EB-2014-0105

ONTARIO ENERGY BOARD

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

AND IN THE MATTER OF an Application by Ottawa River Power Corporation pursuant to the Ontario Energy Board Act for an Order or Orders approving rates for the distribution of electricity commencing May 1, 2016

Final Argument
of the
Vulnerable Energy Consumers Coalition (VECC)

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Introduction

1. The applicant, Ottawa River Power Corporation (ORPC) has requested to be allowed to recover in its revenue requirement interest at the rate 7.25% upon the debt owing to its four municipal shareholders. The debt owing is in the amount of $5,585, 538.

2. The intervening parties and Board staff contend that the interest recovered in the revenue requirement should be at the rate of 4.54%, the Board's current deemed debt rate.

3. The context of the disputed issue arises from a disagreement as to the application of the OEB's 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (EB 2009-0084) issued on December 11 , 2009.

4. The Report provided the guidelines for the recovery of interest upon the debt of distribution utilities. The relevant passages of that Report to be considered and applied here are:

> The deemed long-term debt rate will act as a proxy or ceiling for what would be considered to be a market-based rate by the Board in certain circumstances. These circumstances include:
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> - For affiliate debt (i.e., debt held by an affiliated party as defined by the Ontario Business Corporations Act, 1990) with a fixed rate, the deemed long-term debt rate at the time of issuance will be used as a ceiling on the rate allowed for that debt.
> - For debt that has a variable rate, the deemed long-term debt rate will be a ceiling on the rate allowed for that debt. This applies whether the debt holder is an affiliate or a third-party.
>
> …

- A Board panel will determine the debt treatment, including the rate allowed based on the record before it and considering the Board's policy (these Guidelines) and practice. The onus will be on the utility to establish the need for and prudence of its actual and forecasted debt, including the cost of such debt.[1]

5. It must be determined which of the first two circumstances represent the correct description of the debt owed by the applicant to its municipal shareholders. As well, the applicant must satisfy the Board panel that the cost of such debt is prudent and required.

Determination of ORPC's Debt Interest Rate

6. The terms of the above passage from the Board's Cost of Capital Policy must first be examined. It is to be noted that the policy refers to the treatment of an affiliate debt bearing a fixed rate. The ceiling on such debt is the Board's deemed debt rate to be calculated in the method set out elsewhere in the Report "**at the time of issuance**".[2]

7. The issuance referred to here is not the creation of merely the reason for the debt by way of the transfer of assets pursuant to the shareholders agreement appended to the enabling municipal bylaw, Pembroke's By-Law 2000-0031[3], and the shareholders agreement of October 1, 2000[4] contained in the affidavit of applicant witness, Mr. Scott. The issuance within the meaning of the Board's Cost of Capital Policy Report is the issuance of the promissory notes given in consideration of the same.

8. In order for the applicant's position to have validity, the promissory notes allegedly issued by Pembroke and Beachburg on June 6, 200 and Mississippi Mills and Killaloe

[1] *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (EB 2009-0084) issued on December 11 , 2009, pp.53-54
[2] Ibid at p.53
[3] Exhibit K1 Affidavit of Les Scott, Tab C p.19 shareholders agreement, p.82
[4] Ibid Tab I , at p.133

on October 30, 2000 must have a fixed rate of interest of 7.25% and be non-callable for a twenty year period. In addition, the notes must be found to be incurring costs of debt that were needed and prudent.

9. The applicant has the initial onus of proving that the notes were created when they are alleged to have been created. The evidence is far from clear that they were actually issued. The final submissions of SEC filed herein set out in detail the problems of credibility associated with the premise that the promissory notes were signed, then misplaced. We note that the applicant's witness, Mr. Scott has the same doubts.

> MR. SCOTT: I think there was a gap in follow-through.
> There were changes in the people that were involved, there were political changes, and I would think it might be fair to say that they just were not done, yes.[5]

10. The applicant, in the Argument in Chief (AIC) sets out to discover the intent of the parties in the absence of the relevant documents based on the documents now actually in existence. It should be noted that, in law, promissory notes, in accordance with the *Bills of Exchange Act*[6] are intended to be negotiable instruments that are not to be conditioned or interpreted in conjunction with a related contract.[7] This is somewhat of an unusual exercise attempting to reconstruct the same through related materials.

