

**IN THE MATTER OF a Consultation by the Ontario  
Energy Board on the Cost of Capital and 2nd Generation  
Incentive Regulation for Electricity Distribution  
Companies**

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**TECHNICAL CONFERENCE QUESTIONS  
RESPONSE TO BOARD STAFF QUESTIONS  
BY  
CANADIAN NIAGARA POWER INC.**

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**Note: Canadian Niagara Power Inc. has elected to respond only to those questions where it feels its response will add value to this process.**

**1. Access to Capital**

Please provide any information available on situations where your distribution utility has experienced difficulties in obtaining financing for capital investments on reasonable terms. What reasons were given for the inability to raise capital or on unreasonable (i.e., above-market rates)?

Response:

*To date, Canadian Niagara Power Inc. has been able to obtain financing on reasonable terms. In 2003, CNPI issued \$30 Million in Senior Unsecured Notes at a rate of 7.092% and for a term of 15 years. The Notes were purchased by life insurance companies.*

**7. Load Concentration-related Business Risk**

While Board staff have proposed a common capital structure applicable to all distributors, several stakeholders have commented on business risk, possibly related to a material loss of revenues due to the loss of a customer or business sector served by the distributor and where that customer or business sector constitutes a significant portion of the load and distribution revenues for the distributor.

- a. Could any significant risk that might materialize due to the loss of a significant load concentration be mitigated by Z-factor (or analogous) treatment?

Response:

*Yes, Canadian Niagara Power Inc. agrees with the statement that issues such as business risk could be mitigated by the Z-factor or as an alternative through a deferral mechanism.*

- b. If yes, then what would be the criteria for identifying an occurrence of such an event (e.g. what percentage of distribution revenue attributable to loss of a single customer should be the threshold for identifying a material revenue loss)?

Response:

*Canadian Niagara Power Inc. suggests that the threshold be set at a value equivalent to the proposed productivity factor gain. Such an amount would suggest that an unforeseen event would not completely erode any achieved productivity gains.*

## 9. Incremental Capital Expenditures

Some distributors at the conference expressed concern over aging infrastructure and the need for increased investment in that infrastructure to maintain appropriate levels of service.

- a. What are your known circumstances of where this could arise (addressed to distributors)?

Response:

*From the perspective of a small to medium size distributor, Canadian Niagara Power Inc. has been faced with the challenge of having to make increased investment in its distribution assets. In the intervening period between distribution rate unbundling and rebasing in the 2006 EDR, despite a period of regulatory lag, Canadian Niagara Power Inc. continued to make significant and prudent capital investment in its distribution system to ensure system integrity. Since 2000 Canadian Niagara Power Inc. has found it necessary to replace several aging station transformers in both its legacy and acquired distribution operations, these transformers are normally more than forty years old and all other life-extending maintenance measures have been exhausted. For a smaller distribution system like Eastern Ontario Power, a station transformer replacement and station upgrade could represent as much as 25% of the rate base.*

- b. Should incremental capital spending that is not attributable to load growth be treated outside of the price cap index (similar to what is proposed for CDM)?
- i. If so, should it be eligible for Z-factor treatment?

Response:

*Canadian Niagara Power Inc. believes that it is appropriate to include incremental capital spending in the price cap formula. By not allowing timely inclusion of these necessary projects in rate base, the formula may result in a "snow ploughing" effect resulting in future rate shock. As well, it will inhibit recovery of the associated depreciation expense in the intervening period.*

- c. Are there alternative approaches that the Board might consider?

Response:

*Canadian Niagara Power Inc. believes that the CI-factor proposed by Hydro One is possibly the most appropriate solution to this issue.*

- d. If the Board were to provide for special treatment of these investments, should a threshold apply? If so, how might that be expressed (e.g. percentage of current CapEx budget less depreciation)?

Response:

*Yes, Canadian Niagara Power Inc. believes a threshold should apply but is uncertain as to the best mechanism to apply it.*

**10. CI-factor**

During the technical conference, Mr. John Todd proposed a methodology for a CI-factor as part of the IRM price cap formula as a means for including incremental capital expenditures not related to load growth as an increment to the price cap index.

