



Lakefront
Utilities
Inc.

October 28, 2016

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 26th Floor, P.O. Box 2319
Toronto, ON M4P 1E4

**Re: Lakefront Utilities Inc.
EB-2016-0089 - 2017 COS Rates Application
Reply Submission**

Dear Ms. Walli:

Pursuant to Procedural Order No. 3, please find enclosed Lakefront Utilities Inc.'s ("LUI") Reply Submission in regards to the above matter.

Should the board have questions regarding this matter please contact Adam Giddings at agiddings@lusi.on.ca or myself at dpaul@lusi.on.ca

Respectfully Submitted,

Dereck C. Paul
President
Lakefront Utilities Inc.

Cc: Adam Giddings, CPA, CA
Cc: Parties in EB-2016-0089

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

AND IN THE MATTER OF an Application by Lakefront
Utilities Inc. for an order approving just and reasonable rates
and other charges for electricity distribution to be effective
January 1, 2017.

**REPLY SUBMISSION OF
LAKEFRONT UTILITIES INC.**

October 28, 2016

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Introduction

On April 29, 2016, Lakefront Utilities Inc. (“LUI” or the “Applicant”) filed a cost of service application (the “Application”) with the Ontario Energy Board (the “Board”) under section 78 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B), seeking approval for changes to the rates that LUI charges for electricity distribution, to be effective January 1, 2017. The Board assigned the Application file number EB-2016-0089.

A settlement conference was held on August 22 and 23, 2016 and LUI filed a Partial Settlement Proposal among all parties to the proceeding on September 21, 2016. On October 6, 2016 the OEB accepted the proposed Partial Settlement Proposal and also accepted the parties’ request to address the unsettled issue by way of a written hearing.

The Settlement 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 with an effective date of May 1, 2000, for the principal sum of \$7M.¹ The Note provides for interest at the rate of 7.25% *per annum*, payable monthly. That rate is based on the Board’s deemed long term debt rate as set out in the 2000 *Electricity Distribution Rate Handbook*, issued March 9, 2000.

To be clear, though, LUI’s customers are not currently paying distribution rates that reflect a 7.25% interest rate on the Promissory Note. That interest rate has not been used for rate making purposes for LUI since the 2007 rate year. When LUI rebased for 2008 (EB-2007-0761), the Board determined that its then-current deemed long term debt rate of 6.1% would be used for rate making purposes in respect of the Promissory Note. When LUI rebased for 2012, the Applicant and intervenors in its cost of service application (EB-2011-0250) agreed that the rate to be used for rate making purposes for the 2012 Test Year was 4.41%, which was the Board’s updated deemed long term debt rate for use in cost of service rate applications for rates effective May 1, 2012.²

Consistent with LUI’s 2008 and 2012 rebasing cases, LUI used the rate of 4.54%, equal to the deemed long term debt rate for cost of service applications for rates effective in 2016. Yesterday, the Board issued its Cost of Capital Parameter Updates

¹ Exhibit 5, Attachment A

² The Board’s Mar. 2, 2012 letter setting out the Cost of Capital Parameter Updates for 2012 Cost of Service Applications for Rates Effective May 1, 2012 is available at: http://ontarioenergyboard.ca/oeb/ Documents/2012EDR/Ltr_Cost-of-Capital-Parameters_20120302.pdf

for Cost of Service Applications with Rates effective in 2017³, and the deemed long term debt rate for 2017 is 3.72%. LUI had previously indicated that it would update its proposed debt rate for the promissory note for rate making purposes to the Board's deemed long term debt rate for 2017.

Board Staff (also referred to here as "OEB Staff") agree in their submission that the Board's deemed long term debt rate is the appropriate rate to be used for rate making purposes.⁴ The intervenors assert that the Board should be using a lower rate.

LUI offers the following reply to the submissions on the long-term affiliate debt cost from Board Staff, the Vulnerable Energy Consumers Coalition ("VECC"), Energy Probe Research Foundation ("Energy Probe") and the Cobourg Taxpayers Association ("CTA"), each received on October 17, 2016.

LUI will address the following topics in this submission:

1. The issues
2. The Affiliate Debt (Note)
3. Board Policy
4. Renegotiation Efforts
5. Reasonableness of Interest Rates
6. Can Lakefront Pay Off the Affiliate Debt?
7. The impact
8. Conclusion
9. Costs

³ Available at:

http://www.ontarioenergyboard.ca/oeb/_Documents/2017EDR/OEB_Ltr_Cost_of_Capital_Update_20161027.pdf

⁴ Available at:

<http://www.ontarioenergyboard.ca/OEB/Industry/Regulatory+Proceedings/Applications+Before+the+Board/Electricity+Distribution+Rates/2017+Electricity+Distribution+Rate+Applications#20161027b>

1. The Issues

LUI has used the OEB's long-term debt rate of 4.54% as set out in the OEB's October 15, 2015 Cost of Capital Parameter Updates for 2016 Cost of Service Applications. LUI has indicated that it is committed to updating the evidence to reflect the OEB's updated cost of capital parameters for January 1, 2017 applications. Accordingly, if the Board approves LUI's use of the deemed long term debt rate for rate making purposes in relation to the note, the Board's updated rate of 3.72% would be used in the preparation of LUI's Draft Rate Order.

