THE GLOBE AND MAIL

Rebecca MacDonald’s long list of honours includes being named Canada’s top woman CEO for six years in a row

Rebecca MacDonald’s Just Energy: Golden era over for gas marketer

Bruce Livesey and Nicole Brewster-Mercury
Published Wednesday, May. 29, 2013

For Rebecca MacDonald, there’s no better proof that she has reached the highest echelon of Canadian business than her sprawling mansion in the Bridle Path. Here, in Toronto’s—and Canada's—toniest neighbourhood, she hosts charitable events attended by corporate royalty like Bata shoe empress Sonja Bata, philanthropist Suzanne Rogers, Tim Hortons co-founder Ron Joyce, and no-identification-needed figures like Belinda Stronach and Kevin O’Leary. Last fall, she even hosted real royalty: Prince Edward and his wife, the Countess of Wessex.

The founder and executive chair of Just Energy Group Inc., an energy marketing company that recorded sales of nearly $3 billion in fiscal 2012, MacDonald is one of Canada’s wealthiest women—and an exemplar of the immigrant-done-good story. Profit magazine named MacDonald, 59, Canada’s top woman CEO every year from 2003 through 2008; her other honours include an Ontario Entrepreneur of the Year award from Ernst & Young and the International Horatio Alger Award. “She’s probably the smartest businessperson I know,” says James McKelvie, a former CFO of her company and the current chair of Benecaid Health Benefit Solutions Inc.

Those smarts are sales smarts above all, and MacDonald has applied them on three fronts—to a life story eagerly received by the media and the business community; to a business model that she helped pioneer; and to persuading investors to back her. She credits her success to her late husband, Pearson MacDonald. “He taught me the most important lesson—it’s all about sales,” she has said. “You could have the best idea but if you don’t sell it, you’ll never get ahead.”

But between a sales pitch and the actual goods there is always some leeway, and, for MacDonald, that gap is widening in all three areas. Once a darling among investors and Bay Street’s stock pickers for its rich returns, Just Energy is turning radioactive: Staggering under $1 billion of debt, it has chopped its dividend and seen its share price decline from a high of almost $14 last year to around $6.50 as of early May. As for the business model, Just Energy is accused of unethical sales practices and airbrushing its financial situation. The two fronts are converging in the view of forensic accountant Al Rosen. "They are paying dividends while running huge deficits and huge liabilities," he says. "A lot of people are now pulling out."

And even the personal story of Rebecca MacDonald herself now seems to not be exactly as advertised.

When *Report on Business* magazine asked MacDonald for an interview, she declined. But she's told her life story many times, including for a 2006 cover story for this magazine.

She was born Ubavka Mitic in the former Yugoslavia, in what's now Serbia. In her history as she's recounted it when being interviewed by the media or when she's received an honour, it goes as follows. Her father rose from humble origins to become energy minister in the regime of Yugoslavian dictator Marshal Tito. The minister often took young Ubavka on working trips. "I grew up with energy—coal, hydro, nukes, oil and gas," MacDonald said. "As a child it was ingrained that the most important thing was energy." But there were parental pressures too. Her mother pushed her to train for a career as a concert pianist—and then pushed her to go to medical school. "I had no life," MacDonald said. "I didn't have a childhood. I didn't have friends. I didn't play." She had just completed her courses at age 22 when she snapped under the pressure, deciding to escape the country and "my own personal Communism" without telling her parents.

After arriving in Canada in 1974—with no English, no money and no job—MacDonald was stunned to learn that her medical schooling was worthless. She learned English, got a clerical job and met Pearson MacDonald, who was a door-to-door salesman. Through him, she learned how to be a salesperson, even briefly trying to be an Avon lady. "It's the most difficult form of selling, but the most cost-effective," MacDonald said.

After that early period, the record becomes more clear-cut. MacDonald's career-making opportunity arrived thanks to Ontario's decision to deregulate its natural gas industry in 1986. Utilities had long been monopolies controlling both supply and delivery of gas; deregulation was designed to introduce competition by allowing anyone to sell gas to consumers so long as they could secure a supply. Into this field alighted a new kind of company—energy commodity brokers.

These companies send out salespeople to knock on doors and persuade retail consumers to sign multiyear contracts that set their gas at a fixed rate. The difference in price between what the broker charges the customer and what it pays to the supplier is where the broker makes money.