11. Leaving aside for the moment that new promissory notes were executed in March, 2016, the existing documents, set out in exhibit K1 include: (a) authorizing by-laws with appendices (b) two shareholders agreements , the most recent shareholders agreement executed by the applicant and its municipal shareholders dated October 1, 2000; (c) a solicitor's letter dated November 1, 2000 setting out an agreement in the letter dated November 2, 2000 that provides that "Ottawa River Power Corporation is and/or will be

[5] Tr. p.47
[6] RSC 1985 c B-4
[7] *Bank of Montreal v. Abrahams* 68 O.R.(3d)34 (C.A.)

indebted to" the municipal shareholders are not due on the market opening but 20 years from the market opening slated for November 7, 2002 and an agreement with respect to interest; (d) by-laws passed in conformance with subsection 142 (1) of the *Electricity Act*, *1998*; (e) a solicitor's letter dated April 11, 2003 confirming that promissory notes from the Ottawa River Energy Solutions would not be payable until 20 years form the market opening.

12. VECC submits that it is far from clear in reviewing these documents that promissory notes issued by the applicant, if they existed at all, were non-callable and featured a fixed rate of 7.25% for a twenty year period. In fact, a very different view of their contents and the intent of the parties is much more probable.

13. For example, while Pembroke's transfer by-law 2000-31 contains a reference to the "interest at an effective rate **currently** 7.25% per annum" in Schedule G[8], it also notes that the "term and interest are to be renegotiated annually". The by-law appends Schedule M[9] being a shareholders agreement between the Applicant ORPC and the municipal shareholders Pembroke and Beachburg.

14. Schedule M provides for the payment of interest on the promissory notes in paragraph 7 (b)" in an amount not to exceed the maximum interest allowed by the Ontario Energy Board , based on any other regulation, schedule or document prepared and enacted by them or any successors to the said Ontario Energy Board or any other entity with regulatory authority for utilities in the Province of Ontario". [10] Paragraph 7(c) provides that the parties agree that "they may adjust the interest rate on the said Promissory Note at the times, and in the manner as set out by regulation, and in an amount not to exceed the maximum interest rate allowed by any schedule, statute, or otherwise as enacted by the Ontario Energy Board or any successor."[11]

[8] Exhibit K1, p.31
[9] Ibid, at Tab C p.65
[10] Ibid at pp.71-72
[11] Ibid at p.72

15. While the agreement bears a date of January 1, 2000, the actual date of its signing is uncertain. The language, however, is recapitulated in the shareholders agreement of October 1, 2000 between the applicant ORPC and the now four municipal shareholders in Paragraphs 13 (e) and (f) .[12]

16. The intent and the terms of any promissory note appear to be discernable from these documents. There is no fixed rate referenced and the 7.25% interest set out in the by-law Schedule G is subject to renegotiation on a yearly basis. The shareholders agreement language provides for a maximum interest rate that is not static but forward-looking providing for even the calculation of a maximum rate by a successor to the OEB or other regulatory authority.

17. The meaning of the annual renegotiation envisioned by Schedule G of the bylaw is fleshed out in the mutual adjustment section of 7(c) of the first shareholders' agreement and section 13 (f) of the October 1 agreement. The adjustment was thus supposed to respond to the maximum interest rate allowed by the Board in a given year.

18. While the exact date of the first shareholders agreement is difficult to ascertain, it is clear that by the time of the second agreement of October 1, 2000, the parties were aware of the Board's maximum rate of 7.25 % at that time and could have easily provided for it to be the operative fixed rate throughout the twenty year period if they intended to do so.

19. The intent of the parties was not simply to recognize the authority and the overall superintendence of the OEB as suggested by the applicant's AIC[13] but to rely on the fixing of the maximum rate allowed by the OEB as part of an annual process contemplated by the renegotiation or adjustment process.

[12] Ibid at Tab I , pp147-148
[13] Tr. p.119

20. Additionally, the letter of amendment prepared by ORPC's solicitor of November 1, 2000[14] is bereft of any reference to the fixed rate of interest despite the evident knowledge of all of the parties of the Board's maximum rate.

21. Pembroke By-Law 2003-06[15] is of little assistance with the inquiry as to the terms of any promissory note, despite its reference to a 7.25% interest rate. It provides that "**at the present time** the maximum return available on equity for the municipality is 4.17% and the return of interest on the Promissory Note is 7.25%..."[16] The certificate accompanying the Pembroke By-Law references a Promissory Note executed October 1, 2006[17], which instead is evidently the date of the second shareholder's agreement and not the promissory supposedly executed on June 6, 2000 (see affidavit of Terry Lapierre, CAO of Pembroke, March 24, 2016[18]. That agreement does not reference a specific rate, but as noted earlier, provides for the adoption of the OEB's maximum rate as a ceiling on contemplated adjustments going forward.