In their Submissions, VECC, CTA and Energy Probe all raised concerns about the use of the Board's deemed long term debt rate for 2017 rates. In general terms, the Intervenor's are opposing the use of the OEB's deemed long term debt rate for rate making purposes in the current case.

2. The Affiliate Debt (Note)

As summarized by all parties, LUI currently has a \$7,000,000 promissory note with the Town of Cobourg, which through its ownership of Lakefront, is an affiliate of the electricity distributor. The note has an effective date of May 1, 2000.⁵ The note was amended in 2006 to reflect a correction in the value of the assets transferred to LUI on May 1, 2000. In turn, the amount of the debt was increased from \$4M to \$7M. The interest rate of 7.25% did not change. The promissory note to the Town of Cobourg is affiliated debt, with a fixed rate but with no fixed term. In its submission, OEB Staff stated that having a rate above the OEB's ceiling, meant that it would attract the OEB's current deemed long-term debt rate of 4.54% rather than the actual rate of 7.25%. Although the note is silent on terms of repayment, VECC suggested that the note should be deemed "callable" quoting a previous case where a similar note was deemed "callable" by the Board due to its lack of specific terms. OEB staff stated that it was unclear whether LUI's note is a demand note, whereby only the lender can demand repayment of the principal outside of default, or whether it is a promissory note, where either party can initiate repayment of principal or can negotiate an agreement for repayment.

LUI Reply Submission

LUI submits that there is no provision in the note for its repayment or replacement at LUI's option. The \$7,000,000 is payable on demand for the benefit of the Town of Cobourg.

⁵ Exhibit 5, Attachment A

3. Board Policy

OEB Staff, CTA and VECC addressed the topic of Board Policy in their submission.

OEB Staff's position in this matter is that under the current OEB policies on the Cost of Capital, the current deemed debt rate would be the maximum allowed for recovery as part of the OEB-approved revenue requirement with respect to this debt.

OEB Staff goes on to clarify that although LUI may pay interest at 7.25% to its municipal shareholders, it would not recover that amount in interest in distribution rates as long as the 7.25% was above the OEB's current deemed interest rate.

CTA specifically referred to page 53 of the Report of the Board on the *Cost of Capital for Ontario's Regulated Utilities* dated December 11, 2009 ("The 2009 Report") where the OEB stated (EB-2009-0084):

"...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."

VECC also referred to the above excerpt but also quoted the excerpt below, which states:

"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."

VECC's position on the matter is that 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.

LUI Reply Submission

LUI notes that OEB Staff agree with LUI's application of Board Policy stating that the utility's proposed treatment of the affiliate debt conforms to the OEB's policies on the cost of capital⁶. LUI agrees with the OEB Staff comment that although LUI may pay

⁶ The Board's Mar. 2, 2012 letter setting out the Cost of Capital Parameter Updates for 2012 Cost of Service Applications for Rates Effective May 1, 2012 is available at: http://ontarioenergyboard.ca/oeb/Documents/2012EDR/Ltr_Cost-of-Capital-Parameters_20120302.pdf

interest at 7.25% to its municipal shareholders, it would not recoup that amount in interest in distribution rates as long as the 7.25% was above the OEB's current deemed interest rate. As discussed previously in this reply submission, the 7.25% debt rate has not been used for the purpose establishing LUI's distribution rates in almost a decade. From 2008 onward, updated deemed long term debt rates have been used in establishing LUI's distribution rates.

In numerous past decisions including some as recent as May 2016 the Ontario Energy Board has approved the deemed debt rate to utilities long term affiliate debt.

In the cases listed below, the LDCs concurred with the OEB, VECC, Energy Probe, and SEC for an affiliate deemed debt rate of 4.54%:

- Entegrus Powerlines Inc. - EB-2015-0006
- Grimsby Power Inc. - EB-2015-007
- Guelph Hydro Electric Systems Inc. - EB-2015-0073
- Milton Hydro Distribution Inc. - EB-2015-0089
- Ottawa River Power Corporation - EB-2014-0105

While many (but not all) of these cases were the subject of settlements (the rate for affiliate long term debt was contested in the Ottawa River case, with intervenors supporting the use of the OEB's 4.54% deemed long term rate (for applications for 2016 rates), LUI believes that the OEB should be consistent in applying the long term deemed rate as it has in the past, and that this in turn is consistent with the 2009 Report. LUI does not believe that there is a reasonable basis for a departure from the long-standing policy of using the deemed long-term debt rate for affiliate debt.

LUI believes that the objective of regulatory policy is to ensure that regulations are in the public interest, and LUI believes that the 2009 Report achieved that objective. Comprehensive policies such as the 2009 Report ensure that regulations and regulatory frameworks are justified, of good quality and fit for purpose.

This is not the first time that parties have sought to challenge an LDC's cost of capital by arguing that customer preference for lower rates should outweigh another RRFE objective: financial viability, which is achieved through a stable and predictable application of the Board's well understood policy on cost of capital.

