

HAMILTON UTILITIES CORPORATION SUBMISSION TO THE OEB

July 10, 2003

Consumer Security Deposit Policies

OEB File Number RP-2002-0146

The approach undertaken thus far by the OEB in formulating draft credit policy for our industry sector has failed to consider or address practical and well-established commercial principles for measuring and mitigating credit risk. Objective and independent consultation with competent authorities on risk management was not undertaken by the OEB in its draft proposal. As well, credit rating agencies were not consulted for their views on the impact of proposed amendments on the creditworthiness of the sector including rated issuers such as Hamilton Utilities Corporation. The approach taken largely reflects an aggregation and distillation of opinions of various hostile stakeholders that did not ultimately achieve consensus on the draft amendments to the DSC.

Furthermore, the OEB's approach continues to be tactical and does not address a fundamental and strategic flaw in market design which exposes and holds LDCs liable for the credit risk of all participants in Ontario's electricity industry.

We strongly encourage the OEB to obtain independent and objective advice in formulating its regulatory and oversight strategy for credit risk and policy in Ontario's electricity industry before responding tactically such as contemplated in the draft amendments to the Distribution System Code.

Issues Hamilton Utilities Corporation has with the proposed changes:

1. The issue of establishing prudence in the administration of credit policy has not been addressed with this proposal. Will the OEB deem an LDC as having acted prudently if they have followed this policy? If the LDC has been deemed to act in a prudent manner will all losses greater than the amount covered with a deposit be recoverable through rates? It would be unfair to the other ratepayers to place an extra burden of credit loss onto those customers so there must be another mechanism put in place by the OEB to compensate an LDC for its loss. LDCs are now reviewed by external parties such as banks and rating agencies and must employ "best practices" in managing their risks. Without 100% indemnification by the OEB LDCs cannot be exposed to credit practices that are not comparable to other commercial credit granting organizations. In its current form the OEB proposal could not be deemed as prudent by any commercial enterprise extending credit in a non-OEB regulated business. If the OEB were to allow for an annual recovery of 100% of any losses then an LDC should not object to this policy. If however, an LDC were to continue to be exposed then the following issues must be addressed.

In fact, we believe that a competent mediator or judicial authority would find that LDCs have met "prudence" requirements where they have reasonably followed OEB imposed CDP policy and do not otherwise have any further discretion to mitigate risk of credit losses.

2. We will have to return all deposits once GPH as been established. An LDC will lose its credit protection once a customer has satisfied the GPH criteria for a customer class. There are a number of issues surrounding this subject. Will the OEB allow for recovery if a customer defaults the month after we have been forced to return a deposit? The definition of a GPH does not consider all of the criteria that many credit granters would consider. A chronic late payer would be recorded as having a GPH so long as they paid before a disconnection order were issued. Only in an OEB regulated industry would someone be viewed as having a GPH when they pay a bill 7 days after it is due. In practice this time is greatly extended by most LDCs by issuing reminder notices and or "friendly reminders". No external factors could be considered in evaluating credit so if a commercial credit is in-known financial difficulty we would have to unsecure ourselves so long as they continued to pay their hydro bill. A behavioral test such as a payment history is only one of the tools that a bank would use to qualify a borrower. A bank would use a minimum of 3 years for a residential customer in addition to an external score such as a Beacon score from Equifax in order to build a risk profile for an unsecured credit.
3. The use of average load data for a class to calculate the deposit size exposes the LDC to significant risk. The average load over a 12-month period has many spikes and valleys exposing the LDC to significant credit exposure during consumption peaks. On residential accounts the use of averages does not recognize that homes on electric heat or homes with air conditioning have significantly higher levels of energy consumption and would be always above the average for the class. Conversely low use customers would be forced to pay higher deposits than necessary. It has been LDC practice to use the highest customer or location specific monthly load as the basis for consumption. This places some of the responsibility for the calculation on the consumer.
4. The interest rate paid on deposits will be the Prime rate. This rate has no basis in reality. No one can receive a prime rate on a deposit. The highest rate available on deposit on a prime basis would be Prime less 2.5%. Why should an LDC pay more than double what the customer could get on their own for a deposit? If adopted as proposed the interest cost on the deposits will increase to such a level that an LDC will lose 2.5% on every deposit. An LDC with \$10,000,000 in deposits will then be losing \$250,000 of income. Where is an LDC to recover this loss from? LDCs recognize that deposits represent a source of short-term financing and, as such, fair interest rates on such deposits should be no more than the opportunity cost for LDCs to borrow such funds from third parties, less an administrative allowance for managing the deposits.
5. The establishment of a good payment history using the OEB criteria will not capture a history of chronic late payments. Payments made after the due date but before a disconnection order is issued will not be captured or have any bearing on the creditworthiness of a customer. Many LDC's apply such a standard. A GPH under the OEB rules would absolve anyone from paying a bill late so long as they did not receive a disconnection notice. Under the OEB rules an LDC could issue a notice 7 days after the bill is due. In practice a reminder notice is usually issued before a disconnection notice and therefore it is the norm in the LDC sector to have up to 20 days before a disconnection notice has been issued.
6. One NSF cheque will require a deposit. Many LDC's have adopted a grace period of allowing one NSF cheque over a longer qualifying period. This is viewed as more customer friendly while not exposing the LDC to greater risk.

