



**Ontario Energy Board  
Commission de l'énergie de l'Ontario**

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**DECISION AND ORDER**

**EB-2016-0089**

**LAKEFRONT UTILITIES INC.**

**Application for electricity distribution rates and other charges  
beginning January 1, 2017**

**BEFORE: Victoria Christie**  
Presiding Member

**Christine Long**  
Vice-Chair

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**December 8, 2016**

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## 1 INTRODUCTION AND SUMMARY

Lakefront Utilities Inc. (Lakefront Utilities) filed an application with the Ontario Energy Board (OEB) to change its electricity distribution rates effective January 1, 2017 (the Application). Under the OEB Act, distributors must apply to the OEB to change the rates they charge their customers.

Lakefront Utilities provides electricity distribution services to approximately 10,000 customers in the Town of Cobourg and the Village of Colborne.

The OEB's policy for rate setting is set out in a report of the OEB entitled "Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach" (RRFE). The RRFE provides the distributor with performance-based rate application options that support the cost-effective planning and efficient operation of a distribution network. This framework provides an appropriate alignment between a sustainable, financially viable electricity sector and the expectations of customers for reliable service at a reasonable price.

Lakefront Utilities asked the OEB to approve its rates for five years using the RRFE Price-Cap Incentive rate-setting option. Lakefront Utilities and intervenors resolved all but one issue associated with the application at an August settlement conference and filed a Partial Settlement Proposal with the OEB on September 21, 2016.

The OEB found that the Partial Settlement Proposal met the expectations of the RRFE and produced outcomes that benefit ratepayers.

The one unresolved issue was the appropriate long-term debt rate applicable to Lakefront Utilities' affiliated debt (i.e. the debt it has with its shareholder, the Town of Cobourg).

The OEB accepts the long-term debt rate proposed by Lakefront Utilities.

After implementing the findings of this Decision, Lakefront Utilities will provide the OEB with a final calculation of its rates and charges. The OEB will review these filings and determine Lakefront Utilities' final rates for 2017.

## 2 THE PROCESS

Lakefront Utilities filed an application on April 29, 2016 for 2017 rates that complied with the OEB's filing requirements. The OEB issued a Notice of Application on June 6, 2016, inviting parties to apply for intervenor status. The Cobourg Taxpayers Association (CTA), Energy Probe Research Foundation (EP), and the Vulnerable Energy Consumers Coalition (VECC) applied for, and were granted, intervenor status. OEB staff also participated in the proceeding.

The OEB issued Procedural Order No.1 on June 29, 2016. This order established the timetable for a written interrogatory discovery process and the convening of a Settlement Conference.

Lakefront Utilities responded to interrogatories and follow-up questions submitted by OEB staff, CTA, EP, and VECC. On August 19, 2016, the OEB circulated a list of the issues raised through the application and interrogatories.

The Settlement Conference was held on August 22 and 23, 2016. Lakefront Utilities, CTA, EP, and VECC resolved all but one issue and filed a Partial Settlement Proposal with the OEB on September 21, 2016 (see Schedule A attached). OEB staff filed its submission in support of the Partial Settlement Proposal on September 28, 2016.

The OEB accepted the Partial Settlement Proposal. On October 6, the OEB issued its Decision on the Partial Settlement Proposal and Procedural Order No.3, which established a written hearing process to address the unsettled issue.

## 3 DECISIONS ON THE ISSUES

### 3.1 Settlement Proposal

Lakefront Utilities agreed to adjust certain aspects of its original application during the settlement process. The Partial Settlement Proposal resolved all issues except the interest rate for Lakefront Utilities' long-term affiliate debt.

#### Findings

The OEB approved the Partial Settlement Proposal in its Decision on the Partial Settlement and Procedural Order No.3. The OEB indicated that it approved the resulting rates, subject to any adjustments arising from the OEB's decision on the unsettled issue.

### 3.2 Long-Term Debt Rate

The Parties were unable to agree on the appropriate long-term affiliate debt rate and the portion of that cost to pass on to customers through rates. Lakefront Utilities has three long-term debt instruments: two third party loans with Infrastructure Ontario (IO); and a promissory note payable to the Corporation of the Town of Cobourg (Cobourg) for the principal sum of \$7 million. Consistent with OEB policies, the actual interest rate associated with the debt is used for rate-making purposes for the third party instruments. The treatment of the cost of the promissory note, as an affiliate instrument, is different.