We would refer the panel to three other decisions where cost of capital issues were raised by the intervenors:

- i. The Board's Decision and Order in EB-2009-0139 dated April 9, 2010 (Toronto Hydro-Electric System Limited);
- ii. The Board's Decision and Order in EB-2009-0259 dated March 1, 2010 (Burlington Hydro Inc.); and
- iii. The Board's Decision and Order in EB-2013-0116 dated August 14, 2014 (Cambridge and North Dumfries Hydro Inc.).

The following are Board findings from the above decisions:

Toronto Hydro-Electric System Limited ("THESL")

"The Board finds that it is appropriate to apply the cost of capital policy contained in the 2009 Report ("current cost of capital policy") to set THESL's 2010 cost of capital parameters."

Toronto Hydro-Electric System Limited ("THESL")

"In support of its argument that IO was a viable source of long-term debt, and an alternative to the capital market, VECC filed a single page titled "Lending Rates: Local Distribution Companies" taken from the public website of IO. The Board is of the view that the information provided was insufficient to allow any conclusion to be drawn. The Board will not direct THESL to borrow from Infrastructure Ontario ("IO"). It is the responsibility of the management of THESL, not the Board, to manage the affairs of the utility. Any decisions relating to its financing needs are solely within the purview of THESL. In any event, the Board accepts the evidence given by THESL that IO funding is unlikely to be an appropriate alternative source of financing."

Burlington Hydro Inc.

"The Board agrees with Burlington that the rate to be applied to its long-term affiliate debt will be the lower of 7.25% and the Board's deemed long-term debt rate determined in accordance with the 2009 Report, which is 5.87%. While Burlington will also be entering into a debt arrangement with Infrastructure Ontario, this is for purposes of smart meter installation, which is outside the realm of rate base at this time and therefore not relevant for purposes of determining the return on rate base. The Board does not interpret the provisions of the 2009 Report to be that Burlington is obligated to seek third party financing at this point."

Cambridge and North Dumfries Hydro Inc.

“The purpose of the Board’s policy on cost of capital as articulated in its Decision and Order in EB-2009-0259 is to use a consistent approach, so as to avoid rearguing policy matters on cost of capital in each case. CND’s proposal in this application is entirely consistent with the Board’s policy. CND used deemed, not actual, debt to equity ratios, and the interest costs are calculated in accordance with the Board’s current allowed rates; the actual rates for third party debt, and the deemed rate for affiliate debt. The Board’s policy was the result of a generic process involving a broad range of stakeholders. While it does not require slavish adherence by Board panels, if a party, applicant or intervenor, wishes to urge a panel to depart from the policy, convincing evidence is required. This panel has considered the evidence and arguments made by the applicant and the intervenors and finds that CND’s proposal with respect to cost of capital is entirely consistent with the Board’s policy and finds no reason on the basis of the evidence/arguments put forward to depart from it.”

LUI also submits that it has followed Chapter 2 of the OEB’s Filing Requirements for Electricity Transmission and Distribution Applications, which states that:

“The OEB issues the cost of capital parameter updates for cost of service applications. Distributors should use the most recent parameters as a placeholder, subject to an update if new parameters are available prior to the issuance of the OEB’s decision for a specific distributor’s application. Alternatively, the applicant may apply for a utility-specific cost of capital and/or capital structure. If the applicant wishes to take such an approach, it must provide appropriate justification and supporting evidence for its proposal.”

LUI submits that the arguments presented by the Parties represent a narrow technical interpretation of a part of a policy which the intervenors are using to form a basis for setting just and reasonable rates. On January 14, 2016, the OEB updated the Cost of Capital for Ontario’s Regulated Utilities (EB-2009-0084) and concluded that:

“The methodology adopted in late 2009 has worked as intended. Movement in the parameters have followed macroeconomic trends and activity, and have not resulted in excessive or anomalous volatility.”

LUI submits that it remains appropriate for the Board to continue its practice of using its deemed long term debt rate for affiliate debt that is callable or payable on demand for rate making purposes.

4. Renegotiation Efforts

OEB Staff, CTA and Energy Probe addressed LUI's attempt to renegotiate its debt with its Shareholder. OEB Staff submitted that while there may be valid reasons indicating that the utility could attempt to replace its current debt with debt from third-party lenders, there may also be benefits to LUI from the current promissory note conditions.

Both CTA and Energy Probe allege a discrepancy in LUI's answers to two intervenor questions about whether the utility has attempted to renegotiate the debt rate with its shareholder. Both parties suggested that LUI had contradicted itself in its responses to interrogatories and pre-ADR clarification responses and that both answers could not be true.

In its submission, CTA further argued that it had reviewed documents obtained under the *Municipal Freedom of Information and Protection of Privacy Act* ("MFIPPA") and had concluded that none of the documents indicated that LUI had attempted to renegotiate the note. CTA made reference to LUI's Financial Plan, and asserted that the utility is reticent to make changes to the affiliate loan.

