximately $1.99 million from that proposed by FNEI in its application.

3.0 Performance Scorecard

3.1 Is FNEI's proposal regarding its Performance Scorecard reasonable?

In FNEI's interrogatory response to OEB staff, FNEI provided a modified version of the HONI proposed scorecard[59], which included only the metrics that FNEI believes are applicable to FNEI.[60] In response to Undertaking J1.7, FNEI explained why a number of the metrics that are included on HONI's scorecard are not relevant to FNEI.

OEB staff submits that the sample scorecard provided by FNEI, subject to the few minor language changes discussed below, is the appropriate scorecard for FNEI at this time. OEB staff notes that the transmission scorecards are evolving and the OEB may require further changes to FNEI's scorecard in the future.

OEB staff notes that the sample scorecard provided by FNEI includes metrics related to safety, system reliability, regional infrastructure planning, and financial performance.[61] OEB staff agrees with FNEI, for the reasons set out by FNEI in its response to Undertaking J1.7, that the other metrics on HONI's proposed scorecard are not applicable to FNEI.

However, OEB staff submits that the language for the metrics related to "profitability: regulatory" and "return on equity" should be revised. As discussed at Section 6.3 of this submission, OEB staff submits that FNEI should not earn a return on equity, but rather, should earn amounts in excess of its costs through a FVRR. If the OEB accepts OEB staff's submission the language in the scorecard should be revised to reflect that finding. Therefore, the "profitability: regulatory" metric should be changed to "Deemed Financial Viability Revenue Rider" and reflect the approved value of the rider as a percentage of deemed equity. The "return on equity" metric should be revised to

[59] EB-2016-0160.
[60] EB-2016-0231, Interrogatory Responses, 4-Staff-20(c).
[61] EB-2016-0231, Interrogatory Responses, 4-Staff-20(c).

"Achieved Financial Viability Revenue Rider" and reflect the actual value of the rider (which are the actual revenues in excess of costs) as a percentage of actual utility equity. Essentially, the amounts would be calculated in the same way as the return would be calculated in the sample scorecard but would be described as a FVRR to reflect the OEB's findings (if the OEB were to accept OEB staff's submission).

4.0 Operating and Other Revenues

4.1 Is FNEI's 2016 charge determinant forecast reasonable?

OEB staff submits that FNEI should use its most recent three-year (2014-2016) historical average peak demand figures as its forecast for the 2017 charge determinants. As OEB staff has previously argued for a January 1, 2017 effective date, the charge determinant forecast would be used beginning in 2017 (as opposed to the 2016 proposal made by FNEI).

In its application, FNEI proposed to use its three-year (2013-2015) historical average peak demand figures as the forecast for 2016 charge determinants.[62]

In the OEB's Decision in FNEI's 2010 revenue requirement proceeding, the OEB ordered FNEI to use a linear trend method to calculate its charge determinant forecast.[63] FNEI filed a charge determinant forecast on the basis of the linear trend method, on a confidential basis, as part of its evidence update on November 25, 2016.

OEB staff reviewed the charge determinant forecast based on the 2013-2015 historical average methodology, the 2014-2016 historical average methodology and the linear trend method. Based on FNEI's evidence that it has communicated with its customers and there is no expectation of load growth in the near future, OEB staff agrees with FNEI that the linear trend methodology likely results in a charge determinant forecast that is overstated.[64]

OEB staff submits that there is no significant difference between using 2013-2015 or 2014-2016 data for the charge determinant forecast based on a historical average as set out in the table below.

Table 4 – Charge Determinant Forecasts[65]

(MW)	Current	2013-2015 Average	2014-2016 Average
Network	187.12	231.74	230.41

[62] EB-2016-0231, Exhibit 5, Tab 1, Schedule 3, p. 1.
[63] EB-2009-0387, Decision and Order, p. 26.
[64] EB-2016-0231, Argument-in-Chief, p. 17.
[65] EB-2016-0231, Exhibit 5, Tab 1, Schedule 3, p. 2; EB-2016-0231, Undertaking Response J1.8.

Line Connection	213.46	256.12	248.86
Transformation	76.19	73.99	73.04

However, it is OEB staff's view that the most recent information should be used when available, even if there is no material difference between the two forecasts. Therefore, OEB staff submits that the 2017 charge determinant forecast should be based on 2014-2016 historical average of peak demand. This is consistent with OEB staff's proposal to use 2016 actuals (with certain adjustments) to establish FNEI's 2017 revenue requirement as it reflects the use of the most recent available information.

4.2 Is FNEI's 2016 other revenue forecast reasonable?

OEB staff submits that the actual other revenue of $0.15 million received by FNEI in 2016 should be used as the other revenue forecast for 2017.

In its application, FNEI forecasted $0.15 million of other revenues for 2016.[66] On an actual basis FNEI received slightly less than $0.15 million of actual other revenues in 2016.[67] Therefore, OEB staff notes that, after rounding, both the actual and proposed other revenue amounts are the same. OEB staff submits that the OEB should use FNEI's actual 2016 other revenue amount as the other revenue amount for 2017. OEB staff expects that the other revenue amount will stay relatively flat during the IRM term (as it is made up of a cost recovery agreement with DeBeers and interest on investments).

5.0 Operations, Maintenance and Administration (OM&A) Costs

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

OEB staff submits that the OEB should approve a base 2017 test year OM&A budget (excluding depreciation and prior to the IRM based inflationary adjustment) of $3.79 million, rather than the $4.34 million proposed by FNEI in the application, for the following reasons.

[66] EB-2016-0231, Exhibit 5, Tab 1, Schedule 1, pp. 1-2.
[67] The actual 2016 revenues were approximately $4000 less than forecast. See EB-2016-0231, Argument-in-Chief, p. 17.

OEB staff has organized its argument into the following categories: (a) 2016 actual OM&A expenditures; (b) staffing levels and compensation; (c) conservation expenses; (d) regulatory expenses; and (e) poles, towers and fixtures maintenance.

OEB staff notes that FNEI proposed a 2016 OM&A budget of $4.34 million. On an actual basis, OM&A expenditures were $3.92 million in 2016. FNEI's 2010 approved OM&A budget was $3.36 million. Therefore, the 2016 proposed OM&A budget reflects an increase of about $0.98 million (or 29.2%) over 2010 approved. The 2016 actual OM&A spending reflects an increase of about $0.56 million (or 16.7%) over 2010 approved.[68]

2016 Actual OM&A Expenditures

OEB staff submits that the starting point for the approval of the base 2017 OM&A budget should be 2016 actual OM&A spending.

OEB staff submits that the 2016 actual OM&A spending, with certain adjustments, reasonably reflects the level of OM&A spending that will occur over the IRM term.[69] OEB staff notes that the majority of the major capital projects (new head office, 80 km of line acquisition, etc.) were already in service in 2016. Therefore, the actual 2016 OM&A budget reflects the necessary spending related to those assets. OEB staff also notes that FNEI is not expecting any load growth during the IRM term and therefore additional OM&A spending related to load growth is not expected. In addition, a key driver of the decrease between 2016 proposed and 2016 actual OM&A spending is related to FNEI's executive and Board of Directors costs. These costs have dropped significantly ($0.6 million as proposed and $0.44 million actual – a decrease of $0.16 million). The cause of this decline was the hiring of a new CEO at a lower salary and lower costs related to FNEI's Board of Director meetings.[70] OEB staff expects that the lower executive and Board of Director costs[71] experienced in 2016 will continue going forward.

OEB staff notes that FNEI largely agreed to these facts in testimony.[72] Specifically, FNEI agreed with OEB staff's question, "is it fair to say that your actual 2016 OM&A represents a reasonable picture of the OM&A spending that will be required over the proposed five-year term of your revenue requirement?" FNEI responded, "with the exception of the addition of the two staff persons that we held off on hiring."[73]

[68] EB-2016-0231, OEB Staff Compendium, Tab 20.
[69] As discussed in Section 9.1, OEB staff supports an IRM plan for FNEI and therefore the revenue requirement each year will be increased to reflect the inflation minus productivity / stretch adjustment.
[70] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, pp. 164-165
[71] FNEI held 4 Board of Director meetings in 2016 and plans to continue holding 4 Board of Director meetings during the IRM term. EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 168.
[72] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, pp. 152-153.
[73] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 152.

For those reasons, and subject to the discussion of the two new staff persons below, OEB staff submits that the actual 2016 OM&A spending reflects a reasonable starting point for the approval of the base 2017 OM&A budget (prior to the IRM adjustment). This proposal reflects a reduction of about $0.42 million to the proposed 2016 OM&A budget.