22. The muddle is perhaps increased by the fact that the two additional municipal shareholders, Killaloe and Mississippi Mills, join in the shareholders agreement, October 1, 2000 acknowledging receipt of promissory notes therein as payment for the transfer of their assets.[19] According to the affidavits filed[20], these notes are not issued until October 19, 2000, while authorizing by-laws are passed by Killaloe on October 30, 2000[21], and Mississippi Mills on October 19, 2000[22] providing for a transfer of assets to ORPC effective September 30. Schedule C to the Killaloe bylaw provides for no interest payable on the notes from October 1, 2000 (the agreement date- not the supposed

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[14] Ex. K1 Tab J, pp162-166
[15] Ibid, Tab K, ,p.168
[16] Ibid p.169
[17] Ibid at p.168
[18] Ibid at Tab O, p.177
[19] Ibid at Tab O p.147
[20] Ibid at Tabs L and M, pp171-174
[21] ExhibitK1, Tab H, p.125
[22] Ibid at Tab F, p.109

promissory note date) to Market Opening.[23] Schedule F of the Mississippi Mills By-law cryptically absolves the note from bearing interest from January 1, 2000 (some 10 months before the missing note was supposedly executed) until market opening.[24] The establishment of the existence, dates, and terms of promissory notes executed by ORPC is indeed a difficult exercise.

23. ORPC's witness Mr. Scott has conceded that there were administrative difficulties because of transition of key individuals that had been involved in the creation of OPRC and the terms for the same.[25]

24. There has never been a renegotiation or adjustment to the interest rate paid upon debt or an attempt to do so[26]. As the cordial state of matters between ORPC and its municipal shareholders was described by Mr. Scott of ORPC:

> "I think the fact that the 7.25 percent that's been paid has been paid for over 14 years on a regular basis, honestly, forthwith, and maybe just if I can reflect and say based on trust, a handshake, and agreements between four municipalities that wanted to form the Ottawa River Power Corporation. I think that speaks rather well for the agreement and the way that it's been committed and followed through on."[27]

25. There is a rather simple explanation for the reason that interest rate payments remained constant throughout the period from market opening. The Board's deemed debt rate, which was supposed to be the ceiling for the contemplated adjustments, decreased in magnitude in this period in tandem with the market rate and, as conceded in Mr. Scott's affidavit[28], the municipal shareholders relied on the income stream provided by the 7.25% interest rate on the debt.

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[23] Ibid at Tab H p.131
[24] Ibid at Tab F, p.123
[25] Tr. p.31
[26] Tr. pp. 70,71
[27] Tr. p.30
[28] Exhibit K1, p.6, para 23

26. By the time, the Board's 2009 Cost of Capital Report was issued, it was easier for ORPC to assume that the debt rate had been fixed to the Board's deemed debt rate ceiling in 2002 and ignore the language that providing for adjustment and variability.

27. In VECC's submission there must be two central conclusions associated with establishing the interest rate on the debt to the municipal shareholders arising as a result of the transfer of assets in 2000:
    (i) There is considerable doubt that promissory notes were actually issued as required by the by-laws;
    (ii) Any interest rate provided or to be provided on the debt was subject to variance with reference to the changes in the Board's deemed debt interest rate ceiling.

28. As a consequence, applying the 2009 Board policy, the applicable debt rate for the purpose of ORPC's Revenue Requirement should be 4.54%.

29. The Board's policy cited above also requires that the cost of the debt be prudent. While Mr. Scott's affidavit on behalf of the applicant maintains that a locked- in rate of 7.25% was a risk for both the shareholders and the ratepayers and thus presumably was fair[29], the reality was that the shareholders held all the cards. They could get an adjustment upwards if the Board's deemed interest ceiling rate went up and an adjustment wouldn't be requested if the rate went down.

> MR. JANIGAN: Now, in terms of the acceptance of risk, I mean, you indicate in your -- in paragraph 23 in terms of, that both sides accepted risk with respect to this.
>
> I take it that in the event that the municipalities had wanted to increase the rate in conformance with the Ontario Energy Board deemed debt rate, they were essentially the directing mind of the -- of the utility and could have done so if they wished.

[29] Ibid atp.23, paragraph 23

> MR. SCOTT: I think your statement is correct that if they chose to do that there were options there to allow for that to happen.
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> MR. JANIGAN: Okay. And basically it's not really a negotiation, effectively. The municipalities would be pointing to the fact that the Ontario Energy Board was allowing a higher deemed debt rate and they would have asked the utility to provide it.
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> MR. SCOTT: Yes, I would agree with that comment.

30. As Mr. Scott's affidavit notes[30], the shareholders could and would likely even force an increase in the rent paid by ORPC to make up for any downward adjustment to the interest rate paid on the debt as a result of this proceeding[31].