LUI Reply Submission

LUI believes that the purpose of pre-ADR clarification questions is to further explain responses that may have been unclear. In the case of the two questions mentioned by the intervenors, LUI provided a response to ADR 5-CTA-15 which clarified LUI's response to IR 5-CTA-15. The response to Clarification Question superseded LUI's response to the CTA's interrogatory question. LUI's position remains that the utility has had multiple discussions with the Town since 2011 on the subject of the debt. In fact, as indicated in the response to CTA Clarification Question, LUI successfully convinced the Town to suspend dividend payment for a period of five years so that the utility could invest in its distribution system. Clearly, this could not possibly have happened unless a conversation on the subject of debt had occurred. Moreover, this is clear evidence that the utility has made every effort to work with its Shareholder for the benefit of its customers.

LUI submits that it is inappropriate for CTA and Energy Probe to imply, in their submission, that the utility is being willfully dishonest.

LUI submits that it is late in the proceeding for the CTA to be introducing evidence. The parties are in the argument phase, and the CTA is only now (a) presenting selected municipal documents that purport to confirm whether LUI has discussed the reduction of the promissory note rate with the municipality; and (b), as will be discussed later in this reply, presenting the apparent results of CTA's research into interest rates. The CTA has had at least two opportunities to present this material in this proceeding in a manner in which LUI could properly respond – either during the

interrogatory phase or as part of its Clarification Questions. Instead, the CTA has chosen to simply file this material with the Board and claim that it is determinative of the CTA's assertions about discussions with the shareholder regarding the rate, and about other debt rates that should (in the CTA's view) be applicable to LUI. This is not appropriate. However, LUI must respond to the CTA assertions on both items now, because it cannot leave the CTA claims unanswered.

The CTA has now placed on the record, after the record in this proceeding has closed, the results of a freedom of information (FOI) request. The CTA claims that this material indicates that LUI did not discuss the matter of the debt rate on the Promissory Note with its shareholder. LUI submits that the CTA has applied a preconceived, narrow interpretation of an FOI request that appears to support its position. The CTA assumes that because the discussion does not appear on the Town Council minutes, the conversation did not occur. LUI confirms that it has had discussions with its Boards of Directors for both LUI and Town of Cobourg Holdings Inc., both of which include a Town of Cobourg Council member. LUI management has also had discussions with the Town of Cobourg CAO and Director of Corporate Services. As discussed above, the subject of the interest payment occurred in order for the Town to agree to suspend dividend payments for five years in order to allow LUI to increase investments in the distribution system.

As with other material now filed by the CTA, LUI notes that the Financial Plan is new evidence and as such, LUI has not had opportunity to respond. However, LUI can confirm that its Financial Plan was presented to its Board of Directors as support to continue discussions with the Town of Cobourg to re-negotiate the interest rate on affiliate debt.

As with other material now filed by the CTA, LUI notes that the Financial Plan is new evidence, and the argument phase of the proceeding is not the appropriate time for the CTA to file it. However, LUI can confirm that its Financial Plan was presented to its Board of Directors as support to continue discussions with the Town of Cobourg to renegotiate the interest rate on affiliate debt.

OEB staff stated that the renegotiation of the debt is a management decision, and for the utility and its shareholder to decide whether to re-negotiate or replace debt so long as the customer is treated fairly and the amounts recovered in rates are consistent with the OEB's policy and practice with respect to the cost of capital. LUI agrees with the submission of OEB staff and LUI submits that the use of the OEB's deemed long term debt rate for rate making purposes provides for fair treatment of the customer and is consistent with the OEB's policies and practice with respect to the cost of capital.

5. Reasonableness of Interest Rates

The issue with respect to the interest rate is whether the OEB's deemed long-term debt rate should be applied to the affiliate promissory note or whether the utility should try to refinance its affiliate debt with a lower rate than the current deemed debt rate.

In its submission, OEB Staff stated that LUI had acted in accordance with current OEB policies on the Cost of Capital, where the current deemed debt rate would be the maximum allowed for recovery as part of the OEB-approved revenue requirement with respect to this debt. OEB Staff went on to say that while LUI may pay interest at 7.25% to its municipal shareholders, it would not recoup that amount in interest in distribution rates as long as the 7.25% was above the OEB's current deemed interest rate.

In its submission VECC argued that the use of the deemed long term debt of 4.54% is imprudent and unreasonable on the basis that it is described as the ceiling but not a given.

Similarly the CTA's view was that LUI not only could have but should have obtained financing at rates below the allowed 4.54% at any time since 2012 and below their current rate at any time in the last ten years.

Both Energy Probe and CTA submitted the same list of distributors that have been able to obtain rates in the 3% range and below in the following table.

LDC	When	Reference	Rate
Wellington North Power, Inc.	April, 2015	EB-2015-0101	3.28%
Waterloo North Hydro, Inc.	June, 2015	EB-2015-0108	3.43%
Milton Hydro Distribution, Inc.	December, 2015	EB-2015-0089	3.58%
Brantford Power, Inc.	February, 2016	EB-2016-0058	4.20%
Grimsby Power, Inc.	June, 2016	EB-2015-0072	2.00%

Energy Probe also quoted Infrastructure Ontario's lending rates at October 11 2016 emphasizing on a 15-year term at 2.60%. In its argument, Energy Probe implied that the Board should disregard its own policy, including the studies and mechanics that provide the foundation for the 2009 Report, in favor of Energy Probe's calculation of a blended rate of 3.10%.