Staffing Levels and Compensation

OEB staff submits that the 2016 actual staffing levels and costs should be used as the starting point for the OEB's approval of this cost category as shown in the following table.

Table 5 – Staffing Levels and Compensation[74]

	2016 Actual	2016 Proposed
Number of FTEs	9	11
Total Compensation ($M)	$0.91	$1.04

OEB staff submits that an incremental $0.1 million in funding should be provided for the hiring of an apprentice station electrician, which would be offset by a decrease of $0.06 million to reflect the removal of funding through the revenue requirement for the 10% one-time pay increase that was applied in 2016. Therefore, on a net basis, the OEB should grant FNEI an incremental $0.04 million in its 2017 OM&A budget associated with staffing costs for the following reasons.

Overall, OEB staff is satisfied that FNEI's 2016 actual staffing levels are reasonable. FNEI's evidence is that it has been bringing expertise in-house to complete work that was previously completed by third-party contractors (or alternatively was not completed at all).[75] It is apparent that this practice has a significant cost attached to it (an increase of $0.35 million since 2010). However, OEB staff agrees with FNEI's evidence that while the costs are higher: (a) more work is required to be completed by the in-house staff than was previously required by the third-party contracts as FNEI's system has grown; and (b) there is an intangible (but real) benefit to having expertise in-house (as opposed to constantly relying on contractors to complete work).[76] Therefore, OEB staff submits that this driver of the overall staffing cost increase is prudent.

OEB staff also supports the hiring of an additional apprentice substation electrician. FNEI's witnesses testified that, at the time of the hearing, FNEI was in the final stages

[74] EB-2016-0231, Argument-in-Chief, pp. 20-21.
[75] EB-2016-0231, Interrogatory Responses, 6-Staff-25(m).
[76] EB-2016-0231, Interrogatory Responses, 6-Staff-25(m).

of hiring this electrician (June 2017).[77] OEB staff submits that, based on FNEI's testimony[78], it is clear that there was work that was not being completed previously for which this employee will provide valuable assistance. OEB staff submits that the OEB should increase the 2016 actual OM&A budget by $0.1 million to provide funding for this employee going forward.

OEB staff recognizes that the same argument could be made for the proposed incremental experienced substation electrician (i.e. there is work that was not previously being completed that this new employee could undertake). However, at the time of the hearing, which was already halfway through 2017, FNEI stated that it not begun any process for hiring the substation electrician.[79] OEB staff submits that, based on regulatory principles, the OEB should not approve costs associated with an employee for which it has no evidence on the expected timeline for hiring. This would result in the approval of amounts in revenue requirement that may not be connected to any actual costs.

With respect to compensation, OEB staff submits that the 2016 actual compensation should be used as the basis for the 2017 OM&A budget. OEB staff submits that, for the most part, the compensation levels for FNEI's staff are reasonable. However, OEB staff submits that the one-time 10% salary increase that was applied to eight of its employees in 2016[80] is not appropriate and should not be recoverable from ratepayers.

FNEI's position on this issue is that the salary increase was necessary to allow FNEI to remain competitive as an employer by offering compensation comparable to other utilities in the electricity sector. FNEI stated that this will assist in the retention of employees over a longer period of time.[81] OEB staff notes that FNEI has been providing inflationary-based raises to its employees each year during the historic period (2010-2015)[82] and FNEI confirmed that no employees have actually resigned from FNEI during that period.[83] On that basis, OEB staff submits that this one-time salary adjustment was not necessary to retain employees. There is no evidence supporting FNEI's assertion that it was having trouble retaining its staff. This proposed reduction would reduce the 2016 actual OM&A budget by about $0.06 million.[84]

[77] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 156.
[78] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 158.
[79] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 157.
[80] EB-2016-0231, Interrogatory Responses, 6-Staff-25(m).
[81] EB-2016-0231, Argument-in-Chief, p. 22.
[82] EB-2016-0231, Interrogatory Responses, 6-Staff-25(h).
[83] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 163.
[84] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 160.

FNEI stated that it will provide annual inflationary based (plus 1% or 2%) increases in the future[85], which will ensure that it remains competitive in the employment market. The IRM-based adjustments supported by OEB staff and discussed at Section 9.1, should ensure that there is sufficient funding available for those annual pay increases (assuming certain productivity savings are achieved over the period).

Conservation Expenses

For the purposes of establishing the base 2017 OM&A budget, OEB staff submits that the 2016 actual OM&A budget should be reduced by approximately $0.07 million to reflect the removal of the conservation budget for 2017.

FNEI proposed to include a $0.03 million budget for conservation activities in its 2016 OM&A budget.[86] On an actual basis, FNEI incurred $0.07 million in conservation expenses in 2016.[87]

FNEI originally stated that the proposed conservation budget of $0.03 million was intended to cover costs, which would not be covered through IESO funding, related to certain conservation programs that FNEI administers.[88] However, on the basis of the evidence, there does not seem to be an expectation that any cost overruns associated with the IESO conservation program (which FNEI administers on behalf of Attawapiskat, Kashechewan and Fort Albany) will arise in the future.[89] Instead, FNEI stated that the budget would be for minor expenditures with respect to conservation materials. However, FNEI also stated that there is no formal plan for the spending.[90]

OEB staff submits that there is no clear evidence as to the use of the conservation budget and in the absence of a formal plan with respect to the budget, the amount should be removed from the base 2017 OM&A budget. Given that the starting point for OEB staff's submission is the 2016 actual OM&A expenditures, $0.07 million should be removed (as that is the amount that is reflected in 2016 actuals for conservation spending).[91] At a minimum, if the OEB determines that a small budget for miscellaneous conservation activities is appropriate, approximately $0.04 million should be removed from the 2016 actual OM&A expenditures for the purposes of setting the base 2017 OM&A budget as this would reduce the conservation budget to the originally proposed $0.03 million.

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[85] EB-2016-0231, Oral Hearing Transcripts, Vol. 1, p. 161.
[86] EB-2016-0231, Interrogatory Responses, 6-Staff-25(b).
[87] EB-2016-0231, Undertaking Response J1.9.
[88] EB-2016-0231, Interrogatory Responses, 6-Staff-25(l).
[89] EB-2016-0231, Oral Hearing Transcripts, Vol. 2, p. 10.
[90] EB-2016-0231, Oral Hearing Transcripts, Vol. 2, p. 10.
[91] EB-2016-0231, Undertaking Response J1.9.

Regulatory Expenses

For the purposes of establishing the base 2017 OM&A budget, OEB staff submits that the 2016 actual OM&A budget should be reduced by approximately $0.05 million to reflect a reduction to the regulatory expenses incurred on actual basis in 2016 (and bring the total regulatory budget back in line with FNEI's proposal).

FNEI proposed a regulatory budget for 2016 of $0.32 million. This amount was derived by taking an average of the 2012-2015 actual regulatory costs ($0.27 million) and adding to that amount one-fifth of the regulatory costs of this proceeding ($0.05 million). Therefore, FNEI estimated that the total cost of this proceeding is $0.25 million.[92] On an actual basis FNEI incurred approximately $0.39 million in regulatory costs in 2016 (an increase over proposed of about $0.06 million). FNEI stated that the reason for the variance between proposed and actual regulatory expenses in 2016 was due to the current cost of service application.[93]

OEB staff anticipates that during the IRM term, the actual regulatory expenses will be more in line with FNEI's proposed amount ($0.32 million) as opposed to the actual costs ($0.39 million) as the actual costs are inflated due to the excess spending on this revenue requirement application during 2016.

OEB staff notes that the OEB's typical practice is to amortize the expenditures related to a cost of service proceeding over the term of the IRM plan (which is what is reflected in FNEI's original proposed 2016 regulatory costs). Therefore, OEB staff submits that the 2016 actual OM&A amount should be reduced by $0.05 million to remove most of the incremental cost impact of the revenue requirement proceeding that is reflected in the actual expenditures. OEB staff notes that it is proposing a $0.05 million reduction, which reduces the regulatory expense budget to about $0.33 million (an increase of about $0.01 million above FNEI's proposal). The reason for this difference (i.e. not reducing the 2016 actuals to exactly the proposed amount) is that the effect of OEB staff's proposal with respect to 2017 representing the first year of the IRM term (as discussed in Sections 1.3 and 9.1) is that there are only 4 years upon which the costs of the rates proceeding can be amortized. Therefore, FNEI requires an incremental $0.01 million each year, beginning in the 2017 test year, to cover the costs of this current proceeding (as the amortization period has been shortened by one year).

