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January 3, 2016

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
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Dear Ms. Walli:

Re: EB-2015-0089–Lakefront Utilities Inc. (LUI)
Submission on cost claim objections of LUI of December 22, 2016

VE#CC is in receipt of LUI's submission of the above-noted date. VECC extends its thanks for the additional time for VECC counsel to file a response to the same. We will endeavour to respond to the submissions by LUI objecting to the intervenor costs associated with the written hearing of the issue of the appropriate rate of interest to be attributed to the long term affiliate debt.

We would note, in passing, the relatively unusual nature of LUI making cost objections in a proceeding with a partial settlement encompassing all but one issue, and a written hearing. LUI's high dudgeon concerning the seeking of potentially a better deal for ratepayers on long term affiliate debt seems somewhat excessive.

However, we wish to address the substance of LUI's objections that appear to be set out in the "three principles" in the correspondence of the December 22, 2016 correspondence. These are:

1. *Ratepayers ought not to be required to fund activities or interventions that do not materially contribute to the Board panel's understanding and resolution of the issues in any given case*.
2. *Ratepayers ought not to be required to fund activities or interventions that become the basis for an intervenor to conduct a broad public campaign, the intent of which may be to influence the outcome of the Board's processes. The Board's processes are well defined and prescribed by law. Intervenors who attempt to influence or circumvent those processes ought not to be rewarded by ratepayers for costs that they incur.*
3. *Costs should be awarded for, and should encourage, responsible participation in Board proceedings.*

Principles 1 and 3 are uncontentious. We are frankly at a loss to understand what broad public campaign LUI is referring to Principle 2. As far, as we aware, VECC's public participation was confined to its Board filings including its final written Argument. In any event, the setting of rates is a public process. The Board encourages public engagement both in the making of the application but also by going out the affected communities prior to the hearing of an application.

We would conclude from LUI's submissions that the quantum of time spent by VECC's representatives in the making of written submissions was not an issue, but whether any time should have been spent at all challenging the LUI position on the interest rate applicable to the affiliate long term debt. As LUI's proposed interest rate was accepted in the Board Decision of December 8, 2016, we believe it is instructive to briefly review the relevant provisions of the existing OEB 2009 Cost of Capital Report, the VECC submissions in the written proceeding herein, and the Board Decision. The accompanying discussion has not been done to critique or re-argue the Decision herein. We submit, however, the analysis rebuts any inference that VECC's final argument submissions were a challenge to what the applicant apparently believes was its clear application of well-defined Board policy and precedent.

The Board 2009 Cost of Capital Report contained the following relevant provisions[1]:

> In distribution utility rate applications heard by the Board since the issuance of the December 20, 2006 Report, the Board has made determinations on the treatment of long-term debt that not only reflect the 2006 guidelines, but are based on the record before it in each application. The Board has also been informed by the findings made in relation to completed applications. **The Board is of the view that it is appropriate for this cost of capital policy to reflect the current practices of the Board with respect to determining the cost of long-term debt based on recent Board decisions**.
>
> The following guidelines on the treatment of long-term debt are intended to provide more certainty for applicants and all participants in general. **The Board wishes to emphasize that the long-term debt guidelines relating to electricity distribution utilities are expected to evolve over time and are expected to converge with the process used by the Board to determine the amount and cost of long-term debt for natural gas distributors**. The Board recognizes that there is still a need for the deemed long-term debt rate, however its usage should become more limited in application. The Board wishes to reiterate that the onus is on the distributor that is making an application for rates to document the actual amount and cost of embedded long-term debt and, in a forward test year, forecast the amount and cost of new long-term debt to be obtained during the test year to support the reasonableness of the respective debt rates and terms.
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> The following guidelines are relevant with respect to the determination of the amount and cost of long-term debt for electricity distribution utilities.

[1] EB-2009-0084, "Report of the Board on the Cost of Capital for Ontario's Regulated Utilities". December 11, 2009, pp.50-54

The Board will primarily rely on the embedded or actual cost for existing long-term debt instruments. 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.

