



Lakefront
Utilities
Inc.

August 25, 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. 2017 COS Rates Application, Interrogatory Responses
Board File No.: EB-2016-0089**

Dear Ms. Walli:

Please find enclosed Lakefront Utilities Inc.'s ("LUI") Pre-ADR clarification responses to Cobourg Taxpayers Association ("CTA") received on August 21, 2016.

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
Manager of Regulatory Compliance and Finance

EB-2016-0089
Pre-ADR Clarification Question Responses from Lakefront Utilities Inc.
2017 Cost of Service Rate Application
Lakefront Utilities Inc.
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[Contents](#)

1-CTA-01 4

1-CTA-08 6

1-CTA-12 8

5-CTA-15 9

AnnRep-CTA-16 10

AnnRep-CTA-18 11

PILS-CTA-29 13

1-CTA-01

Corporate and Utility Organization Structure

Ref: Ex.1/Tab2/Sch.2 – Corporate and utility Structure, Page 22

Lakefront Utilities essentially dismissed all of the questions raised by the CTA in 1-CTA-1 arguing they fell outside the mandate of Lakefront Utilities Inc.'s Cost of Service Rate application rules, codes and guidelines, and regulatory process. LUI's response went on to say "Costs related to non-regulated affiliated companies have nor (*sic*) correlation to LUI's operations, revenues, expenses, nor rates. These questions should be addressed to the Holdco board of directors outside of LUI's regulatory procedure."

On the other hand, LUI provided answers to questions that OEB staff posed (1-Staff-3) regarding the allocation of administrative services due to LUI's corporate restructuring and efficiencies realized by Lakefront Utilities' parent company as a result of these amalgamations.

The questions raised by the CTA all dealt with what were Lakefront Utilities subsidiaries prior to the sale of Cobourg Network Inc. (CNI) to Lakefront Utilities Services Inc. (LUSI), an affiliate company under the corporate structure of Town of Cobourg Holdings Inc. (Holdco) effective January 1, 2016. For the record, it is the CTA's understanding that Lakefront Utilities had three subsidiary companies:

- Lakefront Generation Inc. (LGI) until it was sold to and merged with LUSI, an affiliate company, effective January 1, 2013.
- Lakefront Lighting Inc. (LLI) which was a subsidiary until it was merged on January 1, 2015 with Cobourg Networks Inc. (CNI), a subsidiary of Lakefront Utilities.
- CNI, which remained a subsidiary of Lakefront Utilities until it was sold to and merged with LUSI, an affiliate company, effective January 1, 2016.

The CTA holds that:

- 1) Lakefront Utilities has provided preferential treatment in its response to OEB staff by properly responding to its questions but has demonstrated a discriminatory and prejudicial position against the CTA by dismissing the legitimacy of its questions in their entirety.
- 2) The questions raised by the CTA relate to actions which have a direct impact on LUI's operations, revenues, expenses and the extent of the proposed rate increase.
- 3) The gain or loss that took place when LGI was sold by Lakefront Utilities to LUSI on January 1, 2013 and how this was passed on to LUI's customers at that time is of material importance to LUI's profitability and the proposed rate increase.
- 4) The gain or loss that took place when CNI was sold by Lakefront Utilities to LUSI on January 1, 2016 and how this was passed on to LUI's customers is of material importance to LUI's profitability, allowed RoE and the proposed rate increase.

5) The request for detail regarding the quantity and value of the remaining inventory of Luxlite induction lighting at the time of the settlement of the successful lawsuit by Osram Sylvania Inc. which ruled against LLI in July 2012 and how the inventory was subsequently disposed of and at what price while it remained a subsidiary of either LUI or CNI, LUI's subsidiary until CNI was sold on January 1, 2016 is of material importance to LUI's profitability since July 2012 and the proposed rate increase.

Lakefront Utilities Response

Lakefront Utilities Inc. ("LUI") does not have nor has it ever had any subsidiaries. LUI is an Ontario *Business Corporations Act* corporation, licensed by the OEB as an electricity distributor. By virtue of its licence and registration and Affiliate Relationship Code, LUI maintains separate accounting records, separate from its sister affiliates and parent company. As such, business conducted by LUI's parent company (Holdco) associated with Holdco's other subsidiaries (LGI, CNI, LUSI) is separate and independent of LUI and its accounting and this rate application process. Please see Exhibit 1, Tab 2, Schedule 2 of the Application for a chart showing the structure of LUI's corporate family. LUI notes that the evidence at Ex. 1/Tab 2/Sch.2 line13 (or page 22/246) was erroneous. The evidence should have read "*Historically, LUI had three other affiliated companies; Lakefront Generation Inc. ("LGI"), Lakefront Lighting Inc. ("LLI") and Cobourg Networks Inc. ("CNI").*"

1-CTA-08

Customer Survey

Ref: Ex.1/Tab5/Sch.2 – Customer Satisfaction Survey, Page 51

1) In its response, Lakefront says it feels the response rates of approximately 2% received were reasonably acceptable for measuring customer satisfaction.

