ONTARIO ENERGY BOARD

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

EB-2016-0231

REPLY

OF

FIVE NATIONS ENERGY INC.

SEPTEMBER 8, 2017

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REPLY OF FIVE NATIONS ENERGY INC.

OVERVIEW

Five Nations Energy Inc. ("**FNEI**") applied to the Ontario Energy Board (the "**OEB**"), pursuant to Section 78 of the *Ontario Energy Board Act, 1998*,[1] for approval of a new revenue requirement effective January 1, 2016 (EB-2016-0231).

The most recent developments in this proceeding include FNEI filing its Argument in Chief on August 4, 2017, following which submissions were filed on August 23, 2017 by both OEB staff ("**Board Staff**") and Energy Probe Research Foundation ("**Energy Probe**") (these submissions respectively being the "**Board Staff Submission**" and the "**Energy Probe Submission**").

FNEI has prepared this reply submission (the "**Reply**") in response to the Board Staff Submission and the Energy Probe Submission. A summary of the key issues that are addressed in this Reply include:

a) **ROE.** Board Staff and Energy Probe support FNEI's position that FNEI should be entitled to earn revenues in excess of its costs, but take the position that these excess revenues should be less than the ROE earned by for-profit electricity transmitters. FNEI submits that it should be entitled to earn the same ROE as a for-profit electricity transmitter, as the requirements of the Fair Return Standard are satisfied.

b) **Reserve Fund Framework.** Board Staff and Energy Probe support FNEI's position that the reserve fund framework contemplated in EB-2009-0387 is not appropriate.

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

c) **FNEI Corporate Purposes.** Board Staff and Energy Probe support FNEI's position that FNEI should not be prohibited from applying revenues in excess of its costs to the furtherance of its corporate objectives, *viz.* the promotion economic and social welfare in the communities of Attawapiskat, Kashechewan, and Fort Albany.

d) **Effective Date.** Board Staff and Energy Probe take the position that the effective date should be January 1, 2017. FNEI maintains that the appropriate effective date is January 1, 2016, as FNEI should be entitled to a fair return for that year and the denial of this return would unfairly penalize a small team that was required to address significant administrative burdens while simultaneously operating and maintaining a transmission system. An effective date of January 1, 2016 will provide FNEI with a fair rate of return and would have no impact on Ontario ratepayers, nor would such a decision be without precedent.

e) **OM&A.** Board Staff and Energy Probe take the position that actual 2016 OM&A costs should be used for establishing FNEI's revenue requirement. Such an approach fails to recognize that in 2016 FNEI reduced its expenditures below a sustainable level to accommodate for the reduced revenue, and as a result, earned an ROE of less than 1%. The actual 2016 OM&A costs do not reflect the true costs of operating and maintaining the FNEI transmission system and would compromise the operations of FNEI on a go-forward basis.

f) **Timmins Head Office.** Board Staff proposes to exclude 43% of the cost of the Timmins head office but the approach applied by Board Staff in reaching this result is not supported by ratemaking principles. FNEI submits that the Timmins head office should be fully included in FNEI's rate base, as FNEI acted prudently in making this investment decision at the relevant time.

g) **IRM Term.** Board Staff and Energy Probe propose that the IRM Term be limited to 4 years. FNEI submits that a five year IRM Term is more appropriate, as this aligns with the Filing Requirements and there is no compelling reason to shorten the term and thereby incur the administrative burden of completing the next rebasing application sooner than is necessary.

To provide structure and ease of reference, this Reply is organized on the basis of the proposed issues list, which was circulated by the OEB on June 13, 2017. This structure was applied for the organization of FNEI's Argument in Chief and the Board Staff Submission.

1.0 GENERAL

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

(i) Incremental Tax Credit

Board Staff submits that the $0.045 million that would have been recorded in the incremental tax credit deferral account should be refunded to ratepayers as part of the current proceeding.[2] FNEI does not contest this submission.

(ii) Reserve Fund Framework

Board Staff proposed a new approach to the treatment of the cost of capital and addressed this in Section 6.3 of the Board Staff Submission.[3] Accordingly, FNEI's response is addressed in Section 6.3 of this Reply.

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

Board Staff proposed certain changes to FNEI's proposed revenue requirement and addressed these changes in other sections of the Board Submission.[4] FNEI's response is set out in the corresponding sections selected by Board Staff.

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[2] Board Staff Submission at 5.

[3] Board Staff Submission at 6.

[4] Board Staff Submission at 6.

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

Board Staff and Energy Probe submit that the proposed effective date of January 1, 2016 should be changed to January 1, 2017.[5]

FNEI maintains that the appropriate effective date is January 1, 2016 and relies on the reasons set out in its Argument in Chief.[6] In brief, FNEI should be entitled to earn a fair return on its invested capital for 2016. During that year, FNEI's revenue deficiency was $1.51 million[7] and its actual ROE was only 0.87%,[8] which demonstrates that setting the effective date at January 1, 2017 would deprive FNEI of a fair return for 2016.

Board Staff submits that FNEI should have submitted its Application earlier,[9] but this hindsight overlooks the practical reality that FNEI's team of less than ten people, aside from being responsible for the operation of FNEI's transmission system, also had to contend with other factors that included (i) the acquisition of 80 kilometres of transmission line, (ii) the replacement of FNEI's CEO, (iii) the release of new Filing Requirements, and (iv) the development of a custom IR Plan. That such burdens would overwhelm a small team, especially when trying to satisfy the same requirements as larger electricity transmitters, is to be expected. FNEI submits that it should not be deprived of its fair rate of return for an entire year as a result of these circumstances.

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[5] Board Staff Submission at 6 and Energy Probe Submission at paras 5 and 25.

[6] Argument in Chief at Section 1.3.

[7] Application at Exhibit 2, Tab 1, Schedule 3 and FNEI Response to Board Staff interrogatory 1-Staff-2.

[8] FNEI Response to Board Staff interrogatory 1-Staff-8(a).

[9] Board Staff Submission at 7.

Providing FNEI with a fair rate of return would have no impact on Ontario ratepayers, nor would such a decision be without precedent.

Board Staff also submits that if the OEB approves FNEI earning an ROE, then the ROE should not apply to 2016 because of the timing of the Application.[10] FNEI submits that an ROE is appropriate for 2016, for the reasons set out above.

Board Staff and Energy Probe also submit that the IRM Term should be four years,[11] as opposed to the five years proposed by FNEI and contemplated by the *Filing Requirements for Electricity Transmission Applications*, dated February 11, 2016.[12] Board Staff takes the position that a shortened IRM Term is appropriate because Board Staff has proposed a "financial viability revenue rider" ("**FVRR**") in place of an ROE. FNEI submits that the FVRR is not appropriate or necessary for the reasons set out in Section 6.3(iii)(b) below. In the alternative, even if the FVRR were to be applied, FNEI submits that it would not introduce uncertainty that would justify the administrative burden of requiring another rebasing application in less than five years.

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

Board Staff accepts 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.[13]

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[10] Board Staff Submission at 8.

[11] Board Staff Submission at 8 and Energy Probe Submission at para 5.

[12] Chapter 2 – Revenue Requirement Applications at 1 (the "Filing Requirements").

[13] Board Staff Submission at 9.

2.0 TRANSMISSION SYSTEM PLAN AND RATE BASE

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

Board Staff accepts that FNEI's transmission system plan adequately addresses customer needs and preferences.[14]

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?

