EB-2008-0222/3/4

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.O.15, Sch. B;

AND IN THE MATTER OF Applications by Canadian Niagara Power Inc. and Port Colborne Hydro Inc. for Orders setting just and reasonable rates commencing May 1, 2009.

PROCEDURAL SUBMISSIONS

OF THE

SCHOOL ENERGY COALITION

1. By Procedural Order #3 dated December 19, 2008, the Board sought submissions from the parties to this proceeding with respect to discovery, ADR, and hearing of evidence. These are the submissions of the School Energy Coalition.

2. These submissions deal with four distinct procedural matters:

   (a) ***Further Discovery – Further and Better Answers***. The Applicants have declined to answer, or answer fully, a number of key SEC interrogatories. These are listed below, and we have provided brief information as to their relevance and materiality.

   (b) ***Further Discovery – IRs or Technical Conference.*** The Board will, in our view, need to have further discovery prior to any hearing. We suggest a slightly modified version of a Technical Conference.

   (c) ***Settlement Conference.*** Until we have full discovery, it is not yet clear whether a full settlement conference is likely to be productive. However, at the very least scoping of the issues can be accomplished in an ADR setting.

   (d) ***Oral vs. Written Hearing.*** Given the nature of the issues at this point, we believe it is likely that an oral hearing would be most appropriate. Reduction of issues during ADR could minimize that necessity.

3. We note that, although this Applicant is a relatively small distributor, the substantive issues raised by this combined proceeding are unusually complex. As we discuss in more detail later, the intercorporate relationships – between regulated entities and between regulated and non-regulated affiliates – are complicated and substantial, the arrangement with Port Colborne Hydro Inc. is

unique and problematic, the application includes partial but not full harmonization, and the rate impacts of the application are substantial in many cases.

Further Discovery – Further and Better Answers

4. SEC asked the following interrogatories for which full answers were not provided:

(a) ***Interrogatory #5: Five Year Business Plan.*** The Applicants refused to provide this as being irrelevant. They did provide five year budgets and performance targets, but numbers only, with none of the related narrative. It is submitted that if the numbers are relevant, the supporting rationale and context must be equally relevant. At a broader level, many aspects of the Applications concern 2009 actions that are part of broader multi-year capital or operating strategies. It is important, in our view, for the Board to see the 2009 proposals in the context in which they were in fact written. In general, SEC believes that most utilities have a multi-year plan, and in the context of incentive regulation seeing the multi-year plan is of considerable value to the Board.

(b) ***Interrogatory #8: Former Service Agreements.*** Although the Applicants attached 65 pages of material to the IR response, none of it was responsive to the question. Instead of providing the requested agreements, the Applicants provided a copy of a recent delegated decision of the Board, made without a hearing, that refers to the agreements only obliquely, and with no details. If the change in the Service Agreements from the 2003 version to the 2005 version was immaterial or innocuous, then it is submitted that the Applicants can either provide the agreements or summarize the changes. If the change is material, then in light of the complex inter-company arrangements in this case it would be useful for the Board and the parties to know what was in place, what was changed to get to the current arrangements, and why that happened.

(c) ***Interrogatory #10: BDR Shared Cost Allocation Study.*** SEC requested a copy of the study that was being "updated" for this proceeding. Item (b) in the response says it is attached, but it is not. We ask that it be provided. SEC also requested a copy of the instructions (RFP, terms of reference, etc.) for the consultant, and in (a) the Applicant advises that nothing formal was prepared. If the Board is being asked to rely on the update of the study, then it is critical that the Board knows what the consultant was asked to do. Any emails, memos, letters, etc., that communicated the instructions to the consultant should be produced.

(d) ***Interrogatory #13: Short Term Incentive Plan.*** A copy of the plan was requested, but the Applicant has declined, referring instead to the summary already provided. The Applicant has included four charts as an Appendix, but not the narrative surrounding the plan terms. It is normal Board practice to allow requests for source documents where an application includes a summary for ratemaking purposes, and parties want to see the basis for that summary.