Since 2000, the OEB has employed a deemed capital structure for distributors. Under this structure, the OEB establishes annually the deemed interest rate for long-term debt. The OEB's Report on the Cost of Capital for Ontario's Regulated Utilities<sup>1</sup> (2009 Report) indicates that the deemed long-term debt rate should be used as a ceiling when loans are secured from an affiliate or have a variable interest rate.

Lakefront Utilities issued a promissory note to Cobourg effective May 1, 2000, for the principal sum of \$7M. The note provides an interest rate of 7.25% per annum, payable monthly, consistent with the OEB's deemed long term debt rate from the 2000 *Electricity Distribution Rate Handbook*. Lakefront Utilities has not used this rate for rate-making purposes since 2007. On rebasing for 2008, the utility reduced the rate to 6.1% and

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<sup>1</sup> [EB-2009-0084 Report of the Board on the Cost of Capital for Ontario's Regulated Utilities](#), December 11, 2009

then for 2012 to 4.41%, consistent with the deemed long-term debt rates that the OEB had established for those rate years.

Lakefront Utilities proposed using the OEB's 4.54% 2016 deemed long-term debt rate as a placeholder in this application, and committed to adopt the OEB's 2017 deemed long-term debt rate when issued. On October 27, 2016, the OEB issued the Cost of Capital Parameter Updates for 2017 Cost of Service and Custom Incentive Rate-setting Applications with a deemed long-term debt rate of 3.72%.

Intervenors and OEB staff made submissions on whether the use of the OEB's long-term debt rate is appropriate. The determination of the appropriate rate hinges on Lakefront Utilities' ability to renegotiate the interest rate and/or repayment terms of the promissory note, to secure third party loans, and/or to establish a reasonable alternative rate.

OEB staff and the intervenors in this proceeding each made submissions on two aspects of the unsettled issue:

(1) Whether the loan is callable by Lakefront Utilities or only payable on demand by its Shareholder (i.e. Cobourg) and (2) What rate is appropriate.

1. Can Lakefront Utilities Initiate Repayment of the Promissory Note?

OEB staff submitted that it is unclear whether the debt instrument 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. The title of the note is "Promissory Note" (as opposed to a Demand Note). However, except in the situation of default, the only reference to repayment terms is at the beginning:

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]

The intervenors generally held the view that the promissory note can and should be repaid by Lakefront Utilities without the Cobourg calling the note, and that doing so is in the best interest of ratepayers.

EP argued that the Notes to the Consolidated Financial Statements of Cobourg for the year ended December 31, 2015 provide additional information on the promissory note. The noted statements indicate that Cobourg does not intend to demand repayment of

the promissory note until replacement term financing is in place<sup>2</sup> (emphasis added). EP submitted that this statement implies that if Lakefront Utilities were to arrange for replacement financing, Cobourg would accept that repayment.

EP further submitted that Lakefront Utilities has not established the prudence of the cost of the long-term debt associated with the promissory note. If the promissory note can be replaced with debt at a rate lower than the OEB's deemed rate, then not doing so is not prudent.

VECC's submission echoed the points raised by EP and VECC further argued that the willingness of Cobourg to have the loan repaid can't govern whether an excess amount of interest is collected in rates. VECC also argued that ratepayer interests should not be subordinate to the demands of the shareholder and recommended applying arms-length commercial standards. The CTA held that a note of this nature is callable at any time by the holder and repayable at any time by the borrower. Lakefront Utilities responded to CTA that the Cobourg long-term note is a legally binding document. Lakefront Utilities further pointed out that while it may have an interest in negotiating a lower rate or paying the debt off entirely with another market instrument, it is ultimately up to Cobourg to accept that proposition due to the nature of the promissory note.

Lakefront Utilities, in its reply submission, also took the position that there is no provision in the note for its repayment or replacement. The principal is payable on demand to the benefit of Cobourg.

## 2. What Rate is Appropriate?

In its submission, OEB staff supported Lakefront Utilities' long-term debt rate as amended in response to interrogatories (i.e. 4.32%). OEB staff submitted that while Lakefront Utilities may be paying a higher interest than would otherwise be the case, Lakefront Utilities' actual return on equity is lower because of the current note parameters. The utility's shareholder bears the impact of paying interest on the promissory note at a higher-than-market-based rate. The OEB's policy protects ratepayers.