Board Staff has no concerns regarding the (i) bus isolation project, (ii) transformer station stone replacement, (iii) installation of the diesel backup generators at the fibre shelters, and (iv) replacement of the batteries in each of the transformer station control rooms.[15]

(i) Twinning the Transmission Line from Kashechewan to Attawapiskat

Board Staff expressed some concern with the potential twinning of the transmission line from Kashechewan to Attawapiskat (the "**Twinning**").[16] Board Staff noted that the estimated costs of $35 million would double FNEI's rate base, and recommended that the OEB should caution FNEI that any significant spending prior to OEB approval would be at FNEI's risk.[17]

It should be noted that the Twinning, although certainly a significant undertaking, would not effectively double FNEI's rate base, as this rate base is significantly understated for the reasons set out in Section 6.3(iii)(c) below (i.e. non-inclusion of $34.28 million in FNEI's initial rate base).

[14] Board Staff Submission at 9.

[15] Board Staff Submission at 9.

[16] Board Staff Submission at 10.

[17] Board Staff Submission at 10-11.

FNEI is not seeking approval of the Twinning through this proceeding and submits that it is unnecessary for the OEB to caution FNEI in this regard.

(ii) Capital Project Forecast

Board Staff submits that FNEI should file a summary of five future years of proposed capital expenditures as part of its next rebasing application.[18] FNEI does not contest this submission, as this information is required by the Filing Requirements.[19]

(iii) Benchmarking

Board Staff acknowledges that not all benchmarking in the Transmission Filing Requirements can be achieved by FNEI.[20]

Board Staff submits that FNEI should provide internal program-based benchmarking that compares FNEI's own cost performance over time for the purpose of demonstrating continuous improvement.[21] FNEI is not opposed to such internal benchmarking; however, FNEI cautions that cost performance over time is unlikely to accurately reflect continuous improvement due to FNEI's small size. The significant impact of relatively minor variances would likely result in falsely reporting improvement or a lack thereof.

[18] Board Staff Submission at 11.

[19] Chapter 2 at Section 2.4.3.

[20] Board Staff Submission at 12.

[21] Board Staff Submission at 12.

Board Staff also submits that FNEI should undertake <u>external</u> program-based benchmarking that compares FNEI's cost performance against other electricity transmitters.[22] Board Staff acknowledges that this benchmarking may be difficult, but submits that FNEI should undertake this benchmarking on a best efforts basis.[23] FNEI questions the value of external benchmarking, as FNEI is not aware of another utility that would be an appropriate comparator. Board Staff submits that if FNEI cannot complete this type of benchmarking, then FNEI should be required to provide evidence of its efforts.[24] FNEI is uncertain what form of evidence would be considered adequate in this regard. One potential form of evidence would be for FNEI to retain a third party consultant to study and report on potential comparator utilities, although FNEI questions the value of incurring these costs in the search of external benchmarks. If the OEB believes that such a study would be appropriate, then FNEI submits that its revenue requirement should be increased to account for this additional work, although FNEI is uncertain what such a study would cost.

Board Staff also submits that FNEI should be directed to take into consideration any HONI productivity study published prior to FNEI's next rebasing application.[25] FNEI is not opposed to taking any such study into consideration.

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[22] Board Staff Submission at 12.

[23] Board Staff Submission at 12.

[24] Board Staff Submission at 12-13.

[25] Board Staff Submission at 13.

2.4 Is the proposed 2016 rate base reasonable?

Board Staff submits that FNEI's proposed rate base of $35.78 million should be reduced to $33.79 million – a reduction of $1.98 million.[26]

Board Staff organized its submission into the following categories: (i) 2016 actual rate base, (ii) Timmins head office, (iii) acquisition of 80 kilometres of transmission line from HONI, and (iv) other capital projects. FNEI has organized this Reply to correspond with these categories.

(i) 2016 Actual Rate Base

Board Staff submits that the actual 2016 rate base should be used as the starting point for establishing the 2017 rate base,[27] which is related to Board Staff's submission that the effective date should be January 1, 2017. FNEI maintains that the appropriate effective date is January 1, 2016, for the reasons set out in Section 1.3 above.

The effect of applying the actual 2016 rate base, as proposed by Board Staff,[28] would be to increase the rate base from the $35.78 million proposed by FNEI[29] to $35.87 million – an increase of $0.09 million. FNEI agrees that the actual 2016 rate base of $35.87 million is the more appropriate figure to use for FNEI's 2016 test year.

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[26] Board Staff Submission at 13.

[27] Board Staff Submission at 13.

[28] Board Staff Submission at 13.

[29] Application at Exhibit 3, Tab 1, Schedule 1.

(iii) Timmins Head Office

Board Staff submits that $2.08 million related to the construction of the Timmins head office should be removed from FNEI's rate base[30] – a reduction of approximately 43% of the total cost of $4.86 million.

FNEI submits that the approach to assessing the costs incurred in constructing the Timmins head office should be grounded in the principles of ratemaking, which were recently addressed by the Supreme Court of Canada in *Ontario Energy Board v Ontario Power Generation*.[31] In this decision, the Supreme Court of Canada noted that "it is not necessarily unreasonable … for the Board to evaluate committed costs using a method other than a no-hindsight prudence review",[32] however, the Court proceeded to note:

> As will be explained, particularly with regard to committed capital costs, prudence review will often provide a reasonable means of striking the balance of fairness between consumers and utilities.
>
> …
>
> Capital costs, particularly those pertaining to areas such as capacity expansion or upgrades to existing facilities, often entail some amount of risk, and may not always be strictly necessary to the short-term ongoing production of the utility. Nevertheless, such costs may often be a wise investment in the utility's future health and viability. As such, prudence review, including a no-hindsight approach (with or without a presumption of prudence, depending on the applicable statutory context), may play a particularly important role in ensuring that utilities are not discouraged from making the optimal level of investment in the development of their facilities.[33]

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[30] Board Staff Submission at 14.

[31] 2015 SCC 44 ["*OEB v OPG*"].

[32] *Ibid* at para 104.

[33] *Ibid* at paras 104 and 107.

FNEI submits that a conventional, no-hindsight prudence review is the most appropriate method for assessing the costs related to the Timmins head office, as these were committed capital costs. The prudent investment framework was articulated by the OEB in its Decision in RP-2001-0032 in the following terms:

> - Decisions made by the utility's management should generally be presumed to be prudent unless challenged on reasonable grounds.
> - To be prudent, a decision must have been reasonable under the circumstances that were known or ought to have been known to the utility at the time the decision was made.
> - Hindsight should not be used in determining prudence, although consideration of the outcome of the decision may legitimately be used to overcome the presumption of prudence.
> - Prudence must be determined in a retrospective factual inquiry, in that the evidence must be concerned with the time that the decision was made and must be based on facts about the elements that could or did enter into the decision at the time.

In *Enbridge Gas Distribution Inc v Ontario*, the Ontario Court of Appeal cited the OEB's articulation and noted that the "OEB accurately described the 'prudence' inquiry".[34] In *OEB v OPG*, the Supreme Court of Canada also cited the OEB's articulation and noted the endorsement of the Ontario Court of Appeal.[35]

For the purposes of this proceeding, FNEI does not submit that there is a presumption of prudence operating in FNEI's favour, as the Supreme Court of Canada has held that such a presumption is inconsistent with the scheme of the *Ontario Energy Board Act, 1998*.[36] However, FNEI does submit that the other elements of the prudent investment framework articulated by the OEB are

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[34] (2006), 41 Admin LR (4th) 69 at para 14.

[35] *Supra* note 31 para 99.

[36] *Ibid* at para 79.

applicable for determining whether the FNEI's investment in the Timmins head office was prudently made.