Poles, Towers and Fixtures Maintenance

[92] EB-2016-0231, Exhibit 6, Tab 2, Schedule 6, p. 1.
[93] EB-2016-0231, Undertaking Response J1.9.

For the purposes of establishing the base 2017 OM&A budget, OEB staff submits that the 2016 actual OM&A budget should be reduced by about $0.05 million to reflect the increase in poles, towers and fixtures maintenance expenditures relative to the forecast.

FNEI's proposed 2016 OM&A budget included $0.55 million for poles, towers and fixtures maintenance.[94] On an actual basis, FNEI incurred about $0.6 million of expenses in this category for 2016. FNEI stated that additional costs incurred in 2016 were related to the right-of-way clearing program.[95]

OEB staff asked FNEI if it believed it needed the incremental $0.05 million for poles, towers and fixtures maintenance going forward (or if the original proposed amount was reasonable). FNEI agreed that the original proposed amount reflected a reasonable budget going forward.[96] On that basis, OEB staff submits that the 2016 actual OM&A budget should be reduced by $0.05 million.

Overall, OEB staff's submission results in changes to the proposed 2016 OM&A budget as set out in the following table.

Table 6 – Reductions to the proposed 2016 OM&A budget

Category	**Reduction ($M)**
Use of 2016 Actuals	-$0.42
Funding for Additional Staff	$0.1
Removal of 10% One-Time Salary Increase	-$0.06
Removal of Conservation Budget	-$0.07
Reduction in Regulatory Expenses	-$0.05
Reduction to Poles, Towers, and Fixtures Maintenance	-$0.05
Total	**-$0.55**

On this basis, OEB staff submits that the OEB should approve a base 2017 test year OM&A budget (excluding depreciation and prior to the IRM based adjustment) of $3.79 million.

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

OEB staff's submission on this issue is set out above, in Section 5.1, with the other aspects of its argument with respect to FNEI's base 2017 test year OM&A budget.

[94] EB-2016-0231, Exhibit 6, Tab 2, Schedule 1, p. 2.
[95] EB-2016-0231, Undertaking Response J1.9.
[96] EB-2016-0231, Oral Hearing Transcripts, Vol. 2, pp. 12-13.

5.3 Is FNEI's proposed depreciation expense for 2016 appropriate?

OEB staff submits that FNEI's depreciation expense should be based on the 2016 actual depreciation expense of $1.45 million[97] as this reflects the most up-to-date information. The 2016 actual depreciation expense should then be adjusted to reflect the removal of $2.08 million from rate base associated with the Timmins head office.

Based on the noted adjustments, OEB staff estimates that the 2017 depreciation expense would be approximately $1.38 million. This reflects an increase of $0.09 million from FNEI's proposed 2016 depreciation expense of $1.29 million.[98]

At the oral hearing, OEB staff requested undertakings for further information with respect to the depreciation rates applied by both FNEI and HONI to the 80km of line that FNEI purchased and the depreciation rates applied by FNEI to the Timmins head office. FNEI provided the requested information in undertakings J1.3, J1.4, and J2.1.

First, with respect to the reacquired transmission line, based on OEB staff's understanding of FNEI's evidence[99], HONI was originally depreciating the line over a 40-year period. However, due to the initial agreement between the two companies, when it resold the line to FNEI it made an adjustment to the sale price, which reduced the net book value of the line to reflect a 30-year amortization period. Therefore, the sale price to FNEI reflects the price for the line had it been depreciated using a 30-year amortization period. FNEI is now depreciating the asset using a 40-year amortization period for the poles and fixtures and a 60-year amortization period for the overhead conductors and devices. OEB staff submits that, based on its understanding of FNEI's evidence, it has no concerns with depreciation rates applied by FNEI to the transmission line as they seem to be lower (or at a minimum the same) as the rates that were previously applied by HONI.

OEB staff also has no concerns with the depreciation rates applied to the Timmins head office. OEB staff submits that the depreciation rates applied are reasonable.[100]

For those reasons, OEB staff submits that the only necessary adjustments to the proposed depreciation expense are the use of 2016 actuals and a reduction to rate base for the removal a portion of the capital costs of the Timmins head office.

[97] EB-2016-0231, Interrogatory Responses, 6-Staff-30(c).
[98] EB-2016-0231, Exhibit 6, Tab 3, Schedule 3, p. 9.
[99] EB-2016-0231, Undertaking Response J1.3 and J1.4.
[100] EB-2016-0231, Undertaking Response J2.1.

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

For the purposes of establishing the 2017 OM&A budget, OEB staff submits that FNEI's actual 2016 annual fee expenses (as recorded in Account 4850 – Rents) should likely be used. In 2016, FNEI incurred $0.12 million of land use fees.[101] This reflects an increase of about $0.03 million above 2016 proposed of $0.09 million.[102]

In its evidence, FNEI noted that as a not-for-profit corporation, FNEI is not subject to the payment of income taxes. Therefore, income tax expense does not form part of FNEI's revenue requirement.

In addition, FNEI is not subject to municipal property taxes. However, FNEI forecast for 2016 the payment of two separate annual fees (which are similar to property taxes or land rental fees). The first annual fee is for a land use permit from the Ministry of Natural Resources for the use of provincial Crown land ($0.03 million). The second annual fee is for the use of Reserve lands ($0.06 million).[103]

As the 2016 actual annual fee expenses were provided as part of an undertaking response on an envelope basis[104], OEB staff is unsure as to why the land use expenses have increased between 2016 forecast and actual. OEB staff assumes that this increase in costs will continue going forward (as perhaps a fee change was implemented in 2016 that FNEI was not aware of when it originally filed its application). OEB staff submits that FNEI should confirm whether OEB staff's assumption is correct in its reply submission. If FNEI confirms that the increased annual fee expenses are expected to continue going forward, OEB staff submits that the OEB should use the actual 2016 land use fees to establish the base 2017 OM&A budget.

6.0 Cost of Capital

6.1 Is FNEI's proposed capital structure appropriate?

FNEI proposed a deemed capital structure, for regulatory purposes, of 60% debt and 40% equity. The debt component is comprised of 4% short-term debt and 56% long-term debt. FNEI noted that this is the same capital structure that was approved in FNEI's 2010 rates proceeding.[105]

[101] EB-2016-0231, Undertaking Response J1.9.
[102] EB-2016-0231, Exhibit 6, Tab 4, Schedule 1, p. 1.
[103] EB-2016-0231, Exhibit 6, Tab 4, Schedule 1, p. 1.
[104] EB-2016-0231, Undertaking Response J1.9.
[105] EB-2016-0231, Exhibit 7, Tab 1, Schedule 1, p. 1.

OEB staff submits that FNEI's proposed deemed capital structure is appropriate for ratemaking purposes and should be approved by the OEB. OEB staff notes that this is the same deemed capital structure that is applied by most regulated utilities in the province for ratemaking purposes. However, OEB staff submits that the equity portion of the capital structure should not be used for calculating a "return"; instead, it should be used in the calculation of a FVRR (as discussed in Section 6.3). The use of the equity portion of the capital structure in the calculation of the FVRR will ensure that the Revenue Requirement Workform can continue to be useful in future rates proceedings and allows for a simple presentation of FNEI's revenue requirement.

6.2 Are FNEI's proposed long-term and short-term debt rates appropriate?

OEB staff submits that the OEB should approve FNEI's proposed long-term debt rate of 5.11% and an updated short-term debt rate of 1.76% for 2017.

FNEI proposed that the weighted cost of actual debt (5.11%) be applied to the long-term debt component of the capital structure (56% of rate base) to calculate the cost of long-term debt. OEB staff notes that FNEI held significant non-affiliate debt in 2016, which will continue to be held throughout the proposed IRM term. In addition, FNEI is not forecasting new debt.[106] OEB staff submits that, for the purposes of setting the base 2017 revenue requirement, it is appropriate to use the weighted cost of FNEI's actual debt in the calculation of long-term debt costs. This is the same methodology that is applied by most regulated utilities in the province that have actual non-affiliate debt.

OEB staff notes that FNEI's weighted cost of debt is high relative to the OEB's deemed debt rate for 2017 (3.72%).[107] The deemed debt rate set by the OEB is intended to reflect market-based interest rates. Therefore, FNEI's weighted cost of debt is higher than what is expected from a market-based rate. As it is non-affiliate debt, OEB staff is of the view that it is properly recoverable as part of the revenue requirement. However, OEB staff submits that FNEI should attempt to renegotiate its loans to bring the interest rates in line with market rates before its next rebasing. At the time of its next rebasing, FNEI should be required to file evidence with respect to the efforts it undertook to renegotiate its loans. OEB staff submits that the OEB should advise FNEI that if no efforts are made to reduce its debt costs, the OEB, in the future, may not accept the use of FNEI's weighted average cost of actual debt in the calculation of its long-term debt costs.