The NSF period must be significantly longer than one year to justify this exception.

7. It does not allow for a customer's loss history to be incorporated into the deposit. I.e. if the customer has a previous history of loss with an LDC we could not demand an increased deposit to reflect the customers' previous loss history and increased risk profile.
8. The policy does not allow for an LDC to protect itself against government interference (Bill 210) that allowed for up to 6 months of consumption to be built up prior to a disconnection order to be issued. The maximum deposit would not have covered an LDC for many of the losses that resulted from the non disconnect policy built into Bill 210.
9. The policy does not allow for deposits to be adjusted in areas where LDCs may have an access issue. Apartment buildings and certain residential areas are chronic problem areas for some LDCs and result in higher losses. LDCs with large tenant populations or older neighbourhoods are faced with numerous access-to-meter problem areas resulting in longer than normal times to access meters for accurate readings or disconnection work. This results in higher consumption on meters that cannot be disconnected than the average for the class.
10. The policy is not consistent with the new Ontario Limitation rules. I.e. 2 years. The Provincial government has announced that a new limitations law will come into force on January 1, 2004. This will limit the time period allowed for any collection of a bill to two years versus six years. At a minimum a two-year period should be used to qualify for good credit.
11. The Policy does not protect the LDC from many of the losses they could expect from a commercial customer. A commercial customer often has a GPH only to go bankrupt the next day. The OEB policy provides no protection in the case of bankruptcy. Plant shutdowns, rating agency pronouncements and dramatic shifts in production levels are indicators of a business's strength, which an LDC could not consider, nor could they consider other publicly available information in assessing the credit worthiness of a customer. In many cases the Hydro bill is the last one a company will delay payment on in order to keep the lights on. This results in the Hydro having a GPH right up until it is too late.
12. For large users the OEB proposal is inconsistent with the IMO market rules. A large user could face the following credit enhancement costs:

	Amount of Credit Enhancement
IMO rules	\$13,300,000
Current LDC policy	\$13,000,000
OEB proposal	\$ 0

 - i. Under the OEB proposal an external view could not be applied and therefore when a bankruptcy occurs the LDC would have no deposit if the company had been paying their Electricity bill promptly. This is often the case.
13. Theft of power is not addressed. Many LDC's require extra deposits from customers or locations where there has been a previous history of theft of power. The OEB guidelines do not address this issue.

New Ontario Limitations Law

The new Ontario limitations law will be effective January 2004. This new law will limit the period under which an LDC can collect bad debts to two years from the date of the final bill. For LDCs that have a high transient population this could mean a reduction in recoveries. When a customer returns to a service area after leaving behind a bill the LDC will not be able to demand payment of the old bill prior to reconnect if the old bill is greater than 2 years old. Currently the limitation period is 6 years.

Board Staff Request for Input

If the OEB is serious in applying this Consumer Security Policy as part of the code then they must establish that this policy is prudent and also establish mechanisms whereby an LDC will be reimbursed for any losses over and above the amounts covered under the CSP as proposed. LDC Board of Directors are responsible for establishing policy for an LDC. Without a guarantee from the OEB an LDCs Board cannot approve the policy, as it will not reduce the credit exposure an LDC faces in the current market and in fact will substantially increase it. It also will handcuff an LDC in dealing with customers and surely will result in increased burden on all hydro ratepayers to pay for credit loss.

Implementation Time period

The 3 month time period will not be sufficient to have an LDC implement the policy in its entirety. In some cases the LDC will be asking for deposits from customers for the first time; customers we don't expect to have a credit loss from and they will resist paying. Without the OEB providing clear direction on an LDCs ability to disconnect service for non-payment of a security deposit it would be impossible to have deposits in place in 3 months. It would take a minimum of 6 months.

Maximum requirements

The OEB policy would require us to collect, in some cases a higher deposit than we would require using our own policy. More importantly the maximum is NOT sufficient in many of the high risk areas an LDC has.

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