FNEI submits that the approach employed by Board Staff for the purposes of challenging the costs of the Timmins head office failed to adhere to fundamental ratemaking principles. Specifically:

a) Board Staff errs in considering the potential purchase of the building referenced in the minutes of a March 2011 FNEI Finance Committee meeting.[37] This building was sold to a third party before FNEI could finalize its decision to purchase, and Board Staff's comparison is an inappropriate application of hindsight;

b) Board Staff errs in considering the increased construction costs that FNEI faced during construction.[38] This future escalation of costs were beyond the control of, and could not have been known by, FNEI at the time that the decision was made to construct the Timmins head office;

c) Board Staff errs in its selection of comparators, as four of the six comparator buildings were constructed at the same time or later than FNEI's construction of the Timmins head office.[39] The application of these comparators represents both an application of hindsight and consideration of information that FNEI could not be aware of at the time that it made the decision to proceed with construction;

[37] Board Staff Submission at 15.

[38] Board Staff Submission at 15.

[39] Board Staff Submission at 16.

d) the comparator facilities cited by Board Staff are simply not comparable, due to the significant differences in size, number of employees, and geographic location. These differences were canvassed in FNEI's Argument in Chief;[40]

e) the submission of Board Staff that FNEI should only recover $370 per square foot[41] is arbitrary and does not provide a rational basis for excluding other portions of the costs from the rate base. To the extent that Board Staff seeks to justify this figure on the basis that it is equal to the amount that was self-financed by FNEI,[42] this is completely irrelevant to determining whether FNEI prudently incurred the costs of constructing the Timmins head office;

f) the submission of Board Staff that "minimal harm will result to FNEI will arise from a finding to remove $2.08 million from the rate base…"[43] is completely irrelevant to determining whether the FNEI prudently incurred the costs of constructing the Timmins head office; and

g) Board Staff notes that "FNEI earned significant net income, over the 2010-2016 period, beyond what the OEB's Decision and Order in EB-2009-0387 contemplated".[44] The implication is that FNEI "over-earned" in one area, so these funds will now be "clawed-back" in another. This is the antithesis of principled, sound ratemaking and is completely

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40 Argument in Chief at 12-13.

41 Board Staff Submission at 16.

42 Board Staff Submission at 16.

43 Board Staff Submission at 17.

44 Board Staff Submission at 17.

irrelevant to determining whether FNEI prudently incurred the costs of constructing the Timmins head office. Furthermore, to the extent that Board Staff is of the view that FNEI earned significant net income beyond that which was contemplated, it should be considered that FNEI's revenue requirement is artificially low due to an understated rate base, which is addressed in Section 6.3(iii)(c) below.

FNEI submits that the relevant question to be applied from the prudent investment framework articulated by the OEB is:

> Was FNEI's decision to build the Timmins head office reasonable under the circumstances that were known or ought to have been known to FNEI at the time the decision was made, taking into consideration facts about the elements that could or did enter into the decision at the time?

FNEI submits that its decision to construct the Timmins head office satisfies these requirements. FNEI considered options to lease another facility or purchase an existing building, but these efforts yielded no viable options. Board Staff accepts that there was a need for a new office building and the only real option was to construct.[45] Faced with this situation, FNEI obtained an "opinion of reasonable cost" from an engineer, which estimated the cost of construction at $2.4 million.[46] FNEI

[45] Board Staff Submission at 14.

[46] FNEI Response to Board Staff interrogatory 2-Staff-16(x).

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proceeded to initiate a competitive tender process and received bids in the range of $3.4 to $5.5 million.[47] FNEI considered it reasonable to proceed with construction at that time, as:

a) a new office was required;

b) leasing another facility or purchasing an existing building was not an option;

c) the low bid of $3.4 million was considered reasonable, in relation to the $2.4 million estimate in the "opinion of reasonable cost", due to an increase in mining activity in the region, which had significantly increased construction costs;[48] and

d) FNEI could not defer the project in the hopes that construction prices would fall several years into the future, given the urgent need for adequate office space.

On the basis of the foregoing factors, FNEI made the decision to proceed with construction and selected the low bidder to complete the work. FNEI submits that this decision was reasonable under the circumstances and that the committed capital costs of constructing the Timmins head office should be properly included in FNEI's rate base.

(iv) Acquisition of 80 Kilometres of Transmission Line

Board Staff submits that the acquisition of the 80 kilometres of transmission line from HONI was prudent and should be included in FNEI's rate base.[49]

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[47] FNEI Response to Board Staff interrogatory 2-Staff-16(x).

[48] FNEI Response to Board Staff interrogatory 2-Staff-16(x).

[49] Board Staff Submission at 18.

(v) Other Capital Projects

Board Staff submits that FNEI prudently incurred the costs associated with the (i) bus isolation project, (ii) Attawapiskat and Kashechewan feeder projects, (iii) acquisition of the brush clearing equipment, (iv) construction of the Fort Albany garage, (v) relay replacement project, and (vi) emergency communication system project.[50]

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

Board Staff accepts that FNEI's proposed working capital allowance is appropriate and should be approved.[51]

3.0 PERFORMANCE SCORECARD

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

Board Staff submits that the sample scorecard filed by FNEI[52] is the appropriate scorecard for FNEI at this time.[53] Board staff also agrees with FNEI's exclusion of certain metrics of the HONI proposed scorecard for the reasons FNEI provided in response to Undertaking J1.7.[54]

Board Staff has proposed certain modifications to the language in the FNEI proposed scorecard relating to profit and ROE terminology. The applicability of these changes will depend on the approach that the OEB decides to apply with respect to FNEI earning revenues in excess of its

[50] Board Staff Submission at 19.
[51] Board Staff Submission at 20.
[52] FNEI Response to Board Staff interrogatory 4-Staff-20(c).
[53] Board Staff Submission at 20.
[54] Board Staff Submission at 20.

costs. Once that determination has been made, the language of the proposed scorecard should be modified accordingly.

4.0 OPERATING AND OTHER REVENUES

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

Board Staff agrees that the linear trend methodology results in a charge determinant forecast that is overstated.[55] Board Staff submits that the period for determining the historical peak average should be 2014-2016, based on Board Staff's submission that the effective date should be January 1, 2017. FNEI maintains that the appropriate effective date is January 1, 2016, for the reasons set out in Section 1.3 above.

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

Board Staff submits that FNEI's actual 2016 other revenue amount should be used as the other revenue amount for 2017.[56] FNEI agrees with the quantum, but maintains that the appropriate effective date is January 1, 2016, for the reasons set out in Section 1.3 above.

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[55] Board Staff Submission at 21.

[56] Board Staff Submission at 22.

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

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

Board Staff submits that the OM&A budget should be set $3.79 million, as opposed to the $4.34 million proposed by FNEI.[57]

Board Staff organized its submission into five categories: (i) 2016 actual OM&A expenditures, (ii) staffing levels and compensation, (iii) conservation expenses, (iv) regulatory expenses, and (v) poles, towers and fixtures maintenance. FNEI has organized this Reply to correspond with these categories.

(i) 2016 Actual OM&A Expenditures

Board Staff submits that the OM&A expenses should be based on 2016 actual OM&A expenses.[58] This approach is deceptive in its simplicity, but it errs in assuming that the actual 2016 OM&A spending was adequate, when in fact it was not.

It is important to note that 2016 was a year in which FNEI was operating under a significant revenue deficiency of $1.51 million,[59] which necessitated that operations be reduced below a sustainable level to avoid incurring a deficit. FNEI completed 2016 with an ROE of only 0.87%,[60] which illustrates the razor thin margin that it was operating under during this period. As such, the

[57] Board Staff Submission at 22.

[58] Board Staff Submission at 23.

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

[60] FNEI Response to Board Staff interrogatory 1-Staff-8(a).

actual expenses incurred in 2016 do not represent an accurate baseline for establishing the OM&A costs in this proceeding.