LUI notes that the CTA has filed new evidence as part of their submissions. As discussed previously, the CTA had at least two opportunities to put this material to LUI at a time when it could have properly responded to it. Instead, the CTA waited until the record was closed. That said, in the interest of concluding this proceeding and also

cooperating with an intervener that is new to the process, LUI will address their issues in its reply submission.

LUI Reply Submission

The information provided by both Energy Probe and CTA is misleading in that it failed to mention that in all other cases (with the exception of Brantford Power), the Board approved the deemed debt rate for their long term affiliate debt. LUI has repeated the erroneous table and presented a corrected version of the table below. As can be seen, the interest rates quoted by CTA and Energy Probe are for third party debt, not affiliate debt. It is clear that in the revised table below, the Board has been consistent in applying its Cost of Capital policy in past decisions. LUI asks no more than the same treatment it its own rate case.

Table as filed by CTA and Energy Probe – Corrected by Lakefront Utilities

Utility Name	Date	Case Number	3 rd Party Debt Rate	Approved Long term Affiliate Debt Rate
Wellington North Power, Inc.	April, 2015	EB-2015-0101	3.28%	4.54%
Waterloo North Hydro, Inc.	June, 2015	EB-2015-0108	3.43%	4.54%
Milton Hydro Distribution, Inc.	December, 2015	EB-2015-0089	3.58%	4.54%
Brantford Power, Inc.	February, 2016	EB-2016-0058	4.20%	4.20%
Grimsby Power, Inc.	June, 2016	EB-2015-0072	2.00%	4.54%
Lakefront Utilities Inc.	November 2016	EB-2016-0089	3.71% (avg)	4.54%

In addition to the above, the following LDC’s also received the OEB-Approved 4.54% on affiliate debt: Hearst Power Distribution Company Ltd (EB-2014-0080); Entegrus Powerlines Inc. (EB-2015-0061); and Ottawa River Power Corporation in May of 2016 (EB-2014-0105). As discussed below, VECC argued for the use of the deemed rate in the contested Ottawa River proceeding. In that case, the utility had requested approval of a rate of 7.25% on its affiliate long-term debt.

Energy Probe also referred to Infrastructure Ontario’s lending rates at October 11, 2016, emphasizing a 15 year term at 2.60%. The intent of this table is to show the volatility of the market rates and to emphasize that it is not appropriate to simply adopt Energy Probe’s snapshot of a rate that favours the Energy Probe position. In a low and declining interest rate world, the apparent short-term gain from abandoning stability might seem enticing, but in a rising high interest rate environment where all debt was marked to market prices would become very volatile and wide variants would be seen amongst incumbents’ financial performance. The assumption that the debt market is not sophisticated and will not shorten the duration on long term bonds in a rising interest rate market is naïve.

Table showing IO’s lending rates as of October 23 2016

Indicative Lending Rates as of 23/10/2016

Term	Construction	Serial	Amortizer
1 Month	1.65%	-	-
5 Year	-	1.89%	1.89%
10 Year	-	2.42%	2.44%
15 Year	-	2.81%	2.85%
20 Year	-	3.08%	3.14%
25 Year	-	3.25%	3.32%
30 Year	-	3.35%	3.42%

In its argument, Energy Probe implied that the Board should disregard its own policy, including the studies and mechanics that provide the foundation for the 2009 Report, in favor of Energy Probe's calculation of a blended rate of 3.10%.

LUI's view of Energy Probe's calculation is that it is shortsighted and overly simplistic. Whereas Appendix C of the 2009 Report - *Method to Update the Deemed Long-term Debt Rate* - uses a methodology that is stable, consistent and proven. The assumption that debt can be "market to market" at any given time might be somewhat plausible for a publicly traded company with third party lenders, but problematic for privately held enterprises. The added complexity in a private market, wholly owned subsidiary model is that the return on debt forms a part of the overall return on investment expectation and therefore often a hybrid interest rate rather than a pure debt equivalent market rate.

Moreover, LUI supports the following statement from the Cost of Capital Review released in January of 2016: "...In setting the cost of capital, the regulator takes into account the risk of the utility (relative to the market and, more importantly, firms and sectors of similar business risk).

VECC's submission in the Ottawa River case included the following comments:

*"Since the promissory notes could not be proven to exist, the intervenors and OEB staff submitted that the replacement notes should be treated as new debt, to which the current deemed debt rate would apply. Ottawa River Power argued that the replacement notes embody the original debt obligation and not new debt. For these reasons, **SEC, VECC and OEB submitted that the OEB's deemed long-term debt rate of 4.54% for 2016 should be the applicable interest rate for the affiliate debt for ratemaking purposes.**"*

LUI submits that the use of the deemed debt rate (now 3.72%) is equally appropriate here.

Excerpt from VECC's final argument

*"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%.**"*

*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%.***

*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%.***

In its final argument, VECC also made the following comment;

25. "...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..."

It is therefore fair to assume that VECC believes that the deemed debt rate is indicative of current market rates. LUI strongly believes that the deemed rate (now 3.72%) is appropriate in this case.