With respect to the short-term debt rate, FNEI proposed to use the OEB's 2016 deemed short-term debt rate of 1.65% (consistent with the Cost of Capital Parameter Updates

[106] EB-2016-0231, Exhibit 7, Tab 1, Schedule 1, p. 2.
[107] Cost of Capital Parameter Updates for 2017 Cost of Service and Custom Incentive Rate-setting Applications, October 27, 2016.

for 2016 Applications).[108] OEB staff submits that FNEI's short-term debt rate should be based on the OEB's deemed rate as set out in the Cost of Capital Parameter Updates for 2017 Cost of Service and Custom Incentive Rate-setting Applications. OEB staff notes that this is consistent with OEB staff's argument that the proposed test year beginning January 1, 2016 should be converted to a test year beginning January 1, 2017. The deemed short-term debt rate for 2017 applications is 1.76%.[109]

The overall impact of OEB staff's proposed changes to the debt rates (including the changes to rate base that were proposed in Section 2.3) is a decrease of about $0.05 million to the base 2017 revenue requirement.

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

OEB staff submits that FNEI should not be eligible to earn an ROE in the same manner as a regulated for-profit utility. Instead, FNEI should be granted a FVRR, which would generate revenues in excess of costs in 2017 of approximately $0.61 million, for the reasons that follow.

OEB staff has organized its arguments with respect to FNEI's assertion that it should be granted approval to earn an ROE in the same manner as a regulated for-profit utility into three categories: (a) the legal right to earn a return for a not-for-profit corporation; (b) the requirement to earn a return; and (c) the Financial Viability Revenue Rider.

<u>The Legal Right to Earn a Return for a Not-for-Profit Corporation</u>

FNEI provided evidence and made arguments supporting its position that it is legally allowed to earn a return as a not-for-profit corporation.

FNEI noted that it was incorporated as a not-for-profit corporation, without share capital, under the *Canada Corporations Act*. This status has recently been continued under the *Canada Not-for-profit Corporations Act* (CNFPCA).[110] FNEI stated that the CNFPCA specifically provides that not-for-profit corporations may earn a profit (or revenues in excess of costs). Therefore, FNEI stated that the earning of an ROE is permissible for a not-for-profit utility.[111] While not-for-profit corporations can earn a profit (or ROE), these amounts cannot be distributed to shareholders / members.[112]

108 EB-2016-0231, Exhibit 7, Tab 1, Schedule 1, p. 2.
109 Cost of Capital Parameter Updates for 2017 Cost of Service and Custom Incentive Rate-setting Applications, October 27, 2016.
110 EB-2016-0231, Exhibit 7, Tab 2, Schedule 1, p. 1.
111 EB-2016-0231, Argument-in-Chief, p. 25.
112 EB-2016-0231, Exhibit 7, Tab 2, Schedule 1, p. 10.

With respect to FNEI's tax-exempt status[113], which is different from its not-for-profit status, FNEI filed a memo from its counsel[114] indicating that it is unlikely that the receipt of an ROE will affect FNEI's tax status.[115] The legal memo states that:

> 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.[116]

Overall, FNEI's position, as set out in the pre-filed evidence[117] and the legal memo[118], is that a not-for-profit corporation is legally allowed to earn revenues in excess of costs while maintaining a not-for-profit and tax-exempt status.

OEB staff notes that it did not undertake an expert review of the tax evidence filed by FNEI. OEB staff submits that while FNEI, as a not-for-profit corporation, may be legally allowed to earn an ROE in accordance with the relevant legislation[119], there is no requirement for the recovery of a full ROE in the same manner as a for-profit utility due to the absence of shareholder equity (as is further discussed below).

<u>The Requirement to Earn a Return</u>

FNEI argued that the right of a utility to a fair return as part of its rates has been stated to be "absolute", and that this principle is not, on its face, limited to for-profit utilities.[120] OEB staff submits that the question of whether a not-for-profit utility requires the inclusion of a "fair return" in its revenue requirement is fundamental to the OEB's determination in the current proceeding.

OEB staff notes that the Fair Return Standard as discussed in the *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (the Report)[121] is central to answering this question.

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113 Granted to FNEI under paragraph 141(1)(1) of the Income Tax Act.
114 FNEI's counsel provided a memo that sets out legal advice with respect to the earning of an ROE and the maintenance of FNEI's tax exempt status. The memo is provided at Attachment 1 to the Argument-in-Chief.
115 EB-2016-0231, Argument-in-Chief, p. 25.
116 EB-2016-0231, Argument-in-Chief, Attachment 1, p. 7.
117 EB-2016-0231, Exhibit 7, Tab 2, Schedule 1.
118 EB-2016-0231, Argument-in-Chief, Attachment 1.
119 Canada Not-for-profit Corporations Act and the Income Tax Act.
120 EB-2016-0231, Exhibit 7, Tab 2, Schedule 1, p. 9.
121 EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, December 11, 2009.

The Fair Return Standard sets out the principles that are to be used in the determination of a fair (or reasonable) return on capital. As set out in the Report, the National Energy Board summarized the three main components of the Fair Return Standard as follows:

- The Comparable Investment Standard – A fair return on capital should be comparable to the return available from the application of invested capital to other enterprises of like risk;

- The Capital Attraction Standard – A fair return on capital should permit incremental capital to be attracted to the enterprise on reasonable terms and conditions; and

- The Financial Integrity Standard – A fair return on capital should enable the financial integrity of the regulated enterprise to be maintained.[122]

OEB staff submits that the Fair Return Standard, which is used in the determination of a reasonable return on capital, is informative with respect to the applicability of a return component of the revenue requirement for a not-for-profit utility.

The components of the Fair Return Standard clearly apply to for-profit utilities as they have shareholders that hold equity in the utility. In the case of a privately owned regulated utility (e.g. Enbridge Gas Distribution Inc.), the shareholder clearly has the opportunity to invest its capital in other enterprises and therefore must be granted a level of return on capital that continues to attract its investment in the company on a long-term sustainable basis.

With respect to the municipally- or provincially-owned utilities, the OEB determined that the manner in which the cost of capital will be established is the same for all rate-regulated entities regardless of ownership.[123] OEB staff understands this statement to refer to who the owner of the utility is as opposed to the ownership structure. As such, OEB staff submits that the OEB, in the Report, found that privately-owned and publicly-owned utilities would be treated in the same manner from a cost of capital perspective. It did not find that not-for-profit utilities would be treated in the same manner as for-profit utilities.

OEB staff submits that the need for the payment of a return on capital to a for-profit, publicly-owned utility with share capital (and shareholder equity) is a product of history. It can be stated that a fundamental goal of the Provincial government with respect to the

[122] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, p. 18.
[123] EB-2009-0084, Report of the Board on the Cost of Capital for Ontario's Regulated Utilities, p. 25.

restructuring of Ontario's electricity sector in the late 1990s was the privatization of Ontario Hydro's legacy assets and the amalgamation / privatization of municipal electricity utilities (MEUs).[124] At restructuring, the MEUs were required to incorporate their electric utilities under the *Business Corporations Act* (Ontario), and they became eligible to earn rates of return on capital (and were then described as LDCs to reflect their new corporate structure). In the absence of a return on capital, for-profit public utilities would not be attractive to private investment.

In contrast, FNEI as a not-for-profit corporation has no actual shareholder equity and no shareholders. A not-for-profit utility is also not allowed, due to its corporate structure, to provide distributions to its members.[125] Instead, the actual utility equity that FNEI holds in its regulated rate base has been generated over the years through retained earnings.[126] A utility with no shareholder equity does not require a payment of a return on capital in the same manner as a utility that has shareholder equity as is demonstrated by the inapplicability of the Fair Return Standard below.

In the context of the Fair Return Standard, the absence of a shareholder means that the Comparable Investment Standard cannot apply. FNEI does not have a shareholder that is seeking a return on its investment and comparing a potential investment in the regulated utility with an investment in a similarly risked enterprise elsewhere in the market. Therefore, the comparison of the regulated rate of return on capital to other sectors is not relevant.

Similarly, the Capital Attraction Standard is not applicable. FNEI cannot attract equity capital to the utility as it has no ability to satisfy an investor's need to be repaid its investment with an appropriate return as it cannot pay dividends to the investor. Therefore, from a purely economic (income-generating) perspective, private investors would have no interest in investing their capital in FNEI in its current form as a not-for-profit corporation.

