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October 17, 2016

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

**Re: EB-2016-0089 –Lakefront Utilities Inc.
Final Submissions of Vulnerable Energy Consumers Coalition (VECC)**

Pursuant to Procedural Order No. 3 please find enclosed the Final Submissions of VECC with respect to the above-noted proceeding. Please note we have also directed a copy of the same to the Applicant via email.

Yours truly,

Michael Janigan
Counsel for VECC

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Lakefront – Adam Giddings – agiddings@lusi.on.ca

**Lakefront Utilities Inc.
Application for electricity distribution rates beginning
January 1, 2017**

Final Submissions of the Vulnerable Energy Consumers Coalition (VECC)

Introduction

1. VECC participated in the all significant aspects of this proceeding, and was a signatory to the Partial Settlement Proposal herein that was approved by the Board on October 6, 2016.
2. The Proposal left one issue unsettled, namely the interest amount to be recognized in rates on the long term debt arising from the promissory note payable on demand to the Corporation of the Town of Cobourg (“Cobourg”) issued by the Applicant Lakefront Utilities Limited (“LUI”) on September 12, 2006 for a principal sum of \$7M. The Town of Cobourg is an affiliate of LUI as a result of its ownership interest in the same.
3. LUI has requested the rate of 4.54% be allowed in rates arising from the affiliate debt. This interest rate is derived from the OEB’s long term debt rate set out in the OEB’s October 15, 2015 Cost of Capital update letter for 2016 Cost of Service Applications.¹
4. VECC contends that this rate does not represent a reasonable and prudent interest rate for long term debt that may be available to LUI. These submissions support the position that a lower interest rate reflective of market realities should be incorporated in rates.

The Note

5. The current note of \$7M (“the 2006 note”) was issued by LUI to Cobourg prior to a Transfer Agreement and Bylaw No. 31-00 that retroactively increased the transfer price of utility assets transferred to LUI on May 1, 2000. In turn, the amount of the debt for the assets transferred to LUI, in consideration for ownership shares, was increased from \$4M to \$7M. The new note for increased amount was deemed to be effective retroactively to May 1, 2000 and bore the same interest rate of the old note of 7.25%.²

¹ LUI will update the evidence to accord with the OEB’s letter setting out the rate for 2017COS applications (Exhibit 5, page 3)

² Ex. 5 p.12

6. The 2006 note, was payable on demand to Cobourg, and was silent as to any date or terms of repayment by LUI. It provided for the annual interest rate of 7.25% by using an explicit reference the debt rate established by the OEB as set out in Chapter 3 of the OEB's electricity distribution rate handbook issued March 9, 2000.

7. It is evident that the debt recognized by the 2006 LUI note was callable. A debt payable on demand can be due the moment there is an executed contract.³ The Bills of Exchange Act also provides that there is an inherent right to demand payment where no term is specified⁴.

8. The OEB has, in the past, considered the interest payable on similar debt in accordance with the Board's Report on Cost of Capital and 2nd Generation IRM of December 2006. In the EB-2008-0248 2009 Rates case of West Coast Huron Energy Inc., the Board considered a promissory note similar to the 2006 LUI note (payable on demand with no term) and deemed it callable debt, subject to the then operative provisions of the Board's 2006 Report:

"In the Board's Report on Cost of Capital and 2nd Generation IRM, the Board explicitly determined that callable or demand notes held by an affiliate (or a shareholder) were to be subject to a deemed rate, which could change from time to time depending on market conditions at the relevant time. On page 13 of that report, the Board noted:

"For all variable-rate debt and for all affiliate debt that is callable on demand the Board will use the current deemed long-term debt rate. When setting distribution rates at rebasing these debt rates will be adjusted regardless of whether the applicant makes a request for the change."