6. Can Lakefront Refinance its Affiliate Debt?

OEB Staff suggest that there is a lack of specificity in the terms and conditions of the Promissory Note and is unclear whether the current promissory note is callable by Lakefront Utilities, or only by the lender (i.e. The Town of Cobourg). The note is explicitly labeled as being a “Promissory Note” (as opposed to a Demand Note). OEB Staff noted that the only reference to repayment terms is as follows:

FOR VALUE RECEIVED, Lakefront Utilities Inc. (the “Borrower”) promises to pay on demand to or to the order of The Corporation of the Town of Cobourg (the “Lender”) ... [emphasis added]

In its submission, CTA stated that it is reasonable to assume that LUI can obtain lower rates. LUI submits, however, that third party debt financing has its limitations and drawbacks.

VECC submitted that the willingness or unwillingness of the Town of Cobourg to have the loan repaid cannot govern whether an excess amount of interest is collected in rates. VECC went on to quote a 10-year old decision which stated that a natural gas distributor cannot rely on a parent company’s lack of consent to amend an improvident arrangement for corporate services provided to its parent company in order to obtain regulatory approval for the cost consequences of the arrangement. VECC further stated that 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.

Energy Probe’s view was that there was no direct evidence has been provided by LUI, but that the distributor appears to imply that it cannot pay off the affiliate promissory note without the approval of the Town of Cobourg.

LUI Reply Submission

In response to CTA’s submission which stated that it is reasonable to assume that LUI can obtain lower rates however, LUI believes that third party debt financing has its limitations and drawbacks. There is the issue of qualification requirements. Unlike CTA, LUI does not believe that it is a given that it could easily get approved for financing. There is the issue of collateral. By agreeing to provide collateral to the lender, LUI could be putting some business assets at potential risk. Finally, there is the issue of flexibility. As mentioned in an earlier section of this submission, under its current arrangement, LUI is currently paying interest only on the debt and has the flexibility to negotiate a payment schedule and/or suspend payment for the benefit of the utility and its customers. If the debt were with a third party, the required principal repayments would cause a significant cash flow burden for Lakefront. LUI is reluctant to surrender this arrangement to satisfy the intervenor’s request. LUI is also concerned about its reputation as a borrower.

As a careful and responsible utility, LUI has a responsibility to look at what its contractual obligations are and whether they are at liberty to unilaterally change those without bringing a legal claim for damages or penalty fees.

As also mentioned earlier in this submission, there is no provision in the note that explicitly grants LUI the right to repay the debt; and contrary to the CTA assertions, which are unsupported, it is not clear that LUI may do so without the agreement of the Town.

As stated previously it is not appropriate that CTA is introducing evidence at this time. Once again, however, in the interest of concluding this proceeding as efficiently as possible, LUI will address the issues raised by the CTA in relation to alternative interest rates in this reply submission.

In its submission, CTA referred several times to the table below which was compiled by the members of their group. The table is misleading as it does not show the most important trend which is the Board Approved long term debt rate. LUI wants to make it clear once again that while it may pay interest at 7.25% to its municipal shareholder, it does not recover that amount in interest in distribution rates – as discussed previously, and that 7.25% rate has not been used in determining LUI's rates in almost a decade.

