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Ontario Energy Board Staff Discussion Document

Electricity & Gas Distributor Late Payment Charge Policy

1 PURPOSE

The purpose of this discussion paper is to solicit input from stakeholders on various options for electricity and gas distributor ("distributor") late payment charge policy. These options have been proposed in response to the Supreme Court of Canada's decision in the *Garland v. Consumers' Gas Co.*, [1998] 3 S.C.R. 112 case ("the Garland case").

The scope and context for this discussion paper covers both gas and electricity distributors that provide regulated distribution services to gas and electricity customers in Ontario. This paper only applies to the distributor's late payment penalty, not the generator's, the IMO's, the transmitter's, or the retailer's.

Section 2 provides some background on the topic of voluntary late payment charge policies in Ontario's distribution utilities, and the Board's initiative to review its position with regard to the appropriateness of these charges. Some considerations for selecting a suitable option for regulated late payment charges are set out in Section 3. The options for late payment charge policies and an analysis of these options are described in Section 4. Section 5 outlines Board staff's recommendation.

2 BACKGROUND

History

Late payment charge policy in today's distribution utility is rooted in the voluntary *Residential Guidelines for Credit Collection and Cut-Off Practices of Public Utility Suppliers* tabled in the Ontario Legislature in 1978. The guidelines stipulate a one-time flat rate (maximum 5%) charge on the current portion of the bill (exclusive of previous arrears) and a 16 day credit period from date of mailing or hand delivery of the bill. There are no interest charges. Additional charges may be made for costs associated with the bad account, including shut-off and re-connection. Partial payments are applied first to outstanding arrears and then to current bills.

In a 1995 discussion paper entitled *Policy Frameworks for Establishing Electricity Utility Standard of Service and Specific Service Charges in Ontario*, the Municipal Electric Association (MEA) recommended a province-wide implementation of the one-time 5% late payment charge.

A sampling of current practices in Ontario is summarized in Table 1, below.

Table 1: Sample of Practices in Ontario

Entity	Policy
Many LDCs	A 5% late charge will apply to the “current” portion of a bill if it is paid after the due date. Due date is 16 days after billing date.
Enbridge	5% of gas and gas delivery charge is applied to the following month’s bill if prior months bill not paid by within 16 days of billing date.
Hydro One	1.5% compounded monthly (19.56% per annum) applied to account balances remaining 21 days after issuance of bill.
London Hydro	A 1.5% late charge will apply to the current portion of a bill if it is paid after the due date. Due date is 16 days after billing date.
Mississauga Hydro	A 5% late charge will apply to the “current” portion of a bill if it is paid after the due date. Due date is 16 days after billing date.
Toronto Hydro	1.5% compounded monthly (19.56% per annum) applied to account balances remaining 16 days after issuance of bill.
Union	2-5% of gas and gas delivery charge is applied to the following month’s bill if prior months bill not paid by within 16 days of bill *delivery date*.

The Garland Case

In 1995, Mr Garland commenced a class action against The Consumers’ Gas Co. Ltd. The action claims restitution from the utility on behalf of Mr. Garland and all other customers who have paid late payment penalties since the early 1980s. The basis of the claim is that the late payment penalty breaches s.347 of the Criminal Code which makes it an offence to enter into an agreement to receive interest at a criminal rate. A "criminal rate of interest" is defined in part in section 347 of the Criminal Code as "an effective annual rate of interest .....that exceeds sixty per cent". Mr. Garland contended that where a utility customer pays the late payment penalty within a short time after the due date, the payment constitutes a payment of a rate of interest far in excess of 60% per annum.

The Supreme Court of Canada in its decision in *Garland v. Consumers' Gas Co.*, [1998] 3 S.C.R. 112 held that the prohibition in section 347 of the Criminal Code on the receipt of a payment of interest at a criminal rate is applicable to a late payment penalty structured as a fixed charge which does not increase with the number of days that payment remains outstanding.

In April, 2000, Mr. Justice Winkler of the Superior Court of Justice issued a decision dismissing the action on a motion for summary judgement based on a number of legal issues, other than those decided by the Supreme Court of Canada, that were argued before him. Mr. Justice Winkler's decision has been appealed by Mr. Garland and awaits final resolution.

Class Action Against Toronto Hydro

A similar class action claiming $500 million in restitutionary payments plus interest was brought against Toronto Hydro in late 1998. The action was initiated against Toronto Hydro as the representative of the Defendant Class consisting of all MEUs in Ontario which have charged late payment charges on overdue utility bills at anytime after April 1, 1981. The claim is that late payment penalties result in the MEUs receiving interest at effective rates in excess of 60%/year, which is illegal under Section 347(1)(b) of the Criminal Code.