31. In the context of the ORPC ownership control, any fixed rate, non-callable debt, with realistically only the possibility of an upward adjustment to the rate, was not a prudent arrangement. While ORPC undoubtedly acted in the best interests of the taxpayers of their respective municipalities, the conduct of ORPC associated with the failure to seek an adjustment to the debt rate, did not reflect prudent management to obtain fair and reasonable rates for the ratepayers.

32. As noted in the final argument of SEC, the Board approval of the use of a debt interest rate of 7.25% in the EB 2009-0165 for the purpose of calculating the applicant's revenue requirement was predicated on ORPC's assertion in evidence of the existence of 20 year non-callable promissory notes bearing a fixed rate of 7.25%, and an attempt to shoehorn the debt into the Board's 2009 Cost of Capital policy[32]. The notes and terms of were not produced nor were the applicant's assertions challenged at that time. The same record was not before the Board in that case that is before the Board in this proceeding.

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[30] Ex. K1, p.24

[31] See also Tr. p.77 and Tr. pp 98-99 that rebuts any premise that the original 7.25% interest rate was in consideration for a rental subsidy to the ORPC

[32] See EB-2009-0165,Ex 5, Tab 1,Schedule 2, pp1,2

33. Finally, the new promissory notes executed in March, 2016[33] add an interesting wrinkle to the evidentiary record of this proceeding. As Board Staff counsel has contended in final argument, if no promissory notes ever existed, these are the notes that govern the establishment of the interest rate on ORPC's notes in this proceeding.

34. If the interest rate of the new notes has been fixed in their terms, the Board's policy is that the current OEB deemed debt rate at the time of the issuance (March, 23, 2016) applies to the notes for revenue requirement purposes. This rate is 4.54%.

35. However, it is to be observed that the notes also incorporate the same language from the October 1, 2000 shareholders agreement, discussed earlier in these submissions that connote variability of the interest rate during the term of the note in accordance with the Board's policy. This policy produces a maximum rate of interest upon affiliate debt. This language should reasonably be interpreted as setting out the intention of the parties to adjust the interest rate on the ORPC debt in accordance with adjustments to the Board's deemed interest debt rate ceiling. Thus, the terms of the note and/or the Board's Cost of Capital policy for variable rate debt apply and the applicable interest rate on the ORPC debt for the purpose of determining the revenue requirement is again 4.54%.

36. Moreover, even if intended as replacements, the new notes are characterized as "new" in the supporting documentation and it is acknowledged that the missing notes must be cancelled when found[34]. The terms of the new notes incorporate changes made since the date when the old notes were supposedly issued. For example, the new notes have the May 1, 2002 market opening date as the effective start of the twenty year term, a fact that would not have been known at the time of the execution of any missing notes.[35]

37. In VECC's view, the new notes now govern the terms of ORPC's debt, regardless of whether promissory notes executed by the applicant in 2000 actually existed. The

[33] Ex. K1, Tabs P,Q,R,S, pp179-186
[34] See Indemnities set out in Ex. K1, Tabs LMNO
[35] Ibid at Tabs PQRS

issuance dates of the notes are as recorded on the face of the new notes. Because of the status in law of promissory notes as negotiable instruments, the notes cannot be modified by what may or may not have been provided or intended to be provided in any missing debt instruments.

38. In VECC‘s submission, the interest rate on the new notes that is applicable for ORPC’s revenue requirement purposes must be 4.54 %. This conclusion arises both from the language of the notes themselves and/or the application of 2009 OEB’s Cost of Capital policy.

Conclusion

39. In VECC’s view, ORPC has not shown that the long term debt owed to their municipal shareholders has been fixed at 7.25% for a twenty year period. It cannot produce the original debt instruments themselves, and the language that gives rise to ORPC's assertion of 20 year non-callable debt at a fixed interest rate of 7.25% contends for a more probable conclusion that the debt rate was, in fact, variable.

40. To complicate ORPC’s case further, the imposition of an above-market rate based on the scenario that ORPC entered into a 20 year term at a fixed rate of 7.25% collides with the reasonable fairness to their ratepayers that is required. This is because the reality was likely that the rate would only be altered if the Board’s deemed debt rate went up. This was not prudent management of costs within the meaning of the Board’s 2009 Cost of Capital policy and the setting of just and reasonable rates pursuant to the *OEB Act.*

41. Finally, whatever the conjecture about the existence of promissory notes possibly provided in the year 2000, or the meaning of possible terms that were contained in such notes that were planned or executed, new promissory notes have now been issued by ORPC. The correct interpretation of these notes and the Board’s 2009 Cost of Capital policy require the application of the current deemed rate of 4.54%.

42. VECC requests the payment of its costs in this proceeding for its responsible participation that has been designed to be of assistance to the Board.

Respectfully submitted this 6th day of April, 2016