(e) ***Interrogatory #14: SAP Review.*** A major recent operational decision has been the deferral of the SAP upgrade, which would otherwise have taken place during the IRM period. An "internal review" was carried out, and a copy of that review was requested. The Applicant has said that no "formal" report was done, and therefore has provided nothing. It is

appropriate for whatever internal analysis documents – memos, powerpoints, etc. - that exist to be provided, so that the Board and parties can see the full analysis, rather than just a summary produced for regulatory purposes.

(f) ***Interrogatory #15: CNP Transmission Income.*** Since a key element in this case is the allocation of expenditures as between distribution and transmission functions, it is important for the Board to understand whether the return in the transmission business is unusually high (thus raising an implicit question about the allocations). The Applicants have refused to provide that information as being irrelevant. On the face of the answer given, it appears that the ROE for transmission is about 18.5% (based on $702K interest at 7% implying $10 million debt; at 60% debt, that implies $16.7 million rate base; at income of $1.8 million and taxes of about $575K, that means ROE on $6.7 million of equity at about 18.5%). It is important for the Board to have a proper calculation, not a back of the envelope approximation such as this based on income tax numbers.

(g) ***Interrogatory #16: Cornwall Income.*** As with CNP Transmission, the income of this affiliate with which the Applicant shares services is clearly relevant, but information has been refused. We note that in the past the Board's approach has been that, when regulated and unregulated entities share services, detailed financial information with respect to the unregulated entity must be provided to the Board. A clear example of this principle (one of many) is found in the Enbridge 2005 Rate Case, EB-2005-0001, pages 39-52, where the Board was clear that if a regulated entity wants to share expenses with an unregulated entity, detailed information on the revenues and expenses of the unregulated affiliate must be filed, and is central to the analysis.

(h) ***Interrogatory #25: Port Colborne Financial Information.*** CNP has refused to provide regulatory information with respect to Port Colborne Hydro Inc. on the basis that it does not have control over that entity and does not have the information. In Procedural Order #1 dated October 10, 2008, the Board said:

> *"Because of the nature of the relationship between CNPI – PC and Port Colborne Hydro relating to the lease agreement, and pursuant to its authority under section 21(1) of the Act, the Board deems Port Colborne Hydro as a co-applicant for purposes of the CNPI – PC application. The Board directs CNPI to ensure that Port Colborne Hydro Inc. is aware of this aspect. Unless the Board is informed to the contrary, it assumes that CNPI will be acting on behalf of Port Colborne Hydro."*

Under these circumstances, it is submitted that the IR response is unacceptable. Further, in light of the unique nature of the lease arrangement, which SEC will submit is fundamentally purchase price rather than an operating cost, it is essential that the Board see the overall state of operating costs vs. costs of capital in the context of this franchise.

(i) ***Interogatory #26: City of Port Colborne.*** In the same vein as #25, this information on the sole shareholder of the co-Applicant was refused. It should be provided, for the same reasons.

(j) ***Interrogatory #27: Assets of Port Colborne Hydro.*** See submissions with respect to Interrogatory #25.

(k) ***Interrogatory #29: Assignment of the lease payments as security.*** See submissions with respect to Interrogatory #25. SEC believes on the basis of news reports at the time of the transaction that the co-Applicant, or the shareholder, the City, has effectively capitalized the stream of lease payments as if it were a sale, either through prepayment or borrowing. If that is the case, or any variation thereon, that may be evidence that the true economic nature of the lease is a sale structured to avoid tax.

(l) ***Interrogatory #34: Composite Rate Base.*** See submissions with respect to Interrogatory #25.

5. In the submissions above we have not sought to argue the case fully for each response. In the event that the submissions above are disputed by the Applicants, SEC would appreciate an opportunity to respond to those submissions more fully in whatever manner the Board feels is appropriate.

6. We note that there were a number of refusals or incomplete answers with respect to the IRs of other parties, some of which are of particular interest to SEC as well. However, we will leave it to those parties to seek proper answers.

7. It is submitted that the Board should order full answers for the interrogatories set forth above prior to any further round of interrogatories or technical conference. Provision of that information should drastically reduce the additional information required by SEC prior to any hearing, and should focus the issues in the hearing more clearly and with a stronger foundation.