Ontario Energy Board Initiative

In light of the Supreme Court of Canada's 1998 decision, the Board has decided that it should take action now by reviewing its position with regard to the types of late payment penalties which it may accept in setting rates rather than await the final resolution of the Garland case. A number of utilities have already changed their late payment charges. Since the Board is currently setting rates for all the municipal electricity distribution utilities, Board staff seeks stakeholder input prior to finalizing its recommendation in respect to late payment policies for distributors.

3 CONSIDERATIONS

In developing options, staff considered the following. These considerations need to be balanced to determine the most effective approach to a late payment charge policy:

Fairness and transparency. To the extent possible, distributor late payment charge policies should be fair, transparent, and simple.

Freedom for a distributor to manage its business. A distributor is responsible for governing itself based on business conditions and the objectives of its shareholders within the constraints of rates, and subject to service quality standards, set by the Board. This includes benchmarking against best-in-class business and utility practices.

Impact on rates. A change in credit collection policies may result in revenue adjustments that may need to be dealt with in rate setting. Some may argue that the 5% late payment charge was established to recover collection costs (cost-based design). Since the Supreme Court of Canada has held that the prohibition in section 347 of the Criminal Code on the receipt of a payment of interest at a criminal rate is applicable to a late payment penalty structured as a fixed charge which does not increase with the number of days that payment remains outstanding, utilities may need to adapt their cost effective credit and collection policies. Also, any liabilities associated with the Garland and/or Toronto Hydro class-action suits may need to be dealt with in other rate setting processes.

Harmonization of policies. Improved harmonization of policies among gas and electricity distributors may improve fairness and transparency which may be appropriate as convergence of the gas and electricity markets progresses.

Symmetry between gas and electricity distributors. To the extent possible, and where practical, there ought to be symmetry between the gas and electricity distributors.

4 OPTIONS

For distributors currently following a “5%” approach similar to that challenged in the Garland case, the status quo (i.e. waiting until all court proceedings related to the Garland case are completed) is unacceptable because it is antithetic to the Supreme Court of Canada’s decision that late payment penalties which allow for interest rates exceeding 60% per annum are contrary to the Criminal Code. Options considered by Board staff are set out in Table 2, below.

Table 2: Summary of Proposed Options

OPTION	Characterization
A	Board mandates a prescribed late payment charge and associated terms.
B	Board mandates a prescribed ceiling for late payment charge.
C	Board notes Garland decision and provides guidance to distributors in establishing more commercial-like credit and collection policies resulting in late payment charges that are not contrary to s.347 of the Criminal Code.
D	Board notes Garland decision stating that late payment charges should not be contrary to s.347 of the Criminal Code. Distributors would have full policy design discretion to determine and collect late payment charges, by consistent policy.

OPTION A Board mandates a prescribed late payment charge and associated terms.

Distributors would be obligated to adopt a Board prescribed late payment charge and associated terms (e.g., rate of prime plus X% levied on amounts unpaid within Y days of billing date).

Considerations: Although this option limits the distributor’s flexibility to manage its business, it facilitates symmetry and harmonization of policies among distributors. Determination of a "fair and reasonable rate" that could be applied to each gas and electricity distributor in the province may require significant research. Depending on the distributor's current policy, the degree of impact on company revenues may result in rate adjustment proceedings.

OPTION B Board mandates a prescribed ceiling for late payment charge.

Distributors would be obligated to adopt a late payment charge, applied to outstanding account balances, that does not exceed a Board prescribed ceiling. A staff survey of emerging practices in other Canadian utilities suggests 1.5% as a reasonable monthly compounding rate ceiling (~0.0489% per day, ~19.56% per annum).

Considerations: This option is similar to Option A; however, it offers some flexibility for the distributor. Determination of a "fair and reasonable rate" ceiling that could be applied to each gas and electricity distributor in the province would require significant research. Also, the regulatory burden involved in periodically updating the ceiling rate in line with economic and market conditions could be onerous. Depending on the distributor's current policy, the degree of impact on company revenues may result in rate adjustment proceedings.

OPTION C Board notes Garland decision and provides guidance to distributors in establishing more commercial-like credit and collection policies resulting in late payment charges that are not contrary to s.347 of the Criminal Code.

In a policy statement, the Board would note the Garland decision and set 60% per annum as the bar over which distributors must not cross in establishing late payment charges. Further, distributors would be obligated to establish more commercial-like credit and collection policies in accordance with common commercial practices for overdue bills (e.g., commercially comparable interest rates, discounts given[1]) with the expectation that per annum impact would not exceed a typical comparable.

Distributors may propose a commercial-like comparable. The credit and collection policy terms may reflect practices in other Canadian monopoly network businesses (samples provided in Table 3, below - please note that none results in a per annum impact of more than ~20%, or a per day impact of more than ~0.05%).