The model, then, relies on convincing individual consumers that they will save money, even while a new layer of profit-taking has been introduced.

In 1989, MacDonald founded Energy Marketing Inc. (EMI) to take advantage of this new niche. But tragedy struck when her husband, Pearson, died in a car accident in 1992, leaving her to raise their children, Alexandra and Daniel, on her own. "There was nothing I could do to bring him back," MacDonald later recalled. "I knew that if I didn't hold the family together, we'd be on welfare."

Due in part to falling gas prices, EMI was not a success, despite signing up tens of thousands of customers. In 1996, MacDonald sold off its contracts. She then tried to sell gas deals in the United Kingdom. In 1997, she re-entered the Canadian market by launching Ontario Energy Savings Corp., which had sales of $81 million within just three years, although it never showed a full year of profit.

MacDonald's luck began to improve in 2001, thanks to rising gas prices and the arrival of the income-trust boom, which attracted investors with regular payouts. Ontario Energy Savings Corp. became an income trust called Energy Savings Income Fund (ESIF), for which MacDonald raised more than $110 million on the markets. Two years later, revenue had reached more than half a billion dollars.

As customers signed up, ESIF began throwing off huge returns and it became a darling among investors. The total return—appreciation plus reinvested dividends—on an investment in the company from 2001 until 2011 (in all its forms—OESC, ESIF and Just Energy) was approximately 1,200%, representing an annualized return of about 30%. By 2006, Energy Savings had a 15% share of the residential and small-business slice of the Ontario natural gas market and was expanding across Canada and the United States. It boasted 1.5 million customers. The company was also debt-free, and MacDonald told Bay Street she wanted to keep it that way. “In this whole business she was very, very instrumental in getting it to where it was,” says former CFO James McKelvie.

MacDonald has made an estimated $150 million from the company since 2001. Her success allowed her to acquire her Bridle Path mansion and also a 40,000-square-foot, $20-million (U.S.) beachside villa in the Orchid Bay Estates gated community in the Dominican Republic. In both homes, she entertains a wide circle of friends and colleagues, including Foreign Affairs Minister John Baird, Senator Hugh Segal, former Massachusetts governor William Weld, and former Ontario chief justice Roy McMurtry, the latter three being directors on Just Energy’s board. Her own CV includes board memberships at Canadian Pacific Railway Ltd. and the Royal Ontario Museum.

MacDonald also became a fixture on the charity circuit. Having recovered from a debilitating case of rheumatoid arthritis, she made it the target of her most notable donation: $3 million to Toronto’s Mount Sinai Hospital to build a centre to fight the disease. And MacDonald began racking up business awards and other accolades, including an honorary doctorate from the University of Victoria.

The good times could not last forever. In 2006, the federal government closed a tax loophole on income trusts, which cooled off the market considerably. And gas prices were not destined to climb indefinitely.

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What the bountiful times might have obscured is a potential fatal flaw for companies such as Just Energy. After all, energy commodity brokers “don’t actually own anything,” observes Reno Giancola, who until recently was a portfolio manager at the wealth management firm Gluskin Sheff + Associates

Inc., which used to invest in Just Energy. “They just sort of sell pieces of paper at the end of the day….You’re not building pipelines or transmission lines and you don’t have power plants.” Jeffrey Burchell, co-chief investment officer of the asset management firm Aston Hill, one of whose funds shorted Just Energy’s stock last year, echoes the criticism of energy brokers. “You’re just locking in your gas price. If I knocked on your door and wanted to sell you tinfoil, how’s that a business?”

Deregulation was supposed to create competition. But as middlemen, firms like Just Energy make money by charging an additional fee to consumers that didn’t exist prior to deregulation. National Bank Financial analyst Trevor Johnson, who covers Just Energy, is critical of the model. “The business can be viewed as predatory,” he says. “When you go door-to-door and lock people into contracts that arguably can add value but more often than not don’t, there are issues with that.”