Further Discovery – IRs or Technical Conference

8. The issues apparent from the Applications in this matter are significant and difficult. They include at least the following:

(a) ***Port Colborne Lease.*** CNP is "leasing" the assets of Port Colborne Hydro Inc. for approximately $1.5 million a year [SEC IR #28]. If treated as an operating cost, this has the effect of increasing the OM&A expenses of CNP Port Colborne by about 57% [SEC IR #30], making CNP-PC the worst performing LDC in the province in the PEG Benchmarking Study (most recent update), and by a considerable margin. Without the lease payments included as OM&A, CNP-PC is still a poor performer, but is not the worst, and is within range of a number of other LDCs. The evidence to date suggests that the nature of the Port Colborne lease is a tax planning transaction, in which to avoid transfer tax, and for other reasons, a sale was structured to look like a lease plus termination option at a low value. The lease was the result of a City of Port Colborne RFP for the sale of the utility, to which CNP responded with a unique structure. We note that in the ten years since the pre-CNP operating period, the number of Port Colborne customers has increased by about 20%, while the revenue requirement has increased by about 200%. Inflation and MARR take up about half of that increase. This substantial excess may indicate that the lease arrangement is contrary to the

interests of the Port Colborne ratepayers given its current regulatory treatment. It will be an issue in this proceeding whether the lease payments are recoverable from the ratepayers. Aside from the fact that it is only the lease structure that is preventing CNP from including Port Colborne in the harmonization plan [SEC IR#19], it would appear that the lease is in fact the premium paid by CNP to purchase the franchise, and thus not recoverable from ratepayers. Further details of the transaction (including, for example, information on prepayments and other aspects of the deal, the details on the original proposal before being "structured", the valuations of the business, including the level of undervalue of the option price, etc.) will be necessary for the Board to assess its true economic nature.

(b) ***Inter-Corporate Transactions.*** CNP shares material amounts of expenses with Cornwall, an LDC that has an unusual arrangement under which it is largely unregulated, CNP-Transmission, a small transmission business that appears to make a very high profit relative to its assets [SEC IR#3 and #15], and a number of other entities and businesses. The methods by which amounts are allocated between the regulated and unregulated activities are anything but simple, and this is the first time the Board has had an opportunity to review those arrangements in any detail. This is not just a cost allocation exercise. For example, some payments appear to be made by regulated entities as agent for unregulated entities [SEC IR#17], but there is no comprehensive summary of all inter-corporate flows and relationships.

(c) ***Unusual Intercorporate Relationships.*** CNP has minority positions in at least three other LDCs, apparently purchased at low prices [SEC IR#12], but connected to operational arrangements in which ratepayers pay for services that are in turn provided to the other LDCs at a price that has not been substantiated in the evidence. The risk is that, like the Port Colborne deal, these are indirect ways of recovering purchase premiums from the ratepayers.

(d) ***Rate Harmonization.*** The Applicants propose to harmonize the rates for Fort Erie and Gananoque, increasing the rates for some customers and reducing them for others, but excluding Port Colborne, even though ultimately Port Colborne will likely be included as well [SEC IR #19].

(e) ***Rate Increases.*** The Applications propose very substantial rate increases for many customers. Examples are seen in SEC IRs #36 - #42. While some of this is the result of harmonization, and some the result of changes due to cost allocation, the overall averages and pattern are substantial. This raises the risk that the poor benchmarking performance of CNP in previous years will get worse under IRM. This is exacerbated by the fact that the Applicants' plans do not apear to include improvements in non-financial performance measures over the next few years [SEC IR #5, Attach A].

(f) ***SAP Upgrade***. The Applicants propose to defer a very expensive upgrade of their SAP system, which otherwise would take place in 2010. This could be a good idea, but it also has the effect (intentional or unintentional) of increasing the amount of this upgrade that is recoverable directly from ratepayers, by timing it to co-incide more closely with the next rebasing.