Third-party debt with a fixed rate will normally be afforded the actual or forecasted rate, which is presumed to be a "market rate". However, the Board recognizes a deemed long-term debt rate continues to be required and this rate will be determined and published by the Board. **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:

- 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.
- The deemed long-term debt rate will be used where an electricity distribution utility has no actual debt.
- 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.
- 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.

VECC Final Argument Positions based on the 2009 Report

1. The affiliate debt is callable on demand (within the test year period);
2. The ceiling is the maximum allowed not an automatically deemed rate;
3. The Board expects the long term debt of electricity distributors to converge with the gas distributor requirements and be motivated to make commercial third party debt arrangements;

4. Based on the fact that the OEB has the discretion to determine the rate based on the utility's claim of need, cost and proof of prudence, the inability to obtain consent of the shareholder to refinance the debt should not be an impediment to imputing reasonable market rates;
5. Commercial rates for financing are available that are lower than the OEB's deemed long term debt rate of 4.54% and as such should be imputed ;

OEB Decision of December 8 on VECC positions

1. We note that the Decision is somewhat confusing to us on this point. The2009 Board Report at pp.53-54 differentiates between a debt "callable on demand" and a fixed rate debt. A callable note in common commercial parlance is one that is callable by the holder of the debt[2]. However, the Board Decision appears to define the issue of classification of the debt instrument as "whether the loan is callable by Lakefront Utilities or only payable on demand by its Shareholder[3]. With respect, payable on demand connotes a callable debt and has been interpreted as such by the Board[4].

   In the event that the note was not callable, LUI would be entitled to collect the full amount of the interest rate being the Board's deemed rate at the time of issuance pursuant to the fixed rate provision of the Report. If the note is callable then, accepting the December 8 Decision on other points, the current Board's deemed interest rate applies. Since most promissory notes (unlike callable bonds which are callable by the issuer) are payable on demand, and as a utility usually has little bargaining power with its shareholder to insert a right of repayment, it seems to VECC that the former "non-callable" conclusion would be an unlikely interpretation of the Board's Decision. That interpretation would also not accord with the result.

   Because of the Board's conclusions concerning the symmetry of the Board's deemed long term rate with commercial market rates (see 5 below), the ultimate result urged by VECC could not ultimately succeed in any event. However, we note the problems of interpretation that can arise in the context of the application of the guidelines of the 2009 Report (and, in our view, continue to do so) despite what Lakefront characterizes as settled policy results.

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[2] A number of financial websites confirm the use of "callable" in similar circumstances. See http://www.businessdictionary.com/definition/callable.html callable is defined as "payable on demand", http://finance.zacks.com/demand-notes-9924.html "A demand note is a promissory note that is callable or payable on demand. Unlike most bonds and long-term loans, no default or cause is required for the lender to demand repayment of the loan. A demand note has no fixed term or specified maturity date and can be used for short- or long-term loans. They are typically provided as unsecured, subordinated debt. The interest rates on demand notes are set at the beginning, but generally vary according to contractual terms with periodic adjustments." See also: http://cpaquebec.ca/en/public-and-media/media-centre/news-and-publications/classification-of-long-term-debt-as-a-current-liability-in-an-entitys-balance-sheet-significance-of-debt-agreement-provisions/

[3] Decision and Order, December 8, p.4

[4] EB 2008-0248 West Coast Huron Energy Inc. Decision of the Board, p. 21

2. Depending on the view taken of the "callable" issue, it would appear that the Board imported the wording of the Report's section on fixed rate long term rates - "proxy or ceiling" -into the callable debt provision that only uses the word "ceiling". The Decision was that "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 ceiling- the deemed long-term debt rate- is thus normally the rate to be allowed (and not just a ceiling on a range of possible rates that might be applied).
3. There is no reference in this Decision to the expected evolution of long term debt practice by electricity distributors as envisioned by the Report. The practical effect of this expectation in the Report going forward remains unclear.
4. The OEB accepted that it possessed the discretion to determine rates in accordance with the Report but appeared to later modify the same based on LUI's ability to refinance[5]. Whether the utility's right to refinance affiliate debt can control or impede the imputation of a reasonable market rate did not need to be resolved because of the disposition of Position 5.
5. The Board Decision found insufficient evidence of the desirability of re-financing the affiliate debt based on the perceived benefits of a less volatile predictable rate with the affiliate and a lack of evidence for an improvement of the long-term debt rate in the commercial markets.[6]