Table as filed by CTA

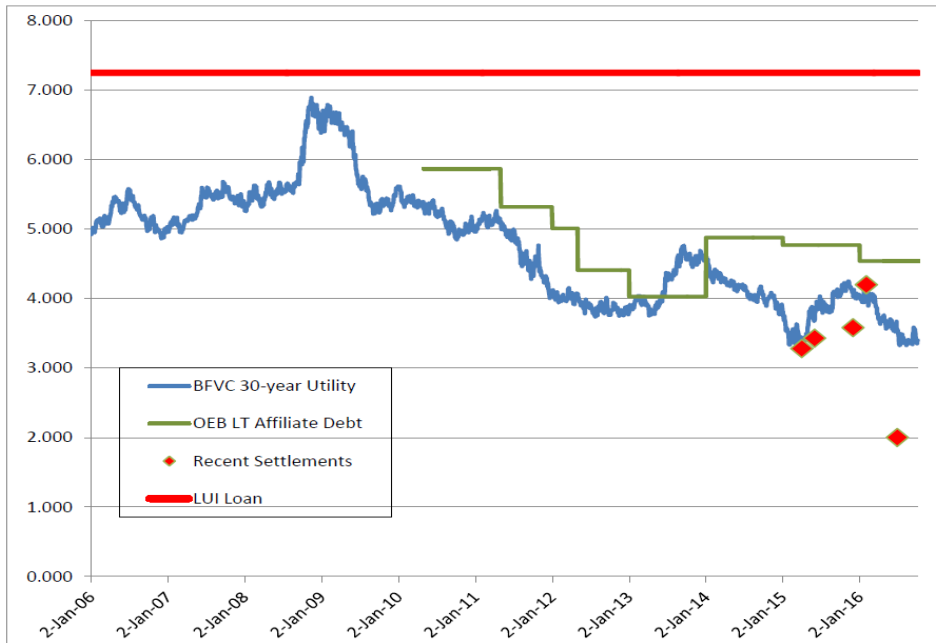
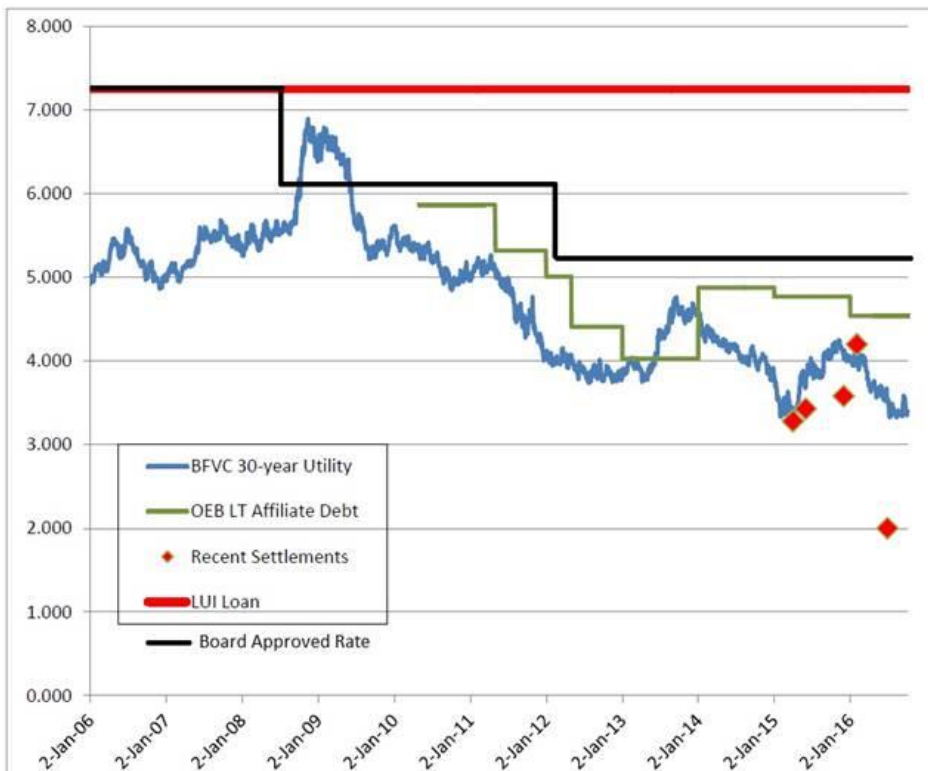


Table as filed by CTA – Corrected by LUI

LUI maintains that while it pays interest at 7.25% to its municipal shareholder, the interest rate recouped in its rates is the OEB deemed interest rate.



In response to VECC's submission which stated that the willingness or unwillingness of Cobourg to have the loan repaid cannot govern whether an excess amount of interest is collected in rates. LUI reiterates that although LUI may pay interest at 7.25% to its municipal shareholders, LUI it does not recoup that amount in interest in distribution rates, and the 7.25% rate has not been used in determining LUI's revenue requirement or distribution rates since 2007.

7. The Impact

On the topic of impacts, CTA's view is that the utility will run into cash flow problems due to costs that are higher than the allowed recovery through rates. CTA calculated the cost to be \$189,700 per year. CTA goes on to state that at its proposed 2.8% rate, cash flow issues would be magnified and financial metrics to be downgraded ultimately affecting LUI's ability to raise new debt and thereby obliging Lakefront to re-negotiate its promissory note with the Town of Cobourg.

Energy Probe parroted CTA's submission that the utility's financial viability is threatened by the continual payment of interest costs that are well in excess of what is included in the revenue requirement.

LUI Reply Submission

LUI began paying interest on the note in May of 2000 at 7.25%, over 16 years ago and since then, the utility has proven itself to be a responsible, well respected utility in the industry by achieving the following outcomes;

- LUI is an industry leader. It promotes and demonstrates effective governance and best in class leadership. LUI innovates and takes reasonable, calculated risks, while finding new ways to increase efficiency.
- In an effort to reduce costs, LUI has reduced its Full Time Employees from 22 in 2012 to 18 in 2017. Instead of replacing the employees, LUI has implemented efficiencies and automation in its internal processes and has instead shifted some workload to other employees, increasing productivity;
- LUI recruits, develops, and retains the qualified staff in the right roles as a highly skilled workforce, driving a culture of high performance and accountability;
- LUI plans on investing to meet the future needs of the system and establishes strategic partnerships to drive operational excellence and leading edge innovation;
- LUI currently has the 4th lowest OM&A cost per customer in the Province of Ontario;
- LUI has the 8th lowest residential rates in the Province of Ontario;
- LUI has repeatedly exceeded the OEB's Service Quality Indicator standards and is recognized as a workplace of choice, providing a safe work environment; and

- LUI is constantly improving its customer service and engagement with its customers as demonstrated by the outreach performed in preparation of its Cost of Service filing. This includes the development of a survey in-house in order to minimize the cost to customers. LUI hears from its customer about the importance of affordable electricity. At the same time, customers also ask for services and have an expectation that the power will stay on and when it is not on will be restored quickly. LUI balances the needs for customer focus, operational effectiveness, public policy responsiveness and solid financial performance.