9. Given the nature of the issues, and the questions about whether sufficient discovery has already taken place, we believe that, once full answers are provided to the initial IRs, it will likely still be appropriate to have additional discovery. This would have the effect of achieving a completer record without unnecessary hearing time, and could also promote settlement of some issues as their true factual basis emerges. In our experience, once the intervenors and Board Staff get the full picture of LDC activities, they are more likely to see the reasonableness of the Application. Conversely, once LDCs disclose all, and see how the other parties respond to the full set of facts, LDCs are often more willing to consider alternative views of those facts.

10. Generally, we believe that technical conferences produce better discovery than IRs, particularly after an IR process has already taken place. We do acknowledge that some questions are much better answered in writing.

11. For these reasons, we believe that the Board should order a Technical Conference, but with the questions from the parties delivered well in advance. If the Applicants propose to answer anything in writing, the written answer should be filed prior to the Technical Conference. The use of undertakings should thus be limited. In our view, this combination of written answers and oral exchanges will produce the most complete record in the shortest time, and will best promote settlement of issues.

Settlement Conference

12. Given the incomplete record, SEC believes it is premature to determine whether there should be a Settlement Conference in this matter. There may be some issues that, given their general importance, are better decided by the Board, such as the recoverability of payments under the Port Colborne Lease. On many other issues, it will not be clear whether an ADR would be productive until the evidence is more complete.

13. That having been said, we believe it would be useful for the Board to schedule a "settlement" conference anyway, but stipulating that it can be either for settlement or for scoping, depending on what appears appropriate as the evidence unfolds. Given the complexity of the issues, scoping would in itself be valuable for reducing hearing time and allowing the Board panel to focus on those matters that are really contentious. If the Board adopts this suggestion, we think it would be useful if, prior to the date of the ADR, the Board gives some direction as to the issues, if any, that it does not feel should be considered in ADR.

Oral vs. Written Hearing

14. It is also probably too early to determine whether an oral or a written hearing is best in this situation, but on the face of it the issues appear to be too complex and fact-driven to be decided without oral evidence and cross-examination, including questions by Board members. It is only if significant issues are settled, with the Board's approval, in ADR that it is possible a written hearing would be suitable for the remaining issues.

15. Under these circumstances, we believe the Board should order an oral hearing for any unsettled issues. The Board always has the option to move to a written hearing if the remaining issues after

ADR do not require oral evidence. It is also possible for the parties, as part of a settlement process, to propose written argument for some or all of the remaining issues, as has been done in some past proceedings.

Regulatory Cost

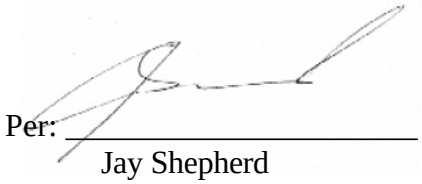
16. It should be noted that we have not, in the submissions above, expressly commented on the cost of the proceedings relative to the size of these LDCs. CNP is part of Fortis, a multi-billion dollar multinational enterprise with many "big-company" practices. Those practices, including the use of complex transactional structures to reduce tax and achieve strategic objectives, and the use of complicated inter-corporate arrangements to share expenses, are the primary reasons why this process is likely to be expensive relative to that which would be appropriate for a simple municipally-owned local distributor with a similar number of customers.

17. There is nothing inherently wrong with those complex approaches to the management of the LDC, particularly if they create efficiencies. However, in the context of Applications that seek payments by ratepayers of $73 million over the four year IRM period, the extra cost that those practices drive in this proceeding should not be an impediment to full review of these Applications by the Board. That is particularly true given that some of the arrangements before the Board in this proceeding are unique, and thus there is potential precedential impact of the regulatory treatment this Board panel determines is appropriate.

18. Therefore in our view, while the Board should always be conscious of regulatory "burden", as utilities often call their regulatory obligations, this is an appropriate case for a fuller process to deal with complex questions that cannot be reviewed adequately otherwise, even if the time and expense involved is somewhat high relative to other LDCs.

Respectfully submitted on behalf of the School Energy Coalition this 9th day of January, 2009

SHIBLEY RIGHTON LLP



Per: _____
Jay Shepherd