VECC would note that issues 1-4 were not a challenge to the existing policies of the Board but a requested application of the same. Apart from the West Coast Huron Energy case earlier referenced, we do not believe the issues associated with the positions advanced in VECC's written argument have been directly argued or addressed in past Board proceedings. Position 5 was, of course, directly related to the matters and circumstances pertaining to LUI's application and, presumably escapes the thrust of LUI's critique.

However, the decision to proceed to a written rather than an oral hearing was a matter of judgment on the part of the intervenors. It precluded the possible solicitation of expert evidence on the remaining issue, as well as the possibility of adducing further market information, apart from recent results of utility debt refinancing and certain publicly available rates. VECC would submit that this method of proceeding, though unhelpful to its case, was advanced in the interests of expediting the determination of the issue and in accordance with its assessment of the possible evidentiary record. The choice of a written, rather than an oral, hearing was a responsible, if perhaps incorrect, decision.

LUI cites a number of proceedings in which the Board's long term debt rate was accepted by intervenors as the applicable rate for long term affiliate debt. It is to be noted that in the Entegrus, Grimsby , Guelph and Milton[7] proceedings , the affiliate long term debt rate was used in full or partial settlement agreements with the applicant utility. Settlement agreements may or may not involve a resolution of

[5] "The OEB concludes therefore that the choice of the appropriate interest rate for the long term debt cannot depend on the renegotiation of the terms and conditions of the promissory note". p.7, December 8 Decision.
[6] The Board's long term debt rate, in the time between the final argument and the Decision had changed from 4.54% to 3.72%.
[7] Milton's refinancing of some of its debt at 3.58% was cited in EP's final argument herein.

some issues by amendments to the application in consideration for the acceptance of others. The requirements of confidentiality in the settlement process preclude VECC from revealing any rationale or consideration benefitting ratepayers associated the acceptance of a specific term in any agreement. LUI was not a party to these applications, and there is no basis for its contention that this was "a sixth attempt to circumvent the OEB's policy on affiliate debt". There was also no onus on VECC or EP to agree to the same arrangements with LUI.[8]

The Ottawa River Power Corporation (EB-2014-0105)application and the Hydro One Brampton Networks Inc.(EB-2010-0132) did involve Board determinations applying the OEB's deemed long term rate, but there was not a dispute concerning whether the long term rate was reasonable in comparison to commercially available rates. In Ottawa River, the issue concerned whether a fixed rate was in place in the agreed affiliate debt terms or a variable rate that was set in tandem the OEB's long term debt rate. In Hydro One Brampton, the issue concerned whether the applicant's forecast debt rate should be used or the OEB's then long term debt rate. In VECC's view, the two Decisions were not instructive to the resolution of the issues herein.

Conclusion

As noted, VECC agrees with Energy Probe that the request for a written hearing of the remaining issue was not a challenge to existing Board policies, but seeking the application of the same in accordance with submissions. The intervenors were not successful, but as we have set out herein , the positions taken were hardly a repudiation of previously determined Board policies or applicable precedent. In any event, while this is not the case here, existing policies or guidelines can be responsibly challenged, scrutinized, and modified in their use when reasonable results, in accordance with statutory regulatory responsibilities, are not being obtained by their application .

We would respectfully ask that the Board reject the cost objections of LUI and make no adjustment to the cost claims of the intervenors herein.

Yours truly,

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[8] The December 8 OEB Decision herein notes on page 8 the adoption of the deemed long term debt rate in EB-2015-0105 Hydro Ottawa proceeding. This was also as a result of a settlement agreement.