Ultimately, the proper OM&A budget is that which is required by a prudent electricity transmitter to operate and maintain its transmission system. It is an error in logic to assume that because an electricity transmitter survived a lean period, during which certain expenses were deferred, that such a level of spending is adequate or can be maintained. Such an error in logic also leads to excess, because it is more likely to prevent utilities from reducing expenses below sustainable levels for short periods of time, out of fear that such actions could be interpreted so as to deprive them of a reasonable and sustainable budget in the future. FNEI does not submit that its prudence should be rewarded, but rather that it simply should not be punished.

FNEI's control of 2016 OM&A costs can be seen when reviewing the variances for particular accounts, set out in FNEI's response to Undertaking J1.9. The accounts in which spending was significantly less than the original forecast were accounts that could be controlled by FNEI (e.g. salaries related to new hires and outside services), as opposed to other accounts in which the expenses are committed or essentially unavoidable (e.g. rents).

The proposed application of FNEI's actual 2016 OM&A costs attempts to improperly crystalize one-time anomalies resulting from FNEI temporarily reducing certain activities below a sustainable level to avoid a net loss for the year. The accounts with a positive variance (actual spending less than proposed) in excess of FNEI's materiality threshold[61] in 2016, as reported in FNEI's response to Undertaking J1.9, are addressed below.

a) Account 4820 – Transformer Station Equipment Operator Labour: The actual expense in 2016 was $0.33 million less than forecast and this significant reduction was related to FNEI deferring the hiring of required employees. Board Staff accepts that an additional $0.1 million should be provided for the hiring of an apprentice station electrician.[62] The balance of the variance is related to the proposed hiring of a substation electrician (addressed in Section 5.1(ii) below) and the capitalization of labour costs.[63]

b) Account 5606 – Executive Salaries and Expenses: The actual expense in 2016 was $0.16 million less than forecast and this reduction was related primarily to the activities of the board of directors being less than in prior years.[64]

c) Account 5630 – Outside Services Employed: The actual expense in 2016 was $0.08 million less than forecast and this reduction was related to FNEI's general approach of minimizing 2016 expenses to avoid incurring a deficit.

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[61] $50,000, as per the Application at Exhibit 1, Tab 4, Schedule 1.

[62] Board Staff Submission at 24.

[63] FNEI response to Undertaking J1.9.

[64] FNEI response to Undertaking J1.9.

(iii) Staffing Levels and Compensation

Board Staff accepts that (i) FNEI's 2016 staffing levels are reasonable, (ii) the increase in costs to bring expertise in-house is prudent, and (iii) that an apprentice station electrician should be hired.[65]

Board Staff also accepts that an argument could be made for the hiring of a substation electrician, but submits that these costs should not be approved because there is no evidence on the expected timeline for hiring.[66] FNEI submits that the necessity for this employee has been demonstrated and FNEI cannot wait until the next rebasing application to make this hire, accordingly, this related amount of approximately $0.15 million should be included in FNEI's revenue requirement.

Board Staff also submits that the one-time 10% salary increase should not be recoverable because no employees had resigned, which Board Staff relies on as evidence that the salary increase was not necessary for retention.[67] FNEI submits that this is not a proper basis for determining whether the salary increase was prudently incurred. From a practical perspective, FNEI cannot wait for one of its employees to resign before taking action, as the loss of one employee would represent the loss of a significant portion of FNEI's institutional knowledge, given the small size of FNEI. As FNEI cannot wait for such a harmful trend to develop, it is necessary to be proactive.

FNEI submits that it prudently made the decision to increase salaries to ensure that it retained the small number of employees that it has invested in significantly to date. This decision had to be made without the benefit of perfect information, given that the small quantum of the salary increase

[65] Board Staff Submission at 24.

[66] Board Staff Submission at 25.

[67] Board Staff Submission at 25.

did not justify a market study by a third party consultant, but FNEI made this decision based on a reasonable approach and its understanding of market conditions.

Energy Probe challenges the salary increase on the basis that the OEB has indicated that excessive wages are paid by OPG and Hydro One.[68] Such an argument underscores the competitive environment in which FNEI is attempting to retain staff and it supports, rather than weakens, the decision of FNEI to increase salaries. FNEI is not a significant market participant in the electricity sector and cannot dictate market rates. If FNEI cannot recover salaries sufficient to retain its staff, then it simply will be unable to do so. It would be unfortunate if the customers of FNEI must suffer from the loss of experienced and competent staff before FNEI can demonstrate the imperative for retention through competitive salaries.

(iv) Conservation Expenses

Board Staff submits that the conservation budget should be eliminated.[69] FNEI believes that the conservation budget provides a small but useful reserve for the purpose of facilitating conservation. Board Staff is correct that there is no formal plan for the allocation of these funds,[70] but FNEI submits that the $0.03 million is intended simply to be a reserve to address the conservation expenses that typically arise during a given year and it is not possible to anticipate the specific form that these expenditures will take. If this budget is eliminated, then FNEI will

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[68] Energy Probe Submission at para 13.

[69] Board Staff Submission at 26.

[70] Board Staff Submission at 26.

cease these conservation efforts, but FNEI submits that the continuance of this budget and related efforts is a preferable course of action.

(v) Regulatory Expenses

Board Staff submits that the actual 2016 portion of the OM&A budget for regulatory expenses should be reduced by $0.05 million[71] to arrive at a final value of $0.33 million.

It should be noted that FNEI did not ask for more in its Application than what it requires. FNEI's Application included a total OM&A budget of $4.34 million, which included $0.32 million for regulatory expenses.[72] The proposed Board Staff adjustment relates solely to the use of 2016 actuals. FNEI does not believe that 2016 actuals are an appropriate basis for determining the OM&A budget for the reasons set out in Section 5.1(i) above.

Board Staff also submits that a budget of $0.33 million should be designated for regulatory expenses, as opposed to the $0.32 million sought by FNEI, on the basis that there is a shorter period of time over which to amortize the costs of a cost of service proceeding,[73] as Board Staff proposes an IRM term of 4 years.[74] FNEI submits that an IRM term of 5 years is more appropriate, for the reasons set out in Section 1.3 above.

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[71] Board Staff Submission at 27.

[72] Application at Exhibit 6, Tab 1, Schedule 1, Table 6-1-1-A, and Exhibit 6, Tab 2, Schedule 1, Table 6-2-1-B.

[73] Board Staff Submission at 27.

[74] Board Staff Submission at 8.

FNEI maintains that the proper OM&A budget for regulatory expenses is $0.32 million, as set out in its Application.[75]

(vi) Poles, Towers and Fixtures Maintenance

Board Staff submits that the actual 2016 portion of the OM&A budget for poles, towers, and fixtures maintenance should be reduced by $0.05 million[76] to arrive at a final value of $0.55 million.

It should be noted that FNEI did not ask for more in its Application than what it requires. FNEI's Application included a total OM&A budget of $4.34 million, which included $0.55 million for poles, towers, and fixtures maintenance.[77] The proposed Board Staff adjustment relates solely to the use of 2016 actuals. FNEI does not believe that 2016 actuals are an appropriate basis for determining the OM&A budget for the reasons set out in Section 5.1(i) above.

FNEI maintains that the proper OM&A budget for poles, towers, and fixtures maintenance is $0.55 million, as set out in its Application.[78]

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

Board Staff addressed this issue in Section 5.1 of its submission.[79] Accordingly, FNEI's response is also set out in Section 5.1 of this Reply.

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[75] Exhibit 6, Tab 2, Schedule 1, Table 6-2-1-B.

[76] Board Staff Submission at 28.

[77] Application at Exhibit 6, Tab 1, Schedule 1, Table 6-1-1-A, and Exhibit 6, Tab 2, Schedule 1, Table 6-2-1-B.

[78] Exhibit 6, Tab 2, Schedule 1, Table 6-2-1-B.