Indeed, Just Energy’s contracts only make sense for consumers if gas prices are rising. Otherwise, they are locked into a fixed price that can be alarmingly expensive if gas prices fall. MacDonald partially blamed the failure of her first company, EMI, on declining gas prices, and Just Energy’s current problems have similar roots. Natural gas prices have plummeted from $13 (U.S.) per million BTU in 2008 to as low as $2 (U.S.) last year; they are currently hovering in the $3-to-$4 range. Just Energy’s contract renewal rate has dropped in Canada from over 80% five years ago, to a little over 60% in fiscal 2012. It has since improved somewhat.

The issue of selling savings that do not materialize was put to Ken Hartwick, Just Energy’s CEO, who met with *Report on Business* magazine in MacDonald’s stead. He works out of a nondescript Mississauga office building that does not sport any signage to indicate that it is the headquarters of a company that does billions of dollars in business. Hartwick apologizes for the fact that his office walls are so thin his head of sales can be overheard next door motivating his team on the phone.

“We have dropped the savings claim for the past four years,” Hartwick explains. “The steps we have taken are really to ensure the consumer knows we are giving you basically an insurance product.” These steps include follow-up verification calls by a third party.

Falling gas prices have another effect on the company’s bottom line: Margin of profit per customer declined too. “The embedded profitability on the newer book of business is far, far lower than the legacy business,” says Burchell of Aston Hill. “And yet the fixed cost to manage those contracts is exactly the same.”

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The switch to emphasizing insurance rather than savings will likely help a company that has taken a reputational hit over its sales tactics and other practices in a number of American and Canadian jurisdictions.

Illinois has been a particular hot spot. The problems started when an alarm was raised by the Citizens Utility Board, a nonpartisan organization set up by the state to represent consumers. CUB was inundated with more than 2,000 complaints from customers of a Just Energy subsidiary, U.S. Energy Savings Corp. (USESC).

That tsunami of dissatisfaction led to a 2008 state lawsuit against USESC that claimed the company was charging gas rates at far higher levels than the local utility, while promising savings. In one of the cases the lawsuit cited, a Just Energy salesperson signed up a disabled senior for a five-year contract at $1.19 (U.S.) per therm (a unit of heat) while the price from the local utility was only 59 cents.

The lawsuit involved expert testimony from Barbara Alexander, former director of the consumer assistance division of the Maine Public Utilities Commission. After examining Just Energy’s data, Alexander concluded that “almost all of [Just Energy’s] plans have cost customers far in excess” of what utilities charge, and “there is no reasonable person who could market this product in 2007 by suggesting that a customer would ‘save’ money…”

Alexander also testified that “USESC marketed this product by...portraying its own product as potentially resulting in savings or by incorrectly portraying the utility’s natural gas supply price. USESC’s sales agents used techniques designed to make the customer think that they were related to an ‘official’ activity, either by the utility itself or by a governmental agency and used the term ‘registration’ to make customers think that there was an official imprimatur associated with the contract. USESC’s agents took advantage of elderly, confused, frail, disabled and non-English-speaking household members. There is evidence that at least some of USESC’s agents deliberately attempted to appear as a utility worker or misrepresented the connection between USESC’s price and the utility’s price for natural gas supply service. USESC has made exorbitant profits from its marketing model and sales activities in Illinois and has charged unfair and unreasonable early termination fees when customers sought to cancel the contract.”

The case concluded with an agreement that, in the words of the state’s press release, “will allow hundreds of Illinois consumers to terminate contracts and receive $1 million in restitution” because USESC “sold fixed-rate gas contracts using misleading sales tactics that falsely promised significant consumer savings.”

The state subsequently had an audit conducted of USESC’s sales operations, which was released last year. The audit revealed that in a 12-month period (which was two years after Illinois launched its suit), Just Energy received nearly 30,000 customer complaints in the state. The audit also found that the company’s Illinois operation did not have adequate corporate oversight, although it said the company had made big strides in cleaning up its act.

At CUB, executive director David Kolata is still not satisfied by the performance of Just Energy and its peers. For this group, “the latest data show that 92% of the [contracts] that have ever been offered have been money-losers,” he says. “We don’t think that this market is working very well for consumers at all....We continue to receive complaints about Just Energy.”

Sanctions against Just Energy were also applied by the states of Ohio and New York, both of which levied penalties against the company because of its door-to-door tactics.