Intervenors argued that a market-based rate lower than the OEB's deemed rate should apply to Lakefront Utilities' long-term affiliated debt.

EP submitted that the OEB should deem a rate for Lakefront Utilities on its affiliate debt somewhere in the range of 2.60% to 3.60% - the range seen in other cost of service

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<sup>2</sup> Notes to the Consolidated Financial Statements of the Corporation of the Town of Cobourg (December 15, 2015, Note 5(c), Page 14

applications by electricity distributors that have recently been able to obtain third-party financing.

EP recommended using a 50/50 weighting of the 15 year rate of 2.60% from Infrastructure Ontario (IO) and the 3.60% rate noted above (rounded). This results in a rate of 3.10%. The weighting is appropriate, in the view of EP, because the 15 year term for the IO portion is consistent with the terms of other IO loans held by Lakefront Utilities, while the 3.60% reflects recent third-party rates obtained by other distributors. The 3.10% rate is also close to the 3.19% IO rate for a 30 year term loan.

VECC supported EP's general range and its specific recommendation of 3.10% as reasonable.

The CTA submitted that it is feasible for Lakefront Utilities to refinance its \$7,000,000 note at rates of between 2.4% and 3.09%. It is the opinion of the CTA that rates in this range are entirely feasible to obtain and would be of significant benefit to both Lakefront Utilities and its customers.

In its reply submission, Lakefront Utilities argued that minimizing costs for ratepayers is not just minimizing the interest rate on long-term debt, as the 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". Lakefront Utilities argued that the OEB does not serve the public interest by imposing arbitrary reductions to a utility's requirements, thereby forcing management to make rash changes to its existing and proven processes or to fund the revenue requirement shortfall through arbitrary operating and capital budgets cuts.

Lakefront Utilities also noted that the promissory note was prudently issued based on the facts known at the time and that the intervenors were arguing for a lower rate based on hindsight. Lakefront Utilities reiterated its position that the OEB's long-term debt rate for 2017 (i.e. 3.72% as issued on October 27, 2016 by the OEB), should be applied to its affiliate promissory note.

### Findings

The OEB approves Lakefront Utilities' application of the OEB's deemed long-term debt rate of 3.72% to the affiliate debt for rate-making purposes. While Lakefront Utilities may continue to pay the Cobourg 7.25% interest on the \$7M principal debt under the current terms of the promissory note, shareholders (not ratepayers) will bear the costs of the difference between the 7.25% and the 3.72%.

The OEB has the discretion to determine the rate considering OEB policy and the utility's claim of need, cost and proof of prudence. For the reasons outlined below, the



OEB concludes that Lakefront Utilities' use of the OEB's 2017 long-term debt rate for rate-making purposes is reasonable and consistent with OEB policy.

The OEB policy contemplates that adopting the deemed long-term debt rate in this case is appropriate. The 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities* (EB-2009-0084) formalizes the OEB's deemed long-term debt rates and deemed capital structures approach. The OEB will generally approve the actual or forecasted interest rate as representative of the "market rate" for third party debt with fixed rates. The deemed long-term debt rate may be used as a proxy or ceiling for the "market rate" under a number of circumstances, including affiliate debt – where the deemed long-term debt rate at the time of issuance is considered as the allowable rate ceiling.

The affiliate debt that Lakefront Utilities holds with Cobourg for the principal sum of \$7M has a 7.25% interest rate, consistent with the OEB's deemed long-term debt rate at the time it was issued. This arrangement was considered prudent at the time.

It is not clear that the terms and conditions of the promissory note would permit Lakefront Utilities to either renegotiate the rate or pay off the debt at will. The sole reference to repayment in the note is not specific. The OEB concludes therefore, that the choice of appropriate interest rate for the long-term debt cannot depend on the renegotiation of the terms and conditions of the promissory note.

Further, there is no evidence that Lakefront Utilities would be able to attain third-party market financing (even if they were to renegotiate the promissory note), or that the risk and transaction costs associated with such financing would outweigh the benefits of less volatile, more predictable affiliate debt.

Lakefront Utilities has been consistent in their treatment of the affiliate debt over time. They have utilized the initial promissory note interest rate as a ceiling, and have adopted, at each rebasing, the applicable OEB deemed long-term rate of interest for rate-making purposes. The shareholders, rather than customers, absorb the cost of the difference between the 7.25% and the deemed rate.