What remains is the Financial Integrity Standard, which does apply to FNEI. OEB staff submits that the OEB does have a responsibility to "facilitate the maintenance of a financially viable electricity industry".[127] However, as the overall framework applied in establishing a "fair return" is not entirely applicable to FNEI, OEB staff submits that FNEI does not need to earn a return in the same manner as for-profit utilities. Instead, FNEI needs to be granted the ability to earn sufficient revenues in excess of costs that will facilitate the protection of its financial viability, including protection of its

[124] Winfield, M. (2012). *Blue-Green Province: The Environment and the Political Economy of Ontario.* Vancouver: UBC Press, p. 135.
[125] EB-2016-0231, Exhibit 7, Tab 2, Schedule 1, p. 10.
[126] EB-2016-0231, Oral Hearing Transcripts, Vol. 2, pp. 25-26.
[127] *Ontario Energy Board Act, 1998*, section 1(1)2 (in part).

creditworthiness and its ability to attract debt capital on reasonable terms. To address this need, OEB staff submits that the OEB should approve OEB staff's proposed FVRR as discussed in the section below.

The Financial Viability Revenue Rider

FNEI argued that if it is prohibited from earning excess revenues (or an ROE), this could result in FNEI failing to satisfy its debt covenants (which would lead to the risk of imminent insolvency). FNEI stated that the only feasible course in those circumstances would be to reorganize as a for-profit entity as to ensure the future permissibility of earning an ROE. FNEI submitted that the risks of such a reorganization (i.e. from not-for-profit to for-profit) include: (a) the administrative burden and costs of reorganization itself; and (b) the subsequent pressure on FNEI to distribute dividends to its shareholders, which, according to FNEI, would pose a serious risk to FNEI and could lead to its collapse.[128]

OEB staff recognizes the risks to FNEI if it is not granted the ability to earn revenues in excess of costs in the current proceeding and submits that the OEB has a responsibility to facilitate the maintenance of the financial viability of the utility.

OEB staff is of the view that a return calculated and applied in the same manner as a for-profit utility is not appropriate for the reasons previously discussed (i.e. the inapplicability of the Fair Return Standard). However, OEB staff does believe that FNEI needs to earn revenues in excess of costs to ensure the ongoing maintenance of its financial viability. Therefore, OEB staff submits that a FVRR should be granted to FNEI beginning in 2017 and continuing throughout the IRM term.

OEB staff submits that the FVRR should be set at a level that is equal to 10% of the revenue requirement (excluding the return component) in a given year. OEB staff submits that this level of funding in excess of FNEI's costs is sufficient to facilitate FNEI's financial viability. It will provide funding to allow FNEI to continue investing in its system, protect against unforeseen events, and manage cash flow issues.

OEB staff submits that there should not be any formal rules or restrictions associated with the use of amounts arising from the FVRR. The amounts are there for FNEI to use at its Board of Directors and management's discretion to ensure the ongoing financial viability of FNEI. OEB staff submits that the OEB should not micromanage the use of these funds.

[128] EB-2016-0231, Argument-in-Chief, p. 26.

For 2017, based on OEB staff's recommended reductions to revenue requirement compared to FNEI's proposal, the base FVRR (before the application of the proposed IRM based adjustment) will provide approximately $0.61 million of revenues in excess of costs. OEB staff submits that the FVRR should be adjusted each year to reflect 10% of the updated revenue requirement based on the IRM adjustments.

In order to calculate the precise revenue requirement, the FVRR should be calculated by applying an interest rate (which for a for-profit utility would be the ROE value) to the equity portion of FNEI's capital structure which results in an amount that is equal to 10% of the revenue requirement (net of the return component). For 2017, to derive a $0.61 million, a 4.55% interest rate is applied to the equity portion of FNEI's capital structure. The reason that OEB staff believes that the FVRR should be calculated in this manner is to ensure that the Revenue Requirement Workform can continue to be useful in future rates proceeding and to allow for a simple presentation of FNEI's revenue requirement.

OEB staff also submits that the FVRR should have a sunset date of December 31, 2020. This coincides with the conclusion of the proposed IRM term. OEB staff submits that this is a new method for the treatment of the cost of capital for a not-for-profit utility and it would be therefore prudent to reevaluate the appropriateness of this proposal at FNEI's next rebasing (which would be effective January 1, 2021). In the event FNEI seeks a deferral of its next scheduled rebasing application, it should do so consistent with the approach taken by electricity distributors. FNEI should inform the OEB of this request by way of letter, with details as to why a deferral is required including an analysis of its revenues and costs and whether the continuation of the FVRR for another year is appropriate.

OEB staff submits that this proposal satisfies FNEI's need to earn revenues in excess of costs to ensure that it has sufficient net income over the IRM term to stay onside of its debt covenants.[129] Based on the FVRR proposal, FNEI will earn substantial revenues in excess of costs (i.e. an amount equivalent to 10% of its revenue requirement each year) on an ongoing basis (assuming that it prudently contains its costs during the IRM term), which will allow FNEI to satisfy its debt covenants. However, OEB staff notes that if FNEI's debt coverage ratios were to drop significantly during the IRM term (for reasons beyond its control), FNEI could file an application with the OEB seeking an increase to the FVRR to address that issue.

OEB staff also submits that the FVRR proposal would allow FNEI to continue operating as a not-for-profit utility. This would insulate FNEI from the financial pressure of

[129] FNEI's debt coverage ratio is a factor of: (a) the ratio of principal to interest in any loan repayment obligations; and (b) net income. The establishment of the revenue requirement has a direct impact on the deemed amount of net income that will be earned by FNEI during the IRM term (2017-2020).

shareholders (as was requested)[130] and also provide ratepayer benefits (in terms of reduced tax burden in FNEI's revenue requirement).

For the above reasons, OEB staff submits that a FVRR set to provide $0.61 million in revenues in excess of costs should be included in the base 2017 revenue requirement as part of the current proceeding. The issue of FNEI's proposal to use revenues in excess of costs to meet other non-transmission related corporate objects is discussed in Section 6.6.

6.4 Is FNEI's proposed ROE appropriate?

As discussed above, OEB staff submits that FNEI should not be granted approval to earn a full ROE. Instead, it should be granted approval to receive a FVRR. The design of and rationale for the FVRR is discussed in Section 6.3.

6.5 Is it appropriate to add a reserve fund component to FNEI's cost structure?

OEB staff submits that, with the exception of the Insurance Reserve Fund, there should be no reserve fund component to FNEI's cost structure.

OEB staff submits that FNEI's existing Insurance Reserve Fund, which is fully funded with $4.0 million recorded in the reserve, should continue going forward. The Insurance Reserve Fund is used as a form of self-insurance coverage on FNEI's transmission line poles and wires (as FNEI was unable to purchase commercial insurance on these assets). The Insurance Reserve Fund is also required by FNEI's lenders.[131]

With respect to potential operating and capital reserve funds, OEB staff submits that these funds will no longer be required if the OEB establishes the FVRR proposed by OEB staff.

OEB staff submits that the FVRR approach provides for an appropriate alternative to the previous reserve fund approach with minimal reporting requirements.

The purpose of the reserve fund framework that was previously established by the OEB is described as follows in FNEI's 2010 rates decision:

> The need for Operating and Capital reserves was established in FNEI's last rate case. The Board believes it is critical for FNEI to have sufficient Operating and Capital reserves. Only in this way can its ratepayers be

[130] EB-2016-0231, Argument-in-Chief, p. 26.
[131] EB-2016-0231, Oral Hearing Transcripts, Vol. 2, pp. 85-86.

> reasonably satisfied that it will continue to be able supply electricity in a safe and reliable manner regardless of contingencies. The reserves, properly structured, prescribed and implemented are the only genuine security the ratepayers, and the ratepayers of its ratepayers, have that the supply of electricity will be reliably and safely delivered in their communities.[132]

OEB staff submits that the FVRR provides the communities served by FNEI with the same protections as the reserve fund framework. More specifically, it provides FNEI with the necessary funding to continue investing in its system, protect against unforeseen events, and manage cash flow issues. While providing the same protections, it also gives FNEI the necessary flexibility to manage its own operations and results in significantly less regulatory accounting complexity.

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

OEB staff submits that its proposal for the FVRR does not include any restrictions on the use of the funds.

OEB staff notes that the OEB does not allow the use of the OM&A component of the revenue requirement for charitable donations (which is similar to the funding of community projects).[133] However, in the context of for-profit utilities, there are no restrictions on charitable donations that are made using cash that arises from net income (which, on a deemed basis, is funded through the return component of the revenue requirement).