In Ontario, the Better Business Bureau for the central and southwestern regions of the province refuses to allow Just Energy to join because it doesn't meet accreditation standards. In the past three years, the office has received 560 customer complaints about the company. Fiona Dunbar, manager of dispute resolution services for the regional BBB, says this number is not off the charts for a company of Just Energy's size, but adds that "in this particular company it has a pattern of complaints we have noted." She adds, "They do agree to make changes, but from what we are seeing it has not occurred."

Indeed, in 2011, the Ontario Energy Board fined Just Energy $40,000 for violating the board's marketing rules. The company signed assurances it would mend its ways. But this past January, the board hit Just Energy with another $80,000 fine and made it sign a new set of assurances.

Similar reports about Just Energy's sales force have been heard across Canada. In Alberta in 2010, three of the company's salespeople pleaded guilty to charges that included forging signatures on energy contracts and pretending to be customers to phone verifiers.

Just Energy pays its sales force no salary; they make their living entirely from commission. Critics say this approach incentivizes salespeople to bend the rules. Even Hartwick admits this can happen: "Yeah, I'd say there is a built-in incentive for them to be very aggressive. But again you temper that with knowing that every home is going to be phone-verified."

The company and its defenders among Bay Street analysts say many energy commodity brokers have been accused of using similar sales methods—which is true. And any large company is bound to have customer complaints, observes Hartwick. "The vast majority of our complaints are from people who never became customers. The vast majority of those are from people who say that we were knocking on their door at 7 o'clock at night when you're trying to eat dinner or do something with your kids," he insists. "But the fact that we have two million customer accounts now validates what we do. And our job as a management group has been to eliminate and minimize the complaints. Our complaints ratio is exactly half of what it was three years ago."

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As long as Just Energy was throwing off robust distributions, brokers and bankers were happy and not terribly worried about how it was making money or whom MacDonald was employing.

For instance, in 2001, when the company was trying to raise money on Bay Street, MacDonald hired Owen Mitchell as a capital markets adviser. Mitchell continues to work for the company to this day as a consultant, and sat in on the interview with CEO Hartwick.

Yet Mitchell was a key player in one of Bay Street's most notorious scandals: the YBM Magnex International Inc. debacle of the late '90s. YBM was a magnet company that was a front for the Russian mafia, which attempts to launder its ill-gotten profits through the markets. Mitchell was a director of YBM and an investor in the company while also being a vice-president of First Marathon Securities Ltd., one of YBM's underwriters. He chaired a special committee that YBM struck to investigate rumours the company had ties to organized crime. Despite being told by the company's private investigators that such links existed, Mitchell produced a report for the board that was later labelled a "whitewash" by one of the investigators. YBM went on to raise $100 million from investors and had a market capitalization of almost $1 billion before it was exposed as a fraud (investors won back $120 million in settlements).

The Ontario Securities Commission charged Mitchell for failing to perform proper disclosure before submitting YBM's prospectus, and in 2003 he was fined $250,000 and banned from sitting on the board of a public company for five years. The OSC also found the investment banker had a "fundamental role" at YBM leading up to the share offering. MacDonald testified as a character witness on Mitchell's behalf at the OSC hearings.

While Bay Street might have overlooked Mitchell's role with MacDonald's company in 2001, by 2005 the forensic accountants at ***Veritas Investment Research Corp***. began to wonder whether Just Energy could sustain its profits and growth. By then, the company's units had hit $18 and Just Energy was the poster child of the income-trust boom. "We were concerned with their business model," says ***Anthony Scilipoti***, president of ***Veritas***. The firm produced a series of reports questioning the future of Just Energy's profitability, since "growth to date has been predicated on customer naiveté and commodity price volatility." ***Veritas*** also noted that the company was going to have a hard time replacing its lost customers, with non-renewal rates rising and competition growing.

Similar concerns arose at Gluskin Sheff + Associates, which was a big Just Energy shareholder. "We liked the business, we liked the growth prospects," says former portfolio manager Giancola, "but over time we noticed the business was changing pretty meaningfully." Gluskin had cashed out its stake by 2008.