- a. What are the implications, advantages and disadvantages of adopting such an approach?

Response:

*By adopting the methodology for a CI-factor, the IRM price cap formula will acknowledge and compensate for the negative affects of regulatory lag. In the past, regulatory lag has meant delayed recovery on capital investment and associated depreciation expense.*

*The advantage of a CI-factor is that the IRM price cap formula will acknowledge required capital investment. Distributors who make prudent incremental capital investment will know that regulatory lag will not diminish their ability to recover their investments and therefore would be less likely to defer projects and possibly risk system integrity.*

*The disadvantage of this approach is the requirement of Board staff to regulate its use.*

- b. Mr. Todd suggested that a distributor file an Asset Condition Assessment Study as support for the proposed CI-factor. Such a study does not directly indicate the cost of incremental capital expenditures needed to address deficiencies in the system. What information on the proposed capital expenditures should a distributor be required to file in addition to the Study?

Response:

*In order to regulate the CI-factor it may be necessary for the distributor to submit capital expenditure justification for any projects that it proposes for CI-factor treatment. Justification of project may include a discussion of the need for the project i.e., safety, regulatory, system integrity, etc. as well a discussion of the alternatives including possible life-extending O&M procedures. Time and resource constraints will require that these projects be reviewed when the distributor makes its application to the Board to rebase.*

- c. What are the implications of adopting this approach where CapEx plans are not reviewed and approved by the Board?

Response:

*The Board will have an opportunity to review these projects when the distributor makes its application to the Board to rebase.*

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**TECHNICAL CONFERENCE QUESTIONS  
RESPONSE TO SCHOOL ENERGY COALITION QUESTIONS  
BY  
CANADIAN NIAGARA POWER INC.**

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4. Dr. Yatchew posits, at page 16 of his report, that mergers or acquisitions of LDCs may have been cancelled, repriced, or otherwise materially affected by uncertainty about whether the acquiror would be able to receive the benefit of savings generated by the transaction. If your utility has any documents showing that this was a consideration in any transaction, please file those documents. If any such document contains confidential information, please file the document in confidence so that the Board's protections for confidential filings can be engaged.

Response:

*Uncertainty with respect to the timing of the rebasing and rate adjustment during the interim period increases the risk associated with mergers and acquisitions due to the difficulty to forecast future revenue streams. Furthermore, rate freezes and regulatory lag have adversely affected the enterprise value of LDC's.*

5. Several parties have suggested that the proposed changes in the ROE and capital structure may cause LDCs to be offside on their debt covenants. Please advise whether such changes may cause your utility to be offside on your debt covenants, and if so file the text of such covenants, the amounts of borrowing to which they relate, and whether the lender is an affiliate/shareholder or an arm's length third party.

Response:

*The proposed changes in ROE and capital structure will not cause Canadian Niagara Power Inc. to go offside on its existing debts covenants.*

6. An important issue in this proceeding is maintaining the creditworthiness of the LDC. If your LDC has been rated by Standard & Poors, DBRS, Moody's, or Dun and Bradstreet within the last 18 months, please file the last full rating from each rating agency, plus any updates since that full rating. If your LDC is rated and you have a public sector shareholder, please also advise the shareholder's debt rating(s) if any.

Response:

*Neither Canadian Niagara Power Inc. nor its shareholder, FortisOntario Inc., is rated by a credit rating agency.*

7. The ability of utilities to attract equity investment has been raised as a critical issue by many parties. Please provide the date, amount, investor identity and terms of the last common equity investment in your utility. If there was an offering or disclosure document, please file that document.

Response:

*In 2003, Canadian Niagara Power Inc. issued 2,500,000 common shares to FortisOntario Inc. for cash consideration of \$2.5 million. No external share offering was extended.*

10. For each LDC that has debt traded in the public markets, either directly or indirectly, please provide a chart for the period 2003 to date showing the average yield of your debt (broken down by issue if you had more than one outstanding) each month in the market, and for the same month the average yield of 10 year Canadas.

Response:

*Canadian Niagara Power Inc.'s long-term debt is not publicly traded.*