[79] Board Staff Submission at 28.

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

Board Staff submits that FNEI's depreciation expense should be based on the 2016 actual depreciation expense of $1.45 million.[80] FNEI agrees that the actual 2016 depreciation expense is the more appropriate figure to use for FNEI's 2016 test year.

Board Staff also submits that the 2016 actual depreciation expense should be reduced to $1.38 million to reflect the removal of $2.08 million from the rate base in relation to the Timmins head office. FNEI submits that this $2.08 million should be included in FNEI's rate base for the reasons set out in Section 2.3(ii) above.

Board Staff has no concerns with the depreciation rates used for the 80 kilometres of transmission line acquired from HONI or the Timmins head office.[81]

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

Board Staff submits that the OM&A budget should be based on the actual 2016 amounts incurred on account of annual fees (Account 4850 – Rents), which was $0.03 million greater than the proposed amount of $0.09 million.[82] Board Staff based its position on the assumption that these costs would continue on an ongoing basis, and asked that FNEI confirm.[83] Board Staff is correct in this assumption, as the $0.03 million relates to additional land use fees that are required or are

[80] Board Staff Submission at 29.

[81] Board Staff Submission at 29.

[82] Board Staff Submission at 30.

[83] Board Staff Submission at 30.

anticipated to be required by the Ministry of Natural Resources and Forestry, Kashechewan First Nation, Fort Albany First Nation, and Attawapiskat First Nation.

6.0 COSTS OF CAPITAL

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

Board Staff submits that FNEI's proposed deemed capital structure is appropriate for ratemaking purposes and should be approved.[84]

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

Board Staff submits that FNEI's long-term debt rate of 5.11% should be approved.[85]

Board Staff submits that FNEI's short-term debt rate should be set at 1.76% should be approved, as opposed to FNEI's proposed deemed rate of 1.65%.[86] This change relates to Board Staff's submission that the effective date should be January 1, 2017. FNEI maintains that the appropriate effective date is January 1, 2016, for the reasons set out in Section 1.3 above.

Board Staff also submits that FNEI should attempt to renegotiate its loans to reduce its weighted cost of debt, and FNEI should be required to submit evidence at its next rebasing to demonstrate these renegotiation efforts.[87] FNEI does not believe that these requirements are necessary or practical. FNEI has always sought to obtain the most favourable financing terms, specifically:

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[84] Board Staff Submission at 31.

[85] Board Staff Submission at 31.

[86] Board Staff Submission at 31-32.

[87] Board Staff Submission at 31.

a) in 2006, FNEI issued a request for proposals to provide $11 million in financing in anticipation of significant capital expenditures. Through this competitive process, FNEI selected a combined proposal from Manulife and Pacific & Western Bank, as it offered the best interest rate and longest amortization. The loan agreement does not provide for the renegotiation of interest rates and the loan will not reach maturity until January 31, 2028. Any early payout would require FNEI to pay significant breakage fees;[88]

b) in 2013, FNEI sought proposals from chartered banks and received interest rate offers that were almost identical. FNEI selected BMO because FNEI had an existing $0.5 million credit facility with BMO that the other bank was not willing to offer. The interest rate is fixed for the initial, which expires in November 2020;[89] and

c) in 2015, FNEI solicited offers from three chartered banks, Manulife, and Pacific & Western Bank, in order to finance the acquisition of the 80 kilometres of transmission line from HONI. FNEI selected Manulife because they offered a fixed term over a longer amortization period. This loan will not reach maturity until 2035.[90]

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

This proceeding has seen positive steps towards the equal treatment of FNEI vis-à-vis other electricity transmitters in Ontario. FNEI is genuinely appreciative that both Board Staff and Energy

88 Application at Exhibit 7, Tab 1, Schedule 1 and FNEI Response to Board Staff interrogatory 7-Staff-32.

89 Application at Exhibit 7, Tab 1, Schedule 1 and FNEI Response to Board Staff interrogatory 7-Staff-32.

90 Application at Exhibit 7, Tab 1, Schedule 1 and FNEI Response to Board Staff interrogatory 7-Staff-32.

Probe have recognized that FNEI should be entitled to earn revenues in excess of its costs,[91] without the imposition of a reserve fund framework,[92] and free from fetters on the ability of FNEI to disburse this excess revenue in accordance with its corporate objectives.[93]

For the purposes of this Reply, FNEI has assumed that the OEB will accept the arguments of Board Staff, Energy Probe, and FNEI, which propose that FNEI be entitled to earn revenues in excess of its costs. To the extent that the OEB has any concerns regarding this issue, FNEI has set out its full reasoning in the Argument in Chief,[94] interrogatory responses,[95] and Application,[96] and it would be unduly repetitive to reproduce them here.

Notwithstanding the positive steps in this proceeding, and the assumption that the recommendations of Board Staff, Energy Probe, and FNEI will be accepted, there remains a lack of consensus regarding the quantum of the revenues in excess of costs that FNEI should be entitled to earn. FNEI submits that it should be entitled to an ROE equivalent to that earned by a for-profit electricity transmitter (a "**Full ROE**"), while Board Staff and Energy Probe take the position that FNEI should only be entitled to an ROE that is less than that earned by for-profit utilities (a "**Partial ROE**").[97]

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[91] Board Staff Submission at 36 and Energy Probe Submission at paras 7 and 30.

[92] Board Staff Submission at 39 and Energy Probe Submission at paras 6, 29 and 31.

[93] Board Staff Submission at 36 and Energy Probe Submission at para 36.

[94] Argument in Chief at Section 6.3.

[95] FNEI Response to Board Staff interrogatory 7-Staff-33.

[96] Application at Exhibit 7, Tab 2, Schedule 1.

[97] Board Staff Submission at 35 and Energy Probe Submission at para 33.

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Before considering the framework pursuant to which it should be determined whether FNEI is entitled to a Full ROE or a Partial ROE, it is necessary to consider how any such framework should be applied to a not-for-profit corporation, which is addressed in the following Section.

(i) Establishing the Conceptual Framework

FNEI is a not-for-profit corporation living in a for-profit world. In this regard, and in this regard alone, FNEI differs from the other electricity transmitters in Ontario. The challenge of FNEI's unique corporate status is that certain regulatory concepts, designed with the for-profit entity in mind, are a poor fit when overlaid on a not-for-profit corporation. Nevertheless, FNEI submits that such concepts are conceptually sound and equally applicable to the circumstances of FNEI, but certain conceptual adaptations are necessary to suit a not-for-profit corporation.

The language and concepts of the for-profit paradigm has given rise to a significant level of consternation, not only during this proceeding, but throughout all of FNEI's proceedings. These linguistic and conceptual hurdles need to be addressed to aid in the clarity of reasoning, and FNEI submits that the meaning of the following terms and concepts should be carefully considered in the context of a not-for-profit.

"Profit". The plain meaning of this word gives rise to cognitive dissonance, as many struggle with the concept of a not-for-profit earning a profit. FNEI submits that a more appropriate term is simply "revenue in excess of costs", which better aligns with the OEB's articulation that "an allowed ROE is a cost and is not the same concept as a profit, which is an accounting term for what is left from earnings after all expenses have been provided for".[98]

"Not-for-Profit". This term causes discomfort because of the impression that a not-for-profit entity should not generate a "profit" or "revenues in excess of costs". However, this impression is incorrect, as any not-for-profit that intends to apply its funds in accordance with its objectives must earn revenues in excess of its costs, or such objectives could never be achieved. An apt example is a charity, which must receive funds in excess of its costs for its charitable purposes – in fact, a measure of a charity's success is the ratio by which received funds are allocated, as donors want the largest proportion possible to be expended for the charitable purposes, as opposed to operating costs.