The timing was prescient. By then, natural gas prices had peaked and begun a steady fall. Moreover, a bushel of hard-charging competitors had entered the field. In order to deal with declining renewal rates and growing costs to corral new customers, Just Energy embraced an expensive solution: It began to acquire competitors. It bought Universal Energy Group Ltd. in 2009, Hudson Energy Corp. in 2010 and Fulcrum Retail Holdings LLC in 2011. These purchases helped drive net debt from zero in 2009 to its current level of $1 billion. In fiscal 2012, the company had net losses of $127 million, while stock returns have soured since the beginning of 2011, with a -43% total return. "I don't think you can have a high-growth business and be debt-free," explains Hartwick. "The intention of those acquisitions was to add an element to our sales channel to allow for future growth.…I think this year [fiscal 2013] we had a record net growth across our home services business which validates the purchases."

Another element of the company's strategy was to diversify operations by getting into electricity contracts, as well as selling water heaters and gas contracts to commercial customers. While these moves may have cushioned the company from the vagaries of falling natural gas prices, they too added to the debt load.

With gross margins down, gas prices falling, growing debt and a commitment to dividend payments, the company's financial situation began to deteriorate. And MacDonald's credibility was beginning to be called into question. "The issue with her is she says 'I don't like debt' and then you fast-forward five years later and she has way too much debt and she's done it to buy acquisitions that have not worked out," says Aston Hill's Burchell. Indeed, bank analysts like Kevin Chiang at CIBC World Markets Inc. believe the debt load is why the stock fell over the past year. "In order to fund the debt or deleverage, obviously that will have an impact on cash flow," says Chiang. "And Just Energy is a high-payout company. So for investors who are in it for the dividend, any concerns around that is going to create a much more volatile share price."

In July, 2012, a second Bay Street forensic accounting outfit—Accountability Research Corp. (ARC), run by the dean of Canada's forensic accountants, Al Rosen—issued a report on Just Energy. He says that as of March, 2012, Just Energy's total liabilities on its audited balance sheet were over $2 billion, whereas its total assets were $1.5 billion. "So if you have a condo worth $150,000 but the mortgage is $200,000, what the hell is your equity?" he asks. "Well, it's negative. They're under water."

As Just Energy's financials worsened and it began losing money, what happened next depends on how you view the opaque world of corporate accounting. Last year, reports from not just ARC but also ***Veritas*** complained about Just Energy's insistence on using "adjusted EBITDA"—earnings before interest, taxes, depreciation and amortization—as a method of measuring its profitability, a non-GAAP and unregulated yardstick. The firms (which earn money by examining companies on a subscription basis for money managers) say Just Energy's practice of using "adjusted EBITDA" excludes or obscures ongoing cash costs of doing business, such as marketing expenses and capital replacement, and thereby gives a healthier portrait of the company than is warranted. ARC said this metric was "highly inappropriate and open to severe misinterpretation." ARC even said the company was playing a "shell game" by overestimating the value of new customers rather than recognizing that Just Energy was merely replacing customers who didn't renew their contracts. "How can you operate this company when you are paying out everything in dividends?" wonders Rosen. (Those payments totalled $180 million in calendar 2012.)

“There is nothing to pay for everything else.” Rosen also accuses Just Energy of using “adjusted EBITDA” to trigger executive bonuses.

Veritas worries that an estimated one-third of Just Energy’s gas and electricity contracts are coming up for renewal in the next year. Replacing those customers who don’t renew will be expensive—at a time when the company is cash-poor. “Either they’d have to spend like crazy on new marketing or acquire another company to get new customers,” says ***Michael Yerashotis***, a ***Veritas*** analyst. “The problem is that Just Energy has almost a billion dollars in net debt and a huge dividend burden to maintain.” ***Veritas*** has labelled the company’s current plight “the perfect storm.”

Just Energy argues that many companies use “adjusted EBITDA” as a measurement tool—and that Just Energy’s quarterly financial reports include all other accounting metrics. Just Energy also believes that ARC and ***Veritas*** are failing to take into account that its existing contracts are “embedded margins” and constitute an asset: They will generate money in the future and are currently valued at $2.2 billion. “We think that the better measure is adjusted EBITDA because that allows us to look at embedded margin,” says Owen Mitchell. “And embedded margin grew $200 million [in fiscal 2013].”

Rosen counters by saying too many things could go wrong for that sum to be counted on, although he admits it could have asset value. In an e-mail, he wrote, “The money is not guaranteed, for numerous reasons: cancellations, bad debts, moving of location, refusal to pay, invalid contract, bankruptcies and so on.”