If OEB staff's submission is accepted, FNEI will not have a return component of the revenue requirement. Instead, it will have the FVRR, which is intended to provide a sufficient level of funding beyond FNEI's actual costs that it can use to invest in its transmission business and maintain its financial viability. If the amounts provided through the FVRR are, at times, in excess of amounts needed by FNEI to invest in its transmission system (as determined by FNEI's Board of Directors and management), then FNEI should not be restricted from using these funds as it chooses. This is conceptually similar to the use of the return component of the revenue requirement to make charitable donations by a for-profit utility.

OEB staff's proposal for the FVRR is based on the notion that a not-for-profit utility does not require more monitoring / restrictions than for-profit utilities. In the past, there may

[132] EB-2009-0387, Decision and Order, p. 21.
[133] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, p. 29.

have been an expectation that any amounts allowed in revenue requirement that exceeded costs for not-for-profit utilities needed to be closely managed by the regulator as this was some kind of a special, one-time provision. However, OEB staff submits that if the OEB finds it appropriate to include funding that is incremental to the costs of operating the utility in the revenue requirement, this funding should then be subject to the same oversight and conditions as would be applied to for-profit utilities.

For example, OEB staff notes that the OEB carefully monitors that a for-profit utility is not paying excessive dividends to its shareholder to the detriment of the operation of its system. Similarly, the OEB should ensure that FNEI is not excessively funding community projects to the detriment of its system (as will be explained below). In addition, OEB staff notes that the OEB does not true up the revenue requirement granted to for-profit utilities. Similarly, the OEB should not do so for not-for-profit utilities. OEB staff's proposal for the FVRR facilitates the symmetrical treatment of for-profit and not-for-profit utilities. OEB staff submits that the FVRR proposal places not-for-profit utilities on the same footing as for-profit utilities in terms of the flexibility and control afforded to management to run their utilities. The only difference is that a not-for-profit will earn revenues in excess of costs on the basis of the FVRR instead of the return component of the revenue requirement for the reasons that were discussed in Section 6.3.

In order to ensure that FNEI appropriately balances community funding with investment in its system (especially for this first term of the new FVRR), OEB staff submits that the OEB should establish a reporting requirement that FNEI must provide, at the time of its next rebasing, the amount of funding that was directed toward meeting FNEI's non-transmission objectives. This reporting requirement along with the proposals that it has made elsewhere in the submission will provide the OEB with the necessary tools to ensure that prudent investments are being made in FNEI's system over the IRM term and that community funding is not occurring at the expense of the system.

As discussed previously in the submission, at Section 2.2, OEB staff argued that a detailed asset management plan (including an up-to-date inventory of assets) should be filed as part of FNEI's next rebasing. This will allow the OEB to evaluate whether sufficient investment has been made in FNEI's capital assets during the IRM term.

In addition, OEB staff argued for the utilization of the performance scorecard as designed in Section 3.1. The performance scorecard includes metrics related to service reliability. OEB staff notes that if service reliability decreases during the IRM term (for reasons that are properly within FNEI's management's control) and the OEB notices significant non-transmission funding has occurred, this could be a sign that community project funding and investment in FNEI's system are not appropriately balanced.

Overall, OEB staff submits that no restrictions should be placed on the use of funds arising from the FVRR. On that basis, FNEI may be allowed to use revenues in excess of its legitimate needs to maintain its financial viability and prudently invest in its system, to meet its other non-transmission corporate objects. To be clear, OEB staff is not proposing that a portion of the revenue requirement be allocated to funding non-transmission corporate objects. Rather, OEB staff submits that should funds be generated through the FVRR beyond those needed to maintain its financial viability and prudently invest in its system, then those excess revenues may be allocated to non-transmission activities. The OEB should ensure, at the time of rebasing, that FNEI has prudently invested in its system and that community project funding did not become a priority that came at a cost to the system. If it turns out that there was harm to the system due to community project funding, the OEB may need to reconsider the permissibility of using the FVRR funding in this manner in the future.

7.0 Deferral / Variance Accounts

7.1 Are the proposed new deferral and variance accounts appropriate?

OEB staff submits that the approval of a Forgone Revenue Deferral Account is appropriate as part of the current proceeding. However, OEB staff submits that certain changes to the proposed account are necessary.

FNEI requested approval of an account to record the revenue requirement deficiencies from the proposed effective date of January 1, 2016 until such time that FNEI's revenue requirement is reflected in the UTRs.[134] FNEI filed a draft accounting order as an undertaking response.[135]

Based on OEB staff's submission that the effective date for FNEI's revenue requirement should be January 1, 2017, and not January 1, 2016 as requested by FNEI, OEB staff submits that the account should record the difference between the actual revenues earned by FNEI through the UTRs (which reflect FNEI's interim approved revenue requirement[136]) and the notional revenues that FNEI would have received had its 2017 approved revenue requirement been captured in the UTRs. The account should record the forgone revenue only for the period January 1, 2017 until such time that FNEI's 2017 revenue requirement is reflected in OEB-approved UTRs. At Appendix B, OEB staff proposes a revised draft accounting order for the Forgone Revenue Deferral Account, which better reflects OEB staff's submission. OEB staff submits that the OEB should approve the revised draft accounting order attached as Appendix B to this submission.

[134] EB-2016-0231, Undertaking Response J2.3.
[135] EB-2016-0231, Undertaking Response J2.3.
[136] EB-2015-0368, Decision and Interim Order, p. 3.

As discussed further in Section 9.1, OEB staff submits that the forgone revenue should be included as a one-time adjustment to FNEI's 2018 revenue requirement. OEB staff notes that it is possible that not all of the actual revenue information required for the calculation of the balance in the Forgone Revenue Deferral Account will be available at the time that FNEI will need to file that calculation (so that the amount can be included in the 2018 UTRs). Therefore, OEB staff submits that the OEB should state in its decision that FNEI may use a best efforts estimate for the actual revenue information in the calculation, if necessary.

OEB staff also requested that FNEI file a draft accounting order for a Z-factor deferral account. FNEI provided the draft accounting order as an undertaking response.[137] After a further review of the OEB's general policy with respect to Z-factor claims, OEB staff submits that the approval of a Z-factor accounting order is not necessary as part of the current proceeding. If a Z-factor event occurs during the IRM term, FNEI may file an application with the OEB for relief if it is in accordance with the Z-factor criteria that are established for FNEI as part of the current proceeding (as discussed in Section 9.1). OEB staff also notes that the costs for the Z-factor event should be recorded in Account 1572 (as is the OEB's standard policy).[138]

8.0 Cost Allocation

8.1 Is the cost allocation to rate pools proposed by FNEI appropriate?

FNEI proposed to allocate its revenue requirement to the UTR asset pools on the same basis as HONI.[139] To allocate its revenue requirement to the rate pools, FNEI used the HONI allocation factors that were in place at the time that FNEI filed its application.[140]

OEB staff submits that the use of the same allocation factors as HONI is appropriate. However, if HONI's 2017 transmission cost of service application[141] is approved prior to the filing of the draft rate order in the current proceeding, the OEB should order FNEI to update its cost allocation to reflect the allocation factors approved in that decision. OEB staff submits that the most recent available information should be used in the cost allocation process. OEB staff notes that FNEI agreed in an interrogatory response that it would make this update.[142]

137 EB-2016-0231, Undertaking Response J2.3.
138 Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.0 p. 32.
139 EB-2016-0231, Exhibit 9, Tab 1, Schedule 1, p. 1.
140 EB-2016-0231, Interrogatory Responses, 9-Staff-35(a).
141 EB-2016-0160.
142 EB-2016-0231, Interrogatory Responses, 9-Staff-35(b).

9.0 Incentive Ratemaking

9.1 Is FNEI'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)?

OEB staff submits that FNEI should be granted an IRM plan for the period 2017-2020. OEB staff submits that the 2017 test year should also be considered the first year of FNEI's IRM term (2017-2020 – 4 years total – with the original proposed 2016 rebasing year forgone) as it will reflect both FNEI's rebased costs (based on 2016 actuals with specific adjustments) and the first IRM-based inflationary adjustment.

OEB staff also submits that certain adjustments to FNEI's proposed IRM plan should be made. OEB staff has structured its submission on the IRM plan as follows: (a) allowable revenue requirement adjustments; (b) Z-factor claims; (c) off-ramp; (d) incremental capital module; (e) 2017 IRM adjustment; and (f) future year IRM adjustments.

Allowable Revenue Requirement Adjustments

OEB staff submits that FNEI's proposed allowable revenue requirement adjustments as set out in its pre-filed evidence are appropriate.