LUI was able to achieve all of the above, while paying the 7.25% interest rate on the promissory note to the shareholder although receiving the OEB's deemed 4.41% on affiliate debt for rate making purposes since 2012 and 6.10% for the 2008 through 2011 rate years. Even with a lower Board Approved deemed debt rate, LUI has never experienced cash flow problems and has never put its financial viability in jeopardy. Instead, LUI has achieved the above outcomes through a robust budgeting and planning process and continuous review of its business and operational goals against its workforce needs, its financial strength and the impact on its customers.

Consequently, LUI's financial viability and cash flow are not threatened by the interest rate payments. In the vast majority of LDCs, the long term debt is not amortized. Amortization requires periodic payment of capital toward paying down the principal of the debt obligation. There is a real opportunity cost to diverting capital away from capital expenditure programs.

In response to CTA's comment that "*the variability was apparent in the \$221,552 decrease noted in note 20 of Lakefront's 2015 financial statements*", as noted in LUI's response to 1-CTA-09 regarding the decrease in other revenue in note 20 and Note 4 in LUI's 2015 audited financial statements, in preparing its opening International Financial Reporting Standards Statement of Financial Position, LUI has adjusted amounts reported previously in accordance with Canadian GAAP. A detailed table in Note 4 in LUI's audited financial statements provided an explanation of how the transition from Canadian GAAP to IFRS has affected the Company's financial position and performance, similar to most utilities in the Province. As a result, the \$221,552 decrease noted by the CTA is not related to LUI's financial performance but related to the organization's financial statement conversion to IFRS, as mandated by the OEB. This was previously explained to the CTA in LUI's response to the interrogatories.

LUI may be paying higher interest than otherwise would be the case, if it negotiated a lower rate with the Town of Cobourg or it replaced the note with a new debt instrument at a market-based rate. It is ultimately the utility's shareholder which bears the impact of paying interest on the promissory note at a higher-than-market-based-rate. Ratepayers are protected by the OEB's policy described above. Further, any attempt to

reduce the interest rate on affiliate debt reduces the future value of the Town of Cobourg's investment in Lakefront Utilities Inc. which negatively impacts all Cobourg taxpayers and is not in their best interests.

LUI notes that the utility's achieved ROE has always been within 300 basis points of its Board Approved ROE, which is, in LUI's view, an indication that it is fully capable of making decisions based on sound judgement while taking into consideration outcomes, obligations, practicalities, and value to the utility and its customers.

Lastly, the table presented below shows LUI's customer bill impacts based on the settled items and the use of the 2016 long term debt rate. As can be seen, LUI has already made every effort to reduce its distributions rates and minimise the impact to its customers.

Rate Class	Usage		\$ Difference	% Difference
	kWh	kW		
Residential - RPP	750		0.80	0.55%
Residential - non-RPP	750		(4.12)	-3.29%
GS <50 kW - RPP	2,000		2.40	0.64%
GS <50 kW - non-RPP	2,000		(10.70)	-3.28%
GS 50-2999 kW	71,944	191	(454.18)	-4.17%
GS 3000-4999 kW	1,245,322	2,822	(8,281.48)	-4.32%
Unmetered Scattered Load	558		(9.19)	-6.90%
Sentinel Lighting	68	0.2037	(0.02)	-0.10%
Street Lighting	45	0.1057	(1.97)	-13.96%

8. Conclusion

LUI believes that its Cost of Service filing was of high quality and the fact that a partial settlement was reached, is a testament to the completeness and quality of the filing.

Minimizing costs for ratepayers is not just minimizing the interest rate on long-term debt, as the other Parties submit. Rather, it is about finding improvements that optimize processes to strike the right balance between a lower interest rate and higher OM&A and capital costs. None of the Parties have made any mention of these corresponding increases in costs. They would assume that they do not exist. The public interest is not served if ratepayers are made worse off in the long-run because, in changing processes to reduce the interest rate, a utility is forced to reduce OM&A and capital expenditures. The public interest is also not served if the Board imposes an arbitrary reduction on a utility's requirements, thereby forcing management to make rapid and not well tested changes to its existing and proven processes or forcing management to fund the shortfall in revenue requirement by making arbitrary cuts to its operating and capital budgets.

VECC, EP, and CTA make the mistake of resting their submission on the benefit of hindsight. Specifically, they each rely on the knowledge that market interest rates have gone down from 7.25% since the date the notes were first issued. Neither LUI, nor any of the municipalities, knew how interest rates would change when the promissory notes were entered into.

LUI has followed Chapter 2 of the OEB's Filing Requirements for Electricity Transmission and Distribution Applications, which states that: "*The methodology adopted in late 2009 has worked as intended. Movement in the parameters have followed macroeconomic trends and activity, and have not resulted in excessive or anomalous volatility.*"

Decisions of utilities management are generally presumed to be prudent. However, those decisions can be challenged on reasonable grounds. The test, when determining prudence, is whether a decision was 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 and should not be assessed using a very narrow, single-factor lens. Rather, an assessment of prudence should account for all of the considerations relevant to a utility management's decision making.

LUI concludes that the OEB's deemed long-term debt rate should be applied to the affiliate promissory note.

9. Costs

In response to submissions and requests that intervenors be awarded 100% of their reasonably incurred costs, LUI may file submissions on the intervenors' cost claims once those claims are filed. LUI is not in a position to comment at this time on claims that have not been received.