The ARC and ***Veritas*** reports spooked Bay Street. How much the Street had cooled on the company became clear last October when Just Energy put forward a shelf prospectus to raise $1 billion by selling various unsecured debt securities, common shares and preferred shares. “It was a dud,” says an analyst with a bank-owned brokerage. “No one else would give them money so that’s why they went to CPPIB.”

After examining Just Energy’s books, the Canada Pension Plan Investment Board lent the firm $105 million at a 9.75% interest rate. To many observers, this rate was an indicator that CPPIB didn’t view the company as entirely “credit-worthy.” It’s on par with a “junior mining company based in Africa,” says the same analyst.

Rosen is incensed that CPPIB threw this lifeline to Just Energy. He says it’s public money invested in what he considers a bad bet. “How they could possibly have loaned them five cents is beyond me,” he declares with a snort. CPPIB itself will not comment on the loan.

In the end, warnings to investors by ARC and ***Veritas*** that Just Energy would cut its dividend were borne out this past February, when the company slashed it by 32%. But this threatened the company’s romance with investors: The stock fell 13% in a day and was down 30% within a month. MacDonald characterized the cut as a hiccup, saying “we do not expect any further changes to our dividend payout, and the margin embedded in our existing customer book and the strong customer growth seen in fiscal 2013 will result in higher cash flow in fiscal 2014, allowing us to both fund growth and pay down debt.” By then, ARC had the stock valued at only $4.

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After this magazine ran its 2006 profile of MacDonald, the magazine was contacted by an engineer living in Western Canada named Miodrag Jankovic. It turns out that Pearson MacDonald was not Ubavka Mitic’s only husband. Jankovic was married to her first. Jankovic, who was born in Belgrade, says he met MacDonald a few weeks before he immigrated to Canada in 1973. “We met and we exchanged phone numbers,” recalls Jankovic. “A series of love letters received from Rebecca convinced me to help her move here by sponsoring her to marry me, because she could not obtain a visa independently.”

Jankovic says he borrowed $2,000 to bring MacDonald to Canada in 1974, and they married upon her arrival. That’s when Jankovic says MacDonald confessed to him that many things she’d said about her past were not true. “That’s how my marriage started,” says Jankovic. “It started with a big lie.”

Indeed, many of the things MacDonald has said about her past are difficult to reconcile with one another, and with public records.

Where a 2009 Profit magazine profile said that MacDonald was “a physician in her native Yugoslavia,” and the National Post quoted her in 2003 as saying that in Canada she’d hoped “to practise medicine again,” the University of Belgrade belied her claim that she even attended medical school there.

If MacDonald’s father was energy minister in Yugoslavia, he seems to have left no imprint on the public record.

As for the budding career as a concert pianist, Jankovic thought it was curious that he never saw MacDonald play piano in their years together.

Although MacDonald declined to be interviewed for this story, she did send an e-mail on the subject of her personal history, “even though I do not believe it has any relevance to our company,” she wrote.

Without naming him, MacDonald’s letter characterizes Jankovic as “an individual that I was associated with for a very short period of time 40 years ago,” who harbours “his own personal agenda against me. I have moved on with my life.... My life 40 years ago, as painful as it was, is part of the struggle that made me who I am today, and I find it in bad taste to even discuss it now.”

On the subject of schooling, she wrote, “I was a student of medicine. I did not graduate....In hindsight, I regret not making more of an effort to clarify inaccurate references to this that appeared in print.”

For *Report on Business* magazine’s profile in 2006, MacDonald said her father, as energy minister, often took her on business trips. In her letter, however, MacDonald refines her father’s tenure and status. “From 1947 to 1949, he was acting minister of energy in the country that was starting to organize under President Tito.” But in that period he would not have been able to take her on trips, as she wasn’t born yet.

Concerning more recent history, MacDonald has said that she made her first million by 1992. Yet, in other accounts, she’s claimed she was broke and “very hungry” by 1996.

The marriage between Jankovic and MacDonald lasted four unhappy years. Jankovic says he supported the two of them by selling encyclopedias door-to-door while being a PhD aerospace engineering student at the University of Toronto.

A divorce was granted in 1978. Also that year, MacDonald became the partner of Jankovic’s best friend and the best man at his wedding—Pearson MacDonald.