OEB staff agrees with FNEI that the annual revenue requirement each year should be adjusted based on the following formula:

RRA = I – (X + S); where "RRA" is Revenue Requirement Adjustment, "I" is the Inflation Factor, "X" is the Productivity Factor, and "S" is the stretch factor.[143]

OEB staff agrees with FNEI that the inflation factor used in the calculation should be based on the inflation factor calculated and released by the OEB each year for Price Cap IR and Annual Index plans. The inflation factor is calculated based on actual year-over-year changes in the annualized average of four quarters of Statistics Canada's Gross Domestic Product Implicit Price Index for Final Domestic Demand (GDP-IPI).[144]

OEB staff also agrees with FNEI that the productivity factor should be the same as is used by the OEB for electricity distributor rate adjustments.[145] OEB staff submits that the use of the same productivity factor that is applied to electricity distributor rate adjustments is appropriate as no sector-wide productivity study has been completed for

[143] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 2.
[144] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 2.
[145] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 2.

the Ontario electricity transmitters at this time. The productivity factor is currently set at 0%. OEB staff also submits that no updates to the productivity factor should be required during the IRM term. The productivity factor applicable to FNEI should be revisited at the time of FNEI's next rebasing.

OEB staff also agrees that a stretch factor should be included in the revenue requirement adjustment. However, OEB staff disagrees that the stretch factor applicable to FNEI should be 0.3% (which reflects a group 3 ranking and is the mid-range for the electricity distributors).[146] OEB staff notes that FNEI filed no benchmarking evidence (whether internal and or external) as part of the current proceeding. In the absence of any empirical evidence, OEB staff submit that the default stretch factor should be considered a group 5 ranking (or 0.6%) as the OEB has no basis to approve a higher ranking. Therefore, OEB submits that a 0.6% stretch factor should be included in the calculation of the revenue requirement adjustment. OEB staff also submits that no updates to the stretch factor should be required during the IRM term. The stretch factor applicable to FNEI should be revisited at the time of FNEI's next rebasing.

Z-factor Claims

OEB staff submits that the FNEI's proposed Z-factor relief framework is appropriate. In its pre-filed application, FNEI provided the criteria that an unforeseen event must meet in order for it to be Z-factor eligible. FNEI also provided the process for bringing forward a Z-factor claim.[147]

With the exception of some minor language changes (to better reflect the Transmission Filing Requirements), OEB staff has no concerns with FNEI's proposal. The suggested changes to FNEI's Z-factor relief framework are set out below.

With respect to the criteria for Z-factor claims, OEB staff submits that the following language should apply.

- Causation: amounts must be clearly related to the Z-factor event, and outside of the base upon which revenue requirements were set. The evidence filed for a Z-factor claim must demonstrate that the management of the transmitter could not have been able to plan and budget for the event and that the harm caused by the extraordinary event is genuinely incremental to their experience or reasonable expectations.

[146] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 2.
[147] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, pp. 2-3.

- Materiality: the event must have a significant influence on the operations of the transmitter. For FNEI, the materiality threshold should be set at $0.1 million (on an individual event and revenue requirement basis).[148]

- Prudence: the amounts must have been prudently incurred. The transmitter's decisions to incur the amounts must represent the most cost-effective option for ratepayers.[149]

Regarding materiality, OEB staff notes that FNEI originally requested a materiality threshold of $0.1 million.[150] In an interrogatory response, FNEI stated that it would be agreeable to a materiality threshold of $0.4 million.[151] OEB staff submits that the Z-factor materiality thresholds are on a revenue requirement basis. Therefore, OEB staff submits that if, for example, a $0.4 million Z-factor event (on a revenue requirement basis) requires capital expenditures, the total cost would be approximately $4 million on a capital basis. OEB staff is of the view that a level of spending associated with a Z-factor event that costs more than $0.1 million (on a revenue requirement basis) would have a significant influence on the operations of FNEI. OEB staff also notes that a Z-factor materiality threshold set at $0.1 million is already higher than the threshold for a utility of FNEI's size established in the Transmission Filing Requirements ($0.05 million).[152] Therefore, OEB staff submits that applying a materiality threshold of $0.4 million is not appropriate. OEB staff submits that $0.1 million as originally proposed by FNEI reflects a reasonable materiality threshold and should be accepted by the OEB.

OEB staff submits that the process proposed by FNEI for bringing forward a Z-factor claim[153] is appropriate, as it is in accordance with the Transmission Filing Requirements. OEB staff also notes that the costs for the Z-factor event should be recorded in Account 1572 (as is the OEB's standard policy).[154]

OEB staff also notes that there could be a situation where the Z-factor event is covered by FNEI's Insurance Reserve Fund. In that situation, OEB staff submits that any amounts that are eventually granted by the OEB to FNEI as Z-factor relief should first be used to fund the Insurance Reserve (back to the level that the reserve was drawn down). If the event is not covered by FNEI's Insurance Reserve Fund, and Z-factor relief

[148] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 2.
[149] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.0, pp. 31-32.
[150] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 2.
[151] EB-2016-0231, Interrogatory Responses, 10-Energy Probe-14(a).
[152] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.1.1, p. 6.
[153] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 3.
[154] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.0 p. 32.

is granted by the OEB, the funding should be credited to FNEI's regular operational accounts.

Off-Ramp

As part of its proposed IRM plan, FNEI proposed a trigger mechanism for regulatory review if its earnings fall outside an annual ROE deadband of plus or minus 300 basis points (based on FNEI's audited financial statement).[155]

OEB staff submits that an off-ramp should be available to FNEI, but there should not be a deadband in place. The off-ramp should be entirely at the OEB's discretion. As the FVRR is a new concept, the OEB may wish to trigger an off-ramp at a different level of over or under-earning (relative to FNEI's proposed deadband). OEB staff submits that the OEB should review the financial performance metrics included in FNEI's performance scorecard each year to determine whether the FVRR is operating as intended.

Incremental Capital Module

FNEI did not propose an ACM in its application. However, OEB staff notes that an ICM is generally contemplated in the revenue cap option available to transmitters.[156]

OEB staff submits that if FNEI would like to seek ICM treatment of a capital project during the IRM term it can do so in accordance with the general direction provided in the Transmission Filing Requirements.[157] The OEB should require that any evidence for the ICM request that is filed during the IRM term must address materiality, need and prudence. In addition, for FNEI, as it has not provided a detailed forecast of capital projects that will be undertaken during the IRM term, the OEB should order that an updated TSP must be filed with the ICM application. This would allow the OEB to evaluate the proposed capital project in the context of FNEI's future capital plans.

2017 IRM Adjustment

As discussed in Section 1.3, the 2017 test year revenue requirement should be established in two stages.

[155] EB-2016-0231, Exhibit 10, Tab 1, Schedule 1, p. 3.
[156] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.5.6, p. 21.
[157] Filing Requirements for Electricity Transmission Applications, Chapter 2 – Revenue Requirement Applications, February 11, 2016, Section 2.5.6, p. 21.

1) The base 2017 revenue requirement should be established using actual 2016 revenue requirement (with certain specific adjustments) as this reflects the best available information on the record. The establishment of the base 2017 revenue requirement is discussed throughout the submission.

2) The final 2017 revenue requirement should be established by applying an IRM-based inflationary adjustment to the base 2017 revenue requirement to provide FNEI with sufficient funds in 2017 to effectively manage inflationary pressures on its costs. The 2017 IRM-based inflationary adjustment is discussed in this section of the submission.

OEB staff submits that it is appropriate, in the context of its submissions, to apply the first IRM adjustment to OEB staff's proposed base 2017 revenue requirement (which is based on 2016 actuals with some suggested modifications). OEB staff submits that applying the IRM adjustment will gross-up the base 2017 revenue requirement amount for inflation minus productivity / stretch. OEB staff believes that this is appropriate as its arguments for setting the base 2017 revenue requirement items use 2016 actuals as the starting point and do not directly consider inflation. OEB staff submits FNEI should be granted an incremental amount relative to OEB staff's proposed base 2017 revenue requirement amount to reflect the impact of inflation minus productivity / stretch.

For 2017, the result of OEB staff's submission is a base revenue requirement amount of approximately $6.63 million (which includes approximately $0.61 million for the FVRR).

Using the formula discussed previously, the revenue requirement adjustment for 2017 is 1.3%, which reflects the OEB approved 2017 inflation factor (1.9%), minus the sum of the productivity factor and the stretch factor (0% + 0.6%). Applying the revenue requirement adjustment factor of 1.3% to OEB staff's proposed base revenue requirement, results in an additional $0.09 million of revenue requirement. Therefore, the OEB should approve as part of the current proceeding a final 2017 revenue requirement (after the inflationary adjustment) of approximately $6.72 million (which includes approximately $0.62 million for the FVRR).