"Return on Equity" or **"ROE".** A proxy for this term has been sought for more than a decade. In EB-2001-0386, the proxy was "internally generated funds",[99] and in the current proceeding Board Staff has proposed "financial viability revenue rider". FNEI is not specifically concerned with the terminology that is chosen, but submits that ROE remains the most appropriate term, as the basis for measuring the revenues in excess of costs is the equity component of an electricity transmitter's rate base, and accordingly such revenues are a "return on equity".

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[98] *Report on of the Board on the Cost of Capital for Ontario's Regulated Utilities,* (December 11, 2009) at 20 (the "Cost of Capital Report")

[99] EB-2001-0386 at Section 3.3.13.

"Shareholder". FNEI does not have shareholders, but it does have members. Its members are the local distribution companies in Attawapiskat, Kashechewan, and Fort Albany, each of which is completely owned and solely controlled by the respective First Nations Band of each of those communities (the "**Bands**"). Furthermore, the Bands are akin to shareholders, as they have invested significantly in the equity of FNEI in exchange for their controlling interests. The Bands received money for the diesel generation of electricity and chose to instead invest this money in a transmission system to provide their communities with a more reliable source of power. As with all investments, this venture was not without risk. Similarly, as with all investments, the expectation was that there would be a return commensurate with this risk. This return takes a form different than a traditional dividend, which is addressed below.

"Dividend". A dividend in the context of a for-profit corporation is a return to a shareholder in the form of cash, securities, or property, distributed from the operating surplus. In the context of a not-for-profit, the concept of a dividend remains, but it would be a distribution from operating surplus in accordance with the corporation's objectives. In the context of FNEI, the Bands (as shareholders) expect their "dividend" in the form of distributions for the benefit of the communities.

(ii) The Fair Return Standard

Board Staff submits that the Fair Return Standard, as articulated in the Cost of Capital Report, is the appropriate framework for determining FNEI's entitlement to earn revenues in excess of its costs.[100] Board Staff notes that the three main components of the Fair Return Standard are the (i) Comparable Investment Standard, (ii) Financial Integrity Standard, (iii) Capital Attraction Standard.[101]

FNEI agrees with Board Staff that the Fair Return Standard is the appropriate framework by which FNEI's entitlement to an ROE should be determined. However, Board Staff and FNEI differ in the results, as Board Staff takes the position that FNEI is entitled to a Partial ROE, whereas FNEI submits that the Fair Return Standard confirms that FNEI should be entitled to a Full ROE.

Each of the main components of the Fair Return Standard are addressed in the following Sections.

(a) Comparable Investment Standard

Board staff submits that the Comparable Investment Standard is not applicable because "FNEI does not have a shareholder that is seeking a return on its investment and comparing a potential investment in [FNEI] with a similarly risked enterprise".[102] FNEI submits that Board Staff has inappropriately applied a for-profit concept without considering how it should be applied to a not-for-profit corporation.

Applying the principles set out in Section 6.3(i) above, a dividend (or return on investment) in the context of FNEI is a distribution for its corporate purposes, which Board Staff and Energy Probe

[100] Board Staff Submission at 33.
[101] Board Staff Submission at 34.
[102] Board Staff Submission at 35.

agree that FNEI should be free to make.[103] Further, the Bands are equivalent to shareholders of a for-profit corporation, as they invested equity into FNEI and have complete control of it.

In the not-for-profit context, the Comparable Investment Standard considers whether FNEI provides the Bands with a return, in the form of community benefit, comparable to what the Bands could achieve if they invested in other enterprises of similar risk. There are two appropriate comparators to serve as "enterprises of similar risk": (i) other electricity transmitters in Ontario, and (ii) FNEI itself. Both are explored below:

Other Electricity Transmitters in Ontario. If the Bands were to invest in a different electricity transmitter in Ontario, then they would receive a return in the form of a dividend that would be equivalent to a Full ROE. The Bands could then use that Full ROE for the benefit of the communities or for any other purpose. In such a scenario, why would the Bands invest in FNEI for a Partial ROE? If anything, the Comparable Investment Standard would require that the FNEI ROE be higher than a Full ROE, as the Bands are fettered with respect to the use of their return from FNEI, which makes investment in a for-profit transmitter more attractive if the ROEs are equivalent.

FNEI. The most direct comparator is FNEI itself, but organized as a for-profit corporation, as the risks are identical. Given that FNEI would earn a Full ROE if organized as a for-profit corporation, then the Comparable Investment Standard would require the same ROE for FNEI as a not-for-profit corporation. FNEI acknowledges that it is not practical to

[103] Board Staff Submission at 36 and Energy Probe Submission at para 36.

reorganize as a for-profit corporation at the current time, but that is irrelevant for the purposes of the Comparable Investment Standard. Nor is this scenario theoretical, as a third-party acquiring FNEI would have no concerns about immediately reorganizing as a for-profit corporation, which means that the sale price of FNEI would be based on the Full ROE that a for-profit electricity transmitter is entitled to. Therefore, the Bands could sell FNEI and then reinvest these proceeds in another electricity transmitter in Ontario. Under this scenario, the Comparable Investment Standard also requires that the ROE received by FNEI as a not-for-profit be equivalent to the Full ROE received by a for-profit electricity transmitter.

(b) Financial Integrity

Board Staff accepts that the Financial Integrity Standard applies to FNEI.[104] FNEI agrees and submits that the necessity of this component of the Fair Return Standard does not require elaboration, as the requirement for financial integrity is self-evident.

One aspect of the Board Staff Submission that does require elaboration is with respect to the perspective of lenders. Board Staff states that FNEI must earn sufficient revenue to protect “its creditworthiness and its ability to attract debt capital on reasonable terms”.[105] FNEI agrees, but to attract debt on reasonable terms FNEI must be in a comparable position to a for-profit electricity transmitter. From the perspective of a lender, if FNEI is earning a Partial ROE, while a for-profit electricity transmitter is earning a Full ROE, then FNEI is more of a credit risk. It is not sufficient

[104] Board Staff Submission at 35.

[105] Board Staff Submission at 35-36.

to say that a lender would be satisfied with a Partial ROE because it would be sufficient to service the debt, as the OEB has noted that an ROE is not profit,[106] rather, the Full ROE provides more "buffer" than the Partial ROE to ensure that the debt can be serviced.

Further, Board Staff submits that FNEI should "attempt to renegotiate its loans to bring the interest rates in line with market rates before its next rebasing",[107] however, Board Staff also proposes a Partial ROE which will make FNEI less attractive than other electricity transmitters. These two positions cannot be reconciled and FNEI submits that the lender perspective supports a Full ROE.

(c) Capital Attraction

Board staff submits that the Capital Attraction Standard is not applicable because "FNEI cannot attract equity capital to the utility as it has no ability to satisfy an investor's need" for a dividend.[108] FNEI submits that Board Staff has inappropriately applied a for-profit concept without considering how it should be applied to a not-for-profit corporation.

Applying the principles set out in Section 6.3(i) above, a dividend in the context of FNEI is a distribution for its corporate purposes, which Board Staff and Energy Probe agree that FNEI should be free to make.[109] Further, the Bands are investors in FNEI and it is their expectation that these distributions (dividends) will be made, which demonstrates that FNEI can satisfy the needs of an investor.

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[106] Cost of Capital Report at 20.

[107] Board Staff Submission at 31.

[108] Board Staff Submission at 35.

[109] Board Staff Submission at 36 and Energy Probe Submission at para 36.