The policy underpinning of this approach is that ratepayers, who cover the costs associated with these notes, are entitled to a measure of objectivity with respect to the notes, an element impossible to guarantee without the application of some external factor."⁵

Board Policy

9. The Report of the Board on the Cost of Capital for Ontario's Regulated Utilities of 2009⁶ provides the current policy guidance of the Board in place with respect to the interest rate allowable on the 2006 LUI note. In this case, as has been noted, the 2006 note represents affiliate debt callable on demand within the test year.

³ *Royal Bank of Canada v. Dwigans* [1933] 1W.W.R. 672 (Alta C.A.) see also *Bank of Montreal v. Mangold* (1988) CanLII 3804 (AB QB)

⁴ Bills of Exchange Act (R.S.C 1985, c.B-4) s. 138(1-2) 186(1-3)

⁵ EB-2008-0248 West Coast Huron Energy Inc., Decision and Order of the Board , p.21

⁶ EB-2009-0084, "Report of the Board on the Cost of Capital for Ontario's Regulated Utilities", December 11, 2009

10. First, it must be noted there are important differences in the Board's 2009 Report and the predecessor 2006 Report referenced above. In VECC's view, these differences militate for an approach to LUI's debt rate that involves more than simply plugging in the Board's long term debt rate for 2016 or 2017 applications.

11. The Board's 2009 Report contained the expectation that the long term debt guidelines were expected to evolve over time and converge with the process used to determine debt for natural gas distribution utilities.⁷

12. The Board's 2009 Report further cautioned electricity distributors that:

"The Board is of the view that electricity distribution utilities should be motivated to make rational decisions for commercial "arms-length" debt arrangements, even with shareholders or affiliates.

In general, the Board is of the view that the onus is on the electricity distribution utility to forecast the amount and cost of new or renewed long-term debt. The electricity distribution utility also bears the burden of establishing the need for and prudence of the amount and cost of long-term debt, both embedded and new."⁸

13. Finally, VECC notes the applicable section of the Report that prescribes the rate treatment to be afforded electricity distribution utilities in considering debt similar to that set out in the 2006 LUI note:

"For debt that is callable on demand (within the test year period), the deemed long-term debt rate will be a ceiling on the rate allowed for that debt. Debt that is callable, but not within the period to the end of the test year, will have its debt cost considered as if it is not callable; that is the debt cost will be treated in accordance with other guidelines pertaining to actual, affiliated or variable-rate debt."

14. Unlike the language contained in 2006 Report, the use of the long term debt rate is described as a "ceiling" not in terms that would imply that the Board will automatically use it. To give meaning to that change, the ceiling cannot be the rate that is always operative.

15. In VECC's view, it has been almost seven years since electricity distributors were cautioned to move to a more rational commercial "arms- length" arrangement for their long term debt. If the language of the 2009 Report is to be given meaning, then the onus is on LUI to show the prudence of the arrangements with its affiliate from a commercial arms-length standpoint.⁹

⁷ Ibid, p.52

⁸ Ibid ,p.53

⁹ In the 2011 Kingston Hydro Rates case, EB-2010-0136, the Board used the long term debt rate annually determined for callable debt without a repayment term. However, the issue here centered upon the efforts by City of Kingston to make the debt non -callable during the test year period in order to protect a higher rate. The Decision does not deal with the new requirements under the 2009 Cost of Capital Report

Reasonableness of the Interest Rate

16. Given the policy guidance provided by the Board in its 2009 Cost of Capital Report, it would appear that LUI's use of the OEB's 2016 Long Term Debt Rate defined as the ceiling in that Report must be additionally shown to be prudent. This exercise would be presumably based on prevailing rates that may be available to LUI for refinancing.

17. Lakefront has not filed evidence concerning the reasonableness of its cost of debt despite this evident onus upon it to do so. There is some evidence of a preliminary investigation of cost savings by LUI but little else.¹⁰

18. VECC has reviewed the Energy Probe submissions that will be filed herein and commends its analysis as setting out an appropriate range of interest rates that may be available to LUI to refinance the \$7M affiliate debt. VECC also notes that the onus is still on LUI establish prudence of the rate sought and the only evidence appears to belie such a conclusion.