OEB staff notes that the final 2017 UTRs will likely be approved in advance of a decision in the current proceeding. Therefore, the forgone revenue associated with the increase to FNEI's revenue requirement (as between 2017 approved and 2016 interim) will not be captured in the 2017 UTRs.

Future Year IRM Adjustments

OEB staff submits that FNEI's IRM plan is relatively straightforward. Based on OEB staff's submission, the only allowable change that will occur on annual basis is the revenue requirement adjustment (based on the formula discussed previously). OEB staff submits that there is no need for FNEI to update its charge determinants each year as there is no expectation that load will change materially over the IRM term.[158]

Given the relative simplicity of FNEI's IRM plan, OEB staff submits that the OEB should find that FNEI does not need to file annual IRM applications during the IRM term unless FNEI seeks an ICM. Instead, FNEI can simply file a letter with the OEB, no later than November 30 of each year[159], which sets out the updated revenue requirement. The letter should be filed under the current proceeding's file number (EB-2016-0231). The letter should include a detailed calculation of the revenue requirement by component similar to the table developed by OEB staff at Appendix A to the submission.

OEB staff will review the letter and ensure that the revenue requirement has been calculated appropriately in accordance with the OEB's findings in the current proceeding. OEB staff will then ensure that the updated revenue requirement is included when the UTRs are established each year. In this way, updates to the revenue requirement during the IRM term can be granted without a hearing or a formal application.

OEB staff notes that for 2018, there are other necessary changes to the revenue requirement beyond the inflationary and productivity / stretch adjustments. On the basis of OEB staff's submission, FNEI in 2018 will have one-time adjustments for both: (a) the disposition of the incremental input tax credit amount ($0.045 million); and (b) the recovery of the forgone revenue. For 2019, these one-time adjustments will need to be removed from the revenue requirement.

OEB staff submits that to allow for the proposal that no hearings are required during the remainder of the IRM term (beyond 2017), the OEB, as part of the current proceeding, should order that the annual IRM adjustments during the period from 2018 to 2020 are to reflect the OEB-approved revenue requirement adjustment (based on the inflation minus productivity / stretch formula). For 2018, the revenue requirement adjustment should be applied to the approved final 2017 revenue requirement and the amounts related to the disposition of the incremental input tax credit and the recovery of forgone revenue should be included. For 2019, the revenue requirement adjustment should be applied to the approved 2018 revenue requirement (after the one-time adjustments related to the incremental tax credit and the forgone revenue have been removed).

[158] EB-2016-0231, Argument-in-Chief, p. 17.
[159] Except for in 2017, where the filing will need to occur immediately after a Rate Order is issued in this proceeding.

10.0 Bill Impacts

10.1 Are the bill impacts resulting from FNEI's application appropriate?

FNEI noted that its application will have no impact on Ontario ratepayers as there is no change to the network, line connection, or transformation connection charge.[160] OEB staff agrees, based on the calculations provided by FNEI[161], that there will be no bill impacts for ratepayers.

However, OEB staff reiterates that while FNEI's costs may not have direct bill impacts on consumers, it remains important to carefully consider the prudence and appropriateness of the underlying costs. OEB staff submits that the OEB has a responsibility to ensure that a monopoly operator is operating as efficiently and productively as possible, in the public interest, irrespective of the bill impacts caused by changes to the revenue requirement.

11.0 Implementation

OEB staff notes that implementation is not an issue included within the OEB's approved issues list. However, OEB staff will provide some comments on this topic.

OEB staff submits that, as part of its decision, the OEB should order FNEI to file a Draft Rate Order that reflects the OEB's findings. If the OEB accepts OEB staff's submission, the Draft Rate Order should include a calculation of the revised revenue requirement (including the FVRR). The calculation should be broken down by component of the revenue requirement. The Draft Rate Order should also include the proposed updated charge determinants and revenue requirement allocation to rate pools.

OEB staff submits that the OEB should also remind FNEI that for its 2018 revenue requirement to be reflected in the 2018 UTRs, a letter providing the calculation of the updated revenue requirement (including the one-time adjustments for the refund of the incremental input tax credit and the recovery of the forgone revenue) must be filed immediately after a Final Rate Order is issued in the current proceeding. With respect to the calculation of the forgone revenue amount, FNEI should file a detailed schedule explaining how the amount was derived. OEB staff will review all of the calculations to ensure accuracy.

All of which is respectfully submitted.

[160] EB-2016-0231, Argument-in-Chief, p. 32.
[161] EB-2016-0231, Exhibit 11, Tab 1, Schedule 1.

Appendix A

OEB Staff Submission

EB-2016-0231

FNEI – 2016 Revenue Requirement

Detailed 2017 Revenue Requirement Calculation

Detailed 2017 Revenue Requirement Calculation[162]

Category	Proposed	OEB Staff Submission	Variance ($)	Variance (%)	Section Reference
Effective Date	Jan. 1, 2016	Jan. 1, 2017			1.3
Rate Base – Net Fixed Assets	$35,626,294	$33,650,845 (reflects actual 2016 net fixed assets and removal of $2,081,255 for Timmins head office)	-$1,985,449	-5.6%	2.3
Rate Base – Working Capital Allowance	$150,026	$134,373 (reflects the reduction to OM&A budget and use of 3.55%)	-$15,653	-10.4%	2.4
Total Rate Base	$35,776,319	$33,785,218	-$1,991,101	-5.6%	
OM&A (Excl. Depreciation)	$4,335,984	$3,785,146 (reflects the use of 2016 actuals, funding for additional staff, removal of 10% one-time pay adjustment, reduction for conservation budget, reduction for regulatory expenses, reduction for certain maintenance activities)	-$550,838	-12.7%	5.1
Depreciation	$1,293,322	$1,384,945 (reflects the use of 2016 actuals and the proposed reduction to rate base)	$91,623	7.1%	5.3
LT Debt	$1,021,131	$966,798 (reflects the proposed reduction to rate base)	-$54,333	-5.3%	6.2
ST Debt	$23,612	$23,785 (reflects the proposed reduction to rate base and the increase in the short-term debt rate)	$173	0.1%	6.2
Return Component	$1,315,137	$614,891 (reflects the proposal with respect to the Financial Viability Revenue Rider)	-$700,246	-53.2%	6.3
Total (Service RR)	**$7,989,186**	**$6,775,565**	**-$1,213,621**	**-15.2%**	
Other Revenue	$150,000	$146,058	-$3,942	-2.6%	4.2
Total (Base RR)	**$7,839,186**	**$6,629,507**	**-$1,209,679**	**-15.4%**	9.1
Total (Base RR) - IRM Update (Final 2017 Revenue Requirement)	**$7,839,186**	**$6,715,691** (reflects the 2017 IRM Update proposal)	**-$1,123,495**	**-14.3%**	9.1

[162] Reflects a high-level estimate calculated by OEB staff.

Appendix B

OEB Staff Submission

EB-2016-0231

FNEI – 2016 Revenue Requirement

Revised Draft Accounting Order

Forgone Revenue Deferral Account

Draft Accounting Order

Forgone Revenue Deferral Account

Deferral Account to Record Revenue Deficiencies Incurred from January 1, 2017

This account records the differences between the actual revenue earned by Five Nations Energy Inc. through the Uniform Transmission Rates (which reflect Five Nations Energy Inc.'s interim approved revenue requirement - EB-2015-0368 - Decision and Interim Order) and the notional revenues that Five Nations Energy Inc. would have received had its 2017 approved revenue requirement (EB-2016-0231 – Decision and Rate Order) been reflected in the Uniform Transmission Rates. The account will capture the forgone revenue only for the period from January 1, 2017 until the date when Five Nations Energy Inc.'s approved 2017 revenue requirement is reflected in the OEB-approved Uniform Transmission Rates. The accounting entries are to be recorded as follows:

USofA #	**Account Description**
Dr: 1574	Other Regulatory Assets – Sub account "Forgone Revenue Deferral Account"
Cr: 4105	Transmission Charges Revenue

To record the difference between the actual revenue earned by Five Nations Energy Inc. through the Uniform Transmission Rates (which reflect Five Nations Energy Inc.'s interim approved revenue requirement) and the notional revenues that Five Nations Energy Inc. would have received had its 2017 approved revenue requirement been reflected in the Uniform Transmission Rates.

USofA #	**Account Description**
Dr: 1574	Other Regulatory Assets – Sub account "Forgone Revenue Deferral Account"
Cr: 4405	Interest and Dividend Income

To record carrying charges on the principal balance of the "Forgone Revenue Deferral Account".