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The history of FNEI also demonstrates that it in fact has attracted equity capital – the Bands were not required to invest the initial $34.28 million in FNEI, as these funds were for the purpose of continuing to generate power through diesel generation (this initial capital is discussed further in Section 6.3(iii)(c) below). The Bands chose to invest this money for the purposes of benefitting the communities, through not only the provision of reliable electricity, but also by using the revenues in excess of costs to better the social and economic welfare of the communities. To now take the position that FNEI cannot attract capital flies in the face of the fact that FNEI has attracted significant capital and the Bands are apt to invest in the future, provided that there is an appropriate return on this investment in the form of benefit to the communities.

(iii) Other Relevant Considerations

FNEI submits that the foregoing is sufficient to establish FNEI's entitlement to a Full ROE under the Fair Return Standard. However, there remain other relevant considerations that also support FNEI's entitlement to a Full ROE.

(a) Equivalent Service Merits Equivalent Treatment

The possibility of two electricity transmitters providing the same service and receiving different ROEs is incongruent. Although such unequal treatment may be justified if the Fair Return Standard supports such a result, Section 6.3(ii) above demonstrates that this is not the case.

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One is then left in search of another basis to support a distinction. It cannot be that FNEI has members instead of shareholders, as the OEB has noted that it "sees no compelling reason to adopt different methods of determining the cost of capital based on ownership".[110]

Energy Probe submits that FNEI is asking for equal treatment (in the form of receiving an ROE) while also asking to be treated differently by seeking to remain a not-for-profit corporation.[111] FNEI disagrees with Energy Probe's characterization, as it incorrectly assumes that the right to remain a not-for-profit constitutes special treatment. FNEI's complete position is that <u>it should be entitled to earn an ROE as a not-for-profit corporation</u>. The complications and risks of migrating to for-profit status were presented in this proceeding to demonstrate the importance of the ROE issue to FNEI. However, FNEI is not asking for differential treatment in this regard, but merely illustrating the untenable position that FNEI would be placed in if its entitlement to an ROE as a not-for-profit corporation is denied. Put another way, FNEI cannot simply "work around" the denial of an ROE by reorganizing itself, which means that it is imperative that FNEI clearly articulate the legal basis for its position and the dire consequences of an unfavourable decision. FNEI believes that is has clearly communicated this message, but in no way is it asking for special treatment. FNEI only seeks equal treatment in all respects.

(b) Problems with the Calculation of the FVRR

Board Staff has invested significant effort into developing the FVRR framework to provide FNEI with revenues in excess of its costs. Notwithstanding that FNEI is appreciative of these efforts,

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[110] Cost of Capital Report at 25-26.

[111] Energy Probe Submission at paras 34-35.

FNEI does not agree with the approach. Put simply, the FVRR is based on the revenue requirement as opposed to equity, which runs afoul of the Fair Return Standard requirement that "[t]he overall ROE must be determined solely on the basis of a company's cost of equity capital".[112] Board Staff's approach appears to be a rough guide to arrive at an arbitrary number that Board Staff considers reasonable, but it is not grounded in the principles of the Fair Return Standard. FNEI submits that this arbitrary determination should yield to the application of the Fair Return Standard, as set out in Section 6.3(ii) above.

(c) The Measuring Stick of an Understated Rate Base

Even a Full ROE represents a reduced return to FNEI, simply because the FNEI rate base is significantly understated. Specifically, FNEI's rate base of $35.78 million does not include $34.28 million that was flowed directly from the government to FNEI and recorded as a contribution in aid of construction. Had these funds been distributed to the Bands or the local distribution company members, and *then* to FNEI, this amount would have been included in FNEI's rate base.[113] The current net book value of this capital contribution is approximately $18.39 million, which means that FNEI has an effective rate base of $54.17 million.

FNEI has not and is not taking the position that this initial capital contribution should be included in the rate base for the purpose of determining the revenue requirement. However, FNEI submits that this "invisible" portion of the rate base is a relevant consideration when determining whether FNEI should be entitled to a Partial ROE or a Full ROE. If the initial capital had been included in

[112] Cost of Capital Report at 31.

[113] FNEI Response to Undertaking J1.7.

the rate base, then the ROE for this Application would have been approximately $1.98 million, as opposed to $1.32 million – a difference of approximately $0.68 million.[114] Furthermore, this differential has existed since the time of the capital contributions, with the cumulative result of FNEI having earned approximately $14.7 million less in the form of an ROE to date.[115] These results will also continue into the future until such time that the original capital contribution has been fully amortized.

From the perspective of FNEI, its financial structure provides significant value to the ratepayers, not only because of the understatement of the rate base, but also because FNEI's non-profit status means that it is tax exempt, which eliminates further expenses that would normally be included in the revenue requirement. Furthermore, although the rate base may be reduced for the purposes of a revenue requirement determination, this component of the rate base is represented by physical assets that FNEI operates and maintains, so the number is very real at an operational level. If FNEI were to be granted a Partial ROE of 4.55% of its equity, as proposed by Board Staff,[116] this would in fact represent an <u>effective ROE of only 2.81%</u> when one considers the understatement of the FNEI rate base.[117] This is approximately <u>70% less than a for-profit electricity transmitter is entitled to earn</u>.

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[114] Incremental ROE = NBV of Capital Contribution x 0.4 Equity x 0.0919 ROE
Incremental ROE = $18.4 million x 40% x 0.0919 = $0.68 million

[115] This figure was determined by applying the formula set out in footnote 114 to each of the years since the investment of this capital contribution.

[116] Board Staff Submission at 37.

[117] Effective ROE = Board Proposed Earnings / (Effective Rate Base x 0.4 Equity)
Effective ROE = $0.61 million / ($54.17 million x 0.4)
Effective ROE = $0.61 million / $21.67 million = 0.0281

FNEI submits that the understatement of FNEI's rate base is a relevant consideration for demonstrating the services that FNEI provides, the value to ratepayers of FNEI's financial structure, and the impact of a Partial ROE. FNEI submits that a Partial ROE is not appropriate and that a Full ROE still represents significant value to ratepayers compared to the costs associated with other electricity transmitters in Ontario.

(iv) Bringing It All Together

FNEI submits that its operation as a not-for-profit corporation is analogous to a for-profit electricity transmitter for the purposes of applying the Fair Return Standard. Specifically, FNEI (i) is a comparable investment to other electricity transmitters in Ontario, (ii) has the same need for financial integrity as other electricity transmitters in Ontario, and (iii) has a demonstrated and ongoing ability to attract capital.

FNEI seeks only to be treated in a manner that is equivalent to other transmitters and submits that the such treatment is achieved through the entitlement to a Full ROE, which is supported by logic when one considers that FNEI provides the same services as other transmitters and the only reason that an argument exists regarding the quantum of the ROE is because of a corporate status that could be changed with the stroke of a pen. FNEI does wish to retain its not-for-profit status, but this does not constitute special treatment, rather, it is grounded in FNEI's view that corporate status should be irrelevant to the ROE determination and a not-for-profit corporation should not be effectively forced to abandon its corporate status due to unequal treatment.

6.5 Is FNEI's proposed ROE appropriate?

Board Staff addressed this issue in Section 6.3 of its submission.[118] Accordingly, FNEI's response is also set out in Section 6.3 of this Reply.

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

Board Staff submits that, with the exception of the Insurance Reserve Fund, there should be no reserve fund component to FNEI's cost structure.[119] With respect to the Insurance Reserve Fund, Board Staff submits that this reserve fund should remain in place. FNEI will continue to maintain the Insurance Reserve Fund, as it is a requirement of FNEI's lenders (as noted by Board Staff).[120] However, FNEI submits that the lender requirement of an Insurance Reserve Fund should not be enshrined in an OEB order, as FNEI should not be required to maintain this reserve if the lenders cease to require it (if, for example, adequate and reasonably-priced insurance becomes available in the market place).