Please explain the basis for this conclusion.

2) In its response, Lakefront says it did not gather information associated with the responder's income and age, and is ever cognizant of operating within the Privacy Act.

If respondents were not asked to provide their names or other information, such as account number or address, that would identify who they were, how would asking for information regarding age or income be in violation of the Privacy Act?

3) Lakefront mentions that it used Facebook and Twitter to improve the survey response rate and to improve accessibility to information, such as outages, to inform its customers.

What percentage of Lakefront's customers follow its' Facebook and Twitter accounts?

4) To improve accessibility to information for its customers, LUI notes in its response that one of the steps it has taken is the preparation of an Annual Report, which details the accomplishments of the utility throughout the year. However, in response to Question a) posed by the CTA under AnnRep-CTA-24, Lakefront Utilities states that it does not produce an Annual Report that is specific to its own operations.

Please explain this inconsistency.

Lakefront Utilities Response

- 1) Lakefront Utilities feels that its response rate is acceptable for measuring customer satisfaction as it received value-added feedback received from customers. LUI also notes that it prepared the customer satisfaction survey internally, as opposed to spending approximately \$25,000 to \$35,000 for a third-party to perform the survey.
- 2) LUI focused its customer satisfaction survey activities on customer classes. LUI is not prepared to request personal information (including age and income) from its customers for the purposes of the survey. The OEB requires LUI to consider bill impact on its customer classes generally, based on various consumption profiles, including the impacts on the 10% percentile of consumption in the residential class with a view to determine whether any mitigation is warranted.

- 3) As indicated in our IRs response, LUI initiated the use of social media recently, which is in its infancy stage, as one of multiple ways of improving information sharing with its customers. Approximately 3% of LUI's customers currently follow its Twitter account which is not unlike LUI's neighboring utilities.

- 4) The Annual Report in question was prepared by LUI's parent company (Holdco) which highlights some of LUI's activities in 2015. LUI contributed to the preparation of the Annual Report for the first time in 2015.

1-CTA-12

Board Qualifications

Ref: Ex.1/Tab 8/Sch.3 – Board Mandate, Page 134

Please detail the recruitment process for LUI's Board of Directors. Specifically, are the positions where the Term of Office is due to expire, publicly advertised and are all residents of LUI's service area encouraged to submit applications?

Lakefront Utilities Response

LUI's Board of Directors are appointed by LUI's parent company, Holdco. Holdco advertises in the local newspapers and online for Directors' vacancies when their term of office are expired.

5-CTA-15

Long Term Note

Ref: Ex. 5, Attachment A – Long term Note Payable to the Town of Cobourg, Page 11

Ref: Appendix 2 of this OEB Submission

The long-term note dated September 12, 2006 with effect as at May 1, 2000 is at an annual interest rate of 7.25%.

Beginning in January 2008, the prime business loan rate has declined from 6.00% to a low of 2.70% where it currently stands. During this same period the rate for 3 month Bankers Acceptances has declined from 3.97% to a low of 0.83%.

Please explain when Lakefront Utilities began the investigation of costs savings with replacing all or some part of the affiliate debt with a lower long-term rate lower than the approved maximum deemed rate for affiliated debt. Renegotiating the demand note interest rate of 7.25% to the current market rate of perhaps 2.5% would reduce the RRWF by almost \$150,000. This would be of significant benefit to LUI's customers.

Lakefront Utilities Response

The interest rate of 7.25% is the rate set out in the Promissory Note, but the rate being recovered in LUI's distribution rates is lower, and has been since 2008. LUI's current Board-approved rate for LUI's long term debt is 4.33%, and that rate has been in place since LUI's last rebasing in 2012. That was the OEB's deemed long term debt rate for 2012. Prior to that, in 2008, the OEB approved a rate of 6.10% for LUI's long term debt for rate making purposes. Again, that rate corresponded to the OEB's deemed long term debt rate for 2008.

In LUI's current rate application, LUI has requested approval of a long term debt rate of 4.32%. This reflects a weighted average of the Promissory Note at the OEB's current deemed rate of 4.54% and the Infrastructure Ontario rates of 3.38% and 4.03% on two IO loans. LUI has proposed to update the rate on the Promissory Note for rate making purposes to the OEB's deemed long term debt rate for 2017 rates, which is expected to be issued in the late fall of this year. The proposed long term debt rate can be found at Exhibit 5, Tab 1, Schedule 3 of the Application, or (p.6 of 36 of the electronic version of Exhibit 5.

The Town of Cobourg long-term note is a legally binding document and although LUI may have interest in negotiating a lower rate or paying it off entirely with another market rate, it is ultimately up to the Town of Cobourg to accept that proposition. LUI has had discussions with the Town since 2011 on the subject.

AnnRep-CTA-16

Holdco Dividend

Ref: AnnRep, Financial Performance, Page 2

Is LUI's response to Question a) in effect saying that Holdco's annual dividend to the Town of Cobourg excludes any net regulated income of LUI and that all of LUI's net regulated income is directed towards meeting infrastructure needs?