Table 3: Sample of Practices in Other Canadian Network Businesses

Entity	Policy
Bell Canada	Late payment charge is a rate based on a formula that uses the Bank of Montreal prime rate plus 7%. This formula allows the late payment

[1] Use of discounts should be at the discretion of the distributor, with the expectation that any discounts are revenue neutral by speeding up payment; i.e., speedup in collections should offset the cost of the discount.

Entity	Policy
Bell Canada *(continued)*	charge to change with fluctuations in the commercial interest rates. Rate is applied to outstanding balances.
BC Hydro	1.5% per month (equivalent to 19.6% per annum compounded monthly). Levied on unpaid balances (any bill that has not been paid in full on or before the due date) of $30 or more.
TransAlta Utilities Corporation	1.5% per month (equivalent to 19.56% per annum) on any overdue amounts for which payment has not been received within 10 days after the date of issue of the bill.
Gaz Metropolitain	1.5% per month added to the unpaid balance of the net amount of the previous bill. There is 15 days between mailing date and due date.
Hydro-Quebec	An "administrative charge" based on the current National Bank of Canada prime lending rate is applied to unpaid balances after 21-day grace period.

Considerations: This option offers flexibility for the distributor providing opportunity for the distributor to benchmark credit and collection policies with commercial market norms. Since the policies adopted by each gas and electricity distributor in the province would be modeled on common commercial practices for overdue bills, this option discourages late payment penalties above commercial comparables and provides consistency and transparency to customers. Customers may be better able to relate to the charge as it may appear more consistent with their typical experience in other credit/bill payment arrangements. Uniformity of policy approach should minimize anomalies among distributors so that customers are not faced with uncertainty and various practices. A uniform late payment charge policy means that the method by which the charge is determined is consistent among distributors. It does not mean, however, that the level of charges in different distribution areas should be the same. The common framework would reduce regulatory burden by easing the Board's review and approval of policies. Depending on the distributor's current policy, the degree of impact on company revenues may result in rate adjustment proceedings.

OPTION D Board notes Garland decision, stating that late payment charges should not be contrary to s.347 of the Criminal Code. Distributors would have full policy design discretion to determine and collect late payment charges, by consistent policy.

Similar to Option C; however, distributors would have full policy design discretion to determine and collect late payment charges, by consistent policy. Board action would be limited to issuing a statement to distributors noting the Garland decision and stating that late payment charges should not be contrary to s.347 of the Criminal Code, and approving consequent rate applications.

Distributors may propose a cost-based policy that reflects the prudent management of their receivables. The distributor's credit and collection policy expenditures (including collection letters, phone calls, personal visits, etc.) should not exceed the benefits resulting from shorter collection periods and lower bad-debt losses. The policy should be supported by a comparison of possible gains from the change in policy and the cost of the change. Optimal credit and collection policies would be those that resulted in the marginal gains equaling the marginal costs.

In general terms, the primary difference between this option and Option C is that distributors would not be obligated to establish more commercial-like terms. For example, in response to the Garland decision, Alberta-based AltaGas and Bonneyville revised their late payment penalty charge policies in 1999. The utilities proposed a 3.5% rate with a 28-day grace period to ensure that penalty would never amount to interest over 60% per annum. The EUB approved the proposal.

Considerations: This option "caps" late payment charges at $59.9\dot{9}$ % per annum. It offers more flexibility to the distributor to establish specific credit and collection policies; however, customers may be faced with uncertainty and various practices. Regulatory burden would be high as each distributor's unique policy proposal is reviewed and approved by the Board on a case-by-case basis. Depending on the distributor's current policy, the degree of impact on company revenues may result in rate adjustment proceedings.

Common to every option is the potential need for regulatory filing. The distributor may be required to file its proposed policy changes with supporting documentation for approval, and a statement of rate impacts to address any anticipated rate adjustment requirements.

5 RECOMMENDATION

Policy

Staff recommend Option C. **Board notes Garland decision and provides guidance to distributors in establishing more commercial-like credit and collection policies resulting in late payment charges that are not contrary to s.347 of the Criminal Code**. Staff believe that this option is the most consistent with the Garland decision and the business environment under which the distributors are regulated.

A Board policy statement would be issued to distributors stating that late payment charges should not be contrary to s.347 of the Criminal Code (noting the Garland decision), and obligating distributors to establish more commercial-like credit and collection policies stating an expectation that per annum impact would not exceed a typical comparable.

Guidance to electricity distributors should be in the form of a revision to Chapter 9, Section 9.3.3 of the Distribution Rate Handbook. Guidance to gas distributors should be in the form of a letter.

Process

Upon finalization and issuance of the Board's policy statement, electricity and gas distributors would be notified and instructed to review their late payment charge policies, propose appropriate revisions, and submit with their next regulatory filing for Board review and approval. If the next regulatory filing is not reasonably near, the distributor may be requested to make a special submission which may, if appropriate, necessitate interim provisions or other rate adjustments.

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