As per the 2017 Cost of Capital Parameter Updates, the OEB considers the deemed long-term debt rate to be reasonable and representative of market conditions at this time. There is insufficient evidence to suggest that the methodologies used by the intervenors to develop alternative market rates are superior to the one used by the OEB.

Lakefront Utilities' use of the OEB's long-term debt rate for rate-making purposes is consistent with the treatment of other cases the OEB has considered. The OEB has

accepted the use of the OEB's deemed long-term debt rates, as updated annually, for use in rate-making with respect to long-term affiliate debt instruments in prior cases, including: Hydro Ottawa (EB-2015-0105); and Hydro One Brampton Networks Inc. (EB-2010-0132). The deemed long-term debt rate has likewise been accepted as the appropriate rate for affiliate debt by intervenors and distribution companies in a number of recent settlement agreements.

The OEB concludes that the use of the deemed long-term debt, as updated to 3.72% for 2017, is likewise appropriate for use by Lakefront Utilities for the promissory note with the Cobourg. Shareholders will absorb the cost of the difference between the 7.25% interest paid to Cobourg and the 3.72% recovered from customers through rates.

## IMPLEMENTATION

Lakefront Utilities shall include the cost consequences of the settlement proposal, updated to incorporate the approved long-term debt rate of 3.72%, in its calculation of its revenue requirement for recovery from customers.

The OEB expects Lakefront Utilities to file detailed supporting material showing the impact of this Decision on the overall revenue requirement, the allocation of revenues between classes and the derivation of base rates.

The CTA, EP and VECC are eligible for cost awards in this proceeding. The OEB has made provision in this Decision for these intervenors to file their cost claims following the OEB's issuance of the final Rate Order. Intervenors should note that the OEB does not intend to allow for an award of costs for the review of the draft rate order or for the filing of any comments on the draft rate order. The OEB will issue its cost awards decision after the following steps are completed.

## 4 ORDER

### THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Lakefront Utilities Inc. shall file with the OEB and forward to intervenors a draft rate order with a proposed Tariff of Rates and Charges attached that reflects the OEB's findings in this Decision and Order, within **7 days** of the date of this Decision and Order. Lakefront Utilities Inc. shall also include customer rate impacts and detailed information in support of the calculation of final rates in the draft rate order.
2. Intervenors and OEB staff shall file any comments on the draft rate order with the OEB, and forward to Lakefront Utilities Inc., within **7 days** of the date of filing of the draft rate order. **The OEB does not intend to allow for an award of costs for the review of the draft rate order or for the filing of any comments on the draft rate order.**
3. Lakefront Utilities Inc. shall file with the OEB and forward to intervenors, responses to any comments on its draft Rate Order within **7 days** of the date of receipt of the submission.
4. Intervenors shall submit their cost claims no later than 7 days from the date of issuance of this Decision and Order.
5. Lakefront Utilities Inc. shall file with the OEB and forward to Intervenors any objections to the claimed costs within 17 days from the date of issuance of this Decision and Order.
6. Intervenors shall file with the OEB and forward to Lakefront Utilities Inc. any responses to any objections for cost claims within 24 days from the date of issuance of this Decision and Order.
7. Lakefront Utilities Inc. shall pay the OEB's costs incidental to this proceeding upon receipt of the OEB's invoice.

All filings to the OEB must quote the file number, EB-2016-0089, filed through the Board's web portal at <https://www.pes.ontarioenergyboard.ca/eservice/>, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at

<http://www.ontarioenergyboard.ca/OEB/Industry>. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file seven paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Georgette Vlahos at [georgette.vlahos@ontarioenergyboard.ca](mailto:georgette.vlahos@ontarioenergyboard.ca) and Board Counsel, Ljuba Djurdjevic at [ljuba.djurdjevic@ontarioenergyboard.ca](mailto:ljuba.djurdjevic@ontarioenergyboard.ca).

**DATED** at Toronto December 8, 2016

**ONTARIO ENERGY BOARD**

*Original Signed By*

Kirsten Walli  
Board Secretary

**SCHEDULE A**  
**DECISION AND ORDER**  
**LAKEFRONT UTILITIES INC.**  
**EB-2016-0089**  
**DECEMBER 8, 2016**