19. Based on the results of long term debt rates for other utilities set out in Board filings coupled with research derived from publicly available market rates, Energy Probe has recommended a deemed rate for ratemaking purposes in the range of 2.60% to 3.60% for the \$7M affiliate debt. VECC also believes that Energy Probe's general range and its specific recommendation in that range of 3.10% are reasonable.

Can LUI Refinance its \$7M Affiliate debt?

19. In its response to 5-CTA-interrogatory 15, LUI relies upon a failure to obtain consent from its shareholder Cobourg as the reason that the OEB should allow in rates the OEB's updated long term interest rate for COS applications on the 2006 note that is greater than rates available in the market.

20. This inability to obtain consent to refinance is maintained by LUI despite evidence in Cobourg's Financial Statements that replacement financing could be possible.¹¹

21. In VECC's view, the willingness or unwillingness of Cobourg to have the loan repaid cannot govern whether an excess amount of interest is collected in rates. A natural gas distributor can't rely on a parent company's lack of consent to amend an improvident arrangement for corporate services provided its parent company in order to obtain regulatory approval for the cost consequences of the arrangement.¹²

¹⁰ See 5-CTA 15 part (b) and 5-EP-19 (c)

¹¹ See attachment to CTA Interrogatory 1-CTA-10

¹² See for example the OEB Decision in the 2006 EGDI Rates case EB-2005-0001/EB-2005-0437 , February 9, 2006

22. This necessity of municipally owned electrics to migrate from the cozy subordination of ratepayer interests to the demands of the shareholder was recognized in the Board's 2009 Cost of Capital Report where the Report emphasized the adoption of arms-length commercial standards and proof of the same to obtain Board approval of interest rates for long term debt. In VECC's submission, the interest rate on the \$7M loan does not depend on the potential success of LUI in convincing Cobourg to allow it to repay its shareholder.

Conclusion

23. There is no provision in the *OEB Act*¹³ that provides for a Board objective in the regulation of electricity distribution to augment municipal revenues or fund worthwhile municipal projects that do not involve revenue requirement for the prudent operation of the electricity distribution franchise.

24. The Board is entrusted with the responsibility to protect consumers' interest with respect to prices, primarily by fashioning just and reasonable rates.¹⁴ This means balancing the interests of the shareholders in earning the highest possible return with the conflicting interest of its customers to be served as cheaply as possible.¹⁵ It is hard to imagine a balancing that comprehends depending on the largesse of utility shareholders to reduce a loan interest rate that exceeds available rates in the market.

26. Whatever the value of the transition period to implementation of the expectations of the regulator for market-based long term interest rates, VECC submits that, in 2016, the transition period should be up. Ratepayers cannot now afford to be gilding the monetary investments of municipal electrical distribution companies.¹⁶ VECC believes that the reduction of the interest claimed by LUI on its 2006 LUI note to a reasonable market rate would be congruent with the Board's policy and its statutory responsibilities.

Costs

27. VECC submits that its participation has been responsible and responsive to the discussion of the issues in this application. VECC requests that it be awarded 100% of its reasonably incurred costs.

All of which is respectfully submitted this 17th day of October 2016

¹³ Ontario Energy Board Act, 1998, S.O. 1998, c.15 Sched B

¹⁴ Ontario Energy Board Act, 1998, S.O. 1998, c.15 Sched B sec1 (1) 1.

¹⁵ *Union Gas Ltd. v Ontario (Energy Board)* 42O.R. (2nd) 489 (Div. Ct.) at p.11

¹⁶ VECC notes the submissions of Energy Probe herein as to the adherence, or lack thereof, of LUI with the principles of the RRFE by gifting its shareholder with a higher than market interest rate. This further supports the conclusion that the OEB must insist that LUI and other municipal utilities move off the approach of fashioning its financial arrangements in-house with shareholder interests prevailing over those of ratepayers.