Lakefront Utilities Response

Lakefront Utilities confirms that the annual dividend to the Town of Cobourg excludes LUI's net regulated income and LUI's net regulated income is directed to infrastructure needs.

LUI also made arrangements with the Town of Cobourg to suspend dividend payments to its shareholder and instead reinvest the funds into maintaining its distribution system and meet its infrastructure needs.

AnnRep-CTA-18

Allocation of Costs

Ref: AnnRep, Human Resources and Overhead Costs, Page 6

Lakefront Utilities response to Question b) says it believes a summary to “detail the individual salary and benefit costs for senior management” would cause privacy concerns. It goes on to say “Furthermore, this is not a requirement of Chapter 2 of the OEB’s Filing Requirements for Electricity Transmission and Distribution Applications.”

1) Please explain Lakefront Utilities’ rationale for the conclusion that detailing individual salary and benefit costs for senior management would cause privacy concerns. Ontario’s Public Sector Salary Disclosure Act, 1996 (makes Ontario’s public sector more open and accountable to taxpayers by make public the names, positions, salaries and total taxable benefits of employees paid \$100,000 each year. If the Ontario government does not consider the publication of this information to be a privacy issue for more than 115,000 public-sector employees, it stands to reason that it should not be a concern for Lakefront Utilities. Prior to 2000, Lakefront Utilities employees being Town of Cobourg employees were subject to this Act. The decision by Lakefront Utilities to not disclose this information suggests that it does not support being open and transparent to ratepayers and the citizens of the Town of Cobourg who are the *de facto* shareholders of Holdco and its subsidiaries including LUI.

2) While Chapter 2 of the Filing Requirements for Electricity Transmission and Distribution Applications explains the OEB’s objective of an outcomes-based regulatory model and its’ streamlined approach to the information required in Appendix 2-K, the OEB nevertheless expects a description of distributors’ compensation strategy and a complete explanation of their basis for performance pay, eligible employee groups, goals, measures and review processes for any pay-for-performance plans and any relevant studies such as, compensation benchmarking, conducted by or for the applicant. The applicant must provide details of employee benefit programs, including pensions and other historical costs charged to OM&A for the last OEB-approved rebasing application, and Historical, Bridge and Test Years.

As mentioned in your response to 2-Staff-43, please provide copies of the 2016 Mearie Management Salary Survey of Ontario LDCs and the 2016 CHEC Wage and Benefit Analysis. If the 2016 versions of these benchmarks are not available, please provide the 2015 version.

Lakefront Utilities Response

- 1) LUI and other municipally owned electricity distributors are not subject to disclosure under the Ontario Public Sector Salary Disclosure Act, 1996. This information is personal information; it is not required by the OEB; and in the absence of a statutory requirement to disclose this information, LUI will not provide it.

- 2) As mentioned in LUI's response to IR 2-Staff-43, LUI has participated in the Mearie and CHEC surveys, however these reports are not yet available.

PILS-CTA-29

Non-Deductible Interest

Ref: Lakefront Utilities_APPL_2017COS_Test_year_Income_Tax_PILs_Workform_2016
0429.xls,

Tab H1 Adj Taxable Income Historic Year

Tab T1 Taxable Income Test Year

Are we to take Lakefront's response as an abdication of management's responsibility for the accurate and timely filing of Lakefront's corporate tax returns?

The question is relevant due to the non-arms length nature of the loan and the above market interest rate. If the CRA were to disallow a portion of the interest expense claimed, Lakefront could incur a considerable tax and interest liability.

Will Lakefront stipulate that the consequences of such an event would not be passed on to its customers?

The CRA makes the following comment regarding interest deductibility:

S3-F6-C1, Interest Deductibility

<http://www.cra-arc.gc.ca/tx/tchncl/ncmtx/fls/s3/f6/s3-f6-c1-eng.html#N10764>

Generally, interest expense is considered to be a capital expenditure and is not deductible unless it meets specific requirements of the Act, such as those contained in paragraph 20(1)(c). Among other specific requirements is the requirement that:

“an amount be paid in the year or be payable in respect of the year under a legal obligation to pay interest; and, **an amount be reasonable.**”

Reasonable amount:

The amount of interest deductible under paragraph 20(1)(c) is limited to the lesser of the actual amount and a reasonable amount. To determine whether an interest rate is reasonable, the **prevailing market rates** for debts with similar terms and credit risks should be considered as well as the existence of any issue premiums (see ¶1.96). Further, as stated in Shell, "Where an interest rate is established in a market of lenders and borrowers acting at arm's length from each other, it is generally a reasonable rate."

Lakefront Utilities Response

LUI's auditors, Collins Barrow, Chartered Accountants have looked at the requirements of the CRA regarding interest deductibility and concluded that the reasonability of the interest paid is

based on the prevailing market rates at the time the debt was issued. The debt was issued in May of 2000 and the rate of 7.25% was reasonable at that time. Further, the promissory note cites the basis for the interest rate at the time of issuance further supporting the reasonability of the rate being charged. The rate being paid is supported so the risk of any reassessment is very low.