Energy Probe suggests that FNEI should be required to maintain a capital reserve fund of at least one year's capital spending to handle an event of force majeure.[121] FNEI submits that such a capital reserve fund is unnecessary, as the risk of such an event is adequately addressed by FNEI's Insurance Reserve Fund.

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[118] Board Staff Submission at 38.

[119] Board Staff Submission at 38.

[120] Board Staff Submission at 38.

[121] Energy Probe Submission at para 36.

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

Board Staff submits that its proposed FVRR not include any restrictions on the use of the funds.[122] Although the positions of Board Staff and FNEI differ regarding the quantum of revenues in excess of costs, as addressed in Section 6.3 above, FNEI submits that the logic applied by Board Staff in reaching its position, *viz.* for-profit utilities are not restricted with respect to their charitable donations from net income, is equally applicable regardless of the terminology applied to revenues earned in excess of costs.

Board Staff submits that FNEI should be subject to the same oversight and conditions as a for-profit utility.[123] FNEI has no objections to such oversight, as it corresponds with FNEI's request for similar treatment and this should apply to both the benefits and the burdens.

7.0 DEFERRAL/VARIANCE ACCOUNTS

7.1 Are the proposed new deferral and variance accounts appropriate?

Board Staff submits that the approval of a Forgone Revenue Deferral Account is appropriate, but would modify it to correspond with Board Staff's submission that the effective date should be January 1, 2017.[124] FNEI maintains that the appropriate effective date is January 1, 2016, for the reasons set out in Section 1.3 above.

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[122] Board Staff Submission at 39.

[123] Board Staff Submission at 40.

[124] Board Staff Submission at 41.

Board Staff submits that the approval of a Z-factor accounting order is not necessary.[125] Accordingly, FNEI submits that the draft accounting order filed in response to Undertaking J2.3 should not be implemented.

8.0 COST ALLOCATION

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

Board Staff submits that FNEI's use of the same allocation factors as HONI is appropriate.[126] FNEI also agrees with Board Staff's submission that the cost allocation factors should be updated to reflect those approved in HONI's 2017 transmission cost of service application, provided that HONI's application is approved prior to the filing of FNEI's draft rate order.[127]

9.0 INCENTIVE RATEMAKING

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

Board Staff organized its submission into six categories: (i) allowable revenue requirement adjustments, (ii) Z-Factor claims, (iii) off-ramp, (iv) incremental capital module, (v) 2017 IRM adjustment, and (vi) future year IRM adjustments. FNEI has organized this Reply to correspond with these categories.

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[125] Board Staff Submission at 42.

[126] Board Staff Submission at 42.

[127] Board Staff Submission at 42.

(i) Allowable Revenue Requirement Adjustments

Board Staff submits that FNEI's proposed allowable revenue requirement adjustments are appropriate[128] and agrees that:

a) the annual revenue requirement each year should be adjusted based on the formula: RRA = I – (X + S); where "RRA" is the Revenue Requirement Adjustment, "I" is the Inflation Factor, "X" is the Productivity Factor, and "S" is the stretch factor;[129]

b) the Inflation Factor should be based on the inflation factor calculated and released by the OEB each year for Price Cap IR and Annual Index plans;[130] and

c) the Productivity Factor should be the same as that used by the OEB for electricity distributor rate adjustments.[131]

Board Staff submits that the Stretch Factor should be 0.6%, as opposed to the 0.3% proposed by FNEI.[132] Board Staff takes the position that a Stretch Factor of 0.6% (which is the most inefficient end of the 0.0%-0.6% range) is appropriate because there is no empirical evidence.[133] FNEI submits that the lack of evidence does not support this extreme position, but rather reinforces that the mid-point of 0.3% proposed by FNEI is the most reasonable position.

[128] Board Staff Submission at 43.
[129] Board Staff Submission at 43.
[130] Board Staff Submission at 43.
[131] Board Staff Submission at 43.
[132] Board Staff Submission at 44.
[133] Board Staff Submission at 44.

(ii) Z-Factor Claims

Board Staff submits that FNEI's Z-factor framework is appropriate and only proposed minor language changes. FNEI agrees with the proposed language changes.

Board Staff also submits that the materiality threshold for a FNEI Z-factor claim should be $0.1 million on a revenue requirement basis.[134] FNEI agrees with this submission.

Board Staff also submits that the process proposed by FNEI for advancing a Z-factor claim is appropriate.[135]

Board Staff also submits that if a Z-factor event is covered by FNEI's Insurance Reserve Fund, then any amounts allowed to FNEI on account of its Z-factor claim should first be used to refund the Insurance Reserve Fund in an amount equal to the funds extracted to address the Z-factor event.[136] FNEI agrees with this submission.

(iii) Off-Ramp

Board Staff submits that there should be a mechanism for regulatory review (an "off-ramp"), but that there should be no "deadband" and the triggering of the off-ramp should be entirely at the OEB's discretion.[137] The position of Board Staff is based on the novelty of the proposed FVRR.[138]

[134] Board Staff Submission at 45.
[135] Board Staff Submission at 45.
[136] Board Staff Submission at 45.
[137] Board Staff Submission at 46.
[138] Board Staff Submission at 46.

FNEI does not believe that the FVRR is the appropriate means of determining the revenues FNEI is entitled to earn in excess of costs, for the reasons set out in Section 6.3(iii)(b) above. Furthermore, regardless of whether the revenues in excess of costs take the form of a FVRR or ROE, there is nothing inherently novel or risky in such an approach as compared to the ROE of a for-profit electricity transmitter. Finally, the very purpose of the deadband is to provide a trigger only if the ROE exceeds the specified envelope – to the extent that the ROE remains within the deadband range, there would be no cause for concern and no necessity to incur the burden and expense of a regulatory review. Based on the foregoing, FNEI maintains that a regulatory review should only be triggered if the ROE falls outside an annual ROE deadband of plus or minus 300 basis points, based on FNEI's annual audited financial statements.

(iv) Incremental Capital Module

Board Staff submits that if FNEI intends to seek ICM treatment of a capital project, then it can do so in accordance with the Transmission System Code.[139] FNEI will follow this process for applying for an ICM, if one should be required.

(v) 2017 IRM Adjustment

Board Staff submits that the test year should be 2017,[140] which corresponds with Board Staff's proposed effective date of January 1, 2017. FNEI maintains that the appropriate effective date is January 1, 2016, for the reasons set out in Section 1.3 above.

[139] Board Staff Submission at 46.

[140] Board Staff Submission at 46.

(vi) Future Year IRM Adjustments

Board Staff submits that FNEI should not be required to file annual IRM applications during the IRM term unless FNEI is seeking an ICM. Board Staff instead proposes that FNEI simply file a letter, no later than November 30th of each year, which includes a calculation of the revenue requirement.[141] FNEI agrees with this submission.

10.0 BILL IMPACTS

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

Board Staff agrees that, based on FNEI's calculations, there will be no bill impacts for ratepayers.[142]

11.0 IMPLEMENTATION

Board Staff submits that FNEI should be required to file a Draft Rate Order that reflects the OEB's findings,[143] which FNEI agrees to do.

Board Staff also submits that FNEI should be reminded that it must submit a letter immediately after the issuance of a Final Rate Order, which sets out the revenue requirement to be reflected in the UTRs and provides a schedule explaining the calculation of the forgone revenue amount.[144] FNEI has no objection to this submission.

[141] Board Staff Submission at 48.
[142] Board Staff Submission at 49.
[143] Board Staff Submission at 49.
[144] Board Staff Submission at 49.

All of which is respectfully submitted.

DATED at Toronto, Ontario, this 8th day of September, 2017.

FIVE NATIONS ENERGY INC.

By its counsel, Osler, Hoskin & Harcourt LLP

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