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### **BY EMAIL and RESS**

December 21, 2015  
Our File No. HV2015-0001

Ontario Energy Board  
2300 Yonge Street  
27<sup>th</sup> Floor  
Toronto, Ontario  
M4P 1E4

### **Attn: Kirsten Walli, Board Secretary**

Dear Ms. Walli:

### **Re: EB-2015-0094 – Oakville Hydro 2016 Rates – HVAC Submissions**

We are counsel for the HVAC Coalition. Pursuant to Procedural Order #1, and the Board's letter dated December 16, 2015, these are HVAC Coalition's submissions with respect to the parts of the Application filed to date.

### **Summary**

HVAC Coalition believes that the Applicant's rates are likely 1% to 4% too high, because the regulated utility is subsidizing an unregulated affiliate in an amount of \$500,000 to \$1,500,000 annually. Based on the Settlement Agreement in EB-2013-0159, the Board ordered that a study of the reasonable amounts to be charged to the unregulated affiliate be filed with this Application. Had it been filed in a timely manner, HVAC Coalition believes the Board would now be in a position to assess the amount, if any, of any subsidy and thus rate overcharge. Because the study has been delayed, the Board is not in a position to make a decision on the impact of affiliate charges in time for January 1, 2016 rates.

HVAC Coalition has seen the first draft of the study, and on December 8, 2015 posed questions to the consultant. Although the consultant advised HVAC Coalition that a response would be received on December 18<sup>th</sup>, that response was not received, and has still not been received.



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As a result of the draft study, and the history of this issue, HVAC Coalition now believes it is more probable than not that the issue of Oakville Hydro's subsidy of its unregulated affiliate will need to be the subject of discovery and cross-examination before the Board will have the full picture.

HVAC Coalition submits that the Board should implement 2016 rates in the normal course, without taking into account the problem of the affiliate charges. However, the Board should declare those new rates interim, and continue with this proceeding. We would anticipate that the study can be filed in January or February, and after discovery and cross-examination, the Board can have a full record on this issue by March or April. This would allow the distribution rates to be corrected – if that is the Board's determination – with the May 1<sup>st</sup> RPP change.

### **The Problem**

The unregulated affiliates of the Applicant that carry on a competitive HVAC business (Sandpiper and OHESI, collectively referred to as the "Competitive Affiliate") are currently being supplied most of their administrative and operational services, including space and other overheads, by the Applicant. The total amount the Competitive Affiliate is paying for that package is about \$90,000 per year. This appears to be only a fraction of both the cost, and the value, of those services. HVAC Coalition has not been provided with information on whether the Competitive Affiliate is paying for any other overheads directly, and so must assume that the allocation from the regulated utility is the sum of the Competitive Affiliate's overheads.

This can be assessed two ways.

First, the Competitive Affiliate appears to have both revenues and employees that are 7-10% of the revenues and employees of the Applicant, the regulated utility. However, the categories of costs being allocated total \$9 million in the Applicant, so only 1% are being allocated to the Competitive Affiliate. This appears to be an under-allocation of \$540,000 to \$810,000 per year (a rate impact of 1.38% to 2.20%).

Second, the overhead costs associated with any competitive HVAC business can be predicted within a certain range. Information that has been provided by HVAC Coalition's consultant to the Applicant and to the joint consultant shows that, for HVAC businesses of the size of the Competitive Affiliate, overheads should be in the range of 25% to 45% of gross revenues. This would suggest an under-allocation of \$500,000 to \$1,700,000 per year (a rate impact of 1.36% to 4.64%).

HVAC Coalition has not as of yet looked at whether any similar issue arises with respect to allocations to any other unregulated affiliate of the Applicant.

### **The Study**

In EB-2013-0159, the Applicant and HVAC Coalition agreed to carry out a joint study of the amounts charged to the Competitive Affiliate, for filing with this Application. The intent was to avoid a dispute about the allocations in that last case (where the record was limited), and



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instead give the Board the opportunity to consider the issue with a more complete evidentiary foundation.

The parties planned to use an RFP to make a joint selection of an appropriate consultant. HVAC Coalition proposed the names of well-respected firms with experience in the field, but they were rejected by the Applicant for reasons that HVAC Coalition has accepted. The unfortunate result was that there was only one firm left, and that firm appeared to have limited experience in this area (although they did have experience in cross-border transfer pricing for tax purposes). In order to ensure that the schedule did not slip any further, HVAC Coalition accepted this less than optimal situation, in the hopes of trying to make it work.

To assist the consultants, HVAC Coalition had an experienced HVAC financial and business consultant provide detailed breakdowns of overhead costs for a number of competitive HVAC companies. This was intended to help the joint consultant assess the reasonableness of the amounts charged to the Competitive Affiliate by benchmarking them to the industry at large.

The first draft of the study was provided to HVAC Coalition on December 4, 2015. We do not know when it was provided to the Applicant. After we reviewed the draft, it was clear that there were a number of problems, including but not limited to:

- The study acknowledges that there is benchmarking information, but doesn't in any way take it into account. Despite this, the study has draft conclusions about the reasonable amounts to be charged.
- The study appears to make no attempt to determine through any other empirical means whether the allocations proposed by the Applicant are, in the first instance, at a reasonable level.
- Some of the data provided about space, executive time, and other items are questionable on their face, yet the consultant does not attempt to address those obvious issues. (For example, the average utility employee needs 594 square feet of space in the shared building, while the average Competitive Affiliate employee needs 62 square feet.)

These are only examples of a draft that was seriously problematic.

Throughout the period the consultant has been working on the study, the consultant and the Applicant have had detailed information about the Competitive Affiliate, but little of that information has been provided to HVAC Coalition. Thus, we have been unable to properly supervise the study.

Given the contents of the first draft, HVAC therefore asked for a number of categories of data that would have been (or should have been) used by the consultant. A copy of that data request is attached to these submissions. Responses to at least some of these requests were to have been received on December 18, 2015. None was received, and we have received no communication from the Applicant in this regard.

HVAC Coalition is no longer confident that its role as a joint sponsoring party of the study is meaningful. Next week we will assess how to best respond to that situation.



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### **The Application – HVAC Recommendation**

Aside from the possible subsidy of the Competitive Affiliate by the Applicant (which admittedly may be material), the Application is a fairly standard Price Cap IR application. HVAC Coalition has not identified any other material aspects of the Application that are contentious.

The Board will be aware that HVAC Coalition's business concern with the apparent subsidy of the Competitive Affiliate is that our members are left to compete with a company that has its costs, and therefore prices, understated by perhaps 25-30%. It is the anti-competitive nature of the situation that sparks HVAC Coalition's involvement.

That having been said, HVAC Coalition is also conscious that the Board's mandate in this case is "just and reasonable rates", and thus the Board must look at this, not primarily from the point of view of fair competition, but from the point of view of ratemaking.

In that context, HVAC Coalition believes that the potential rate differential, while material, is sufficiently small that rates can be implemented for 2016 while the subsidy issue remains to be determined. If the Applicant charges its customers \$15.0 million from January to April, and it turns out it should have charged them \$14.4 million, that can be corrected later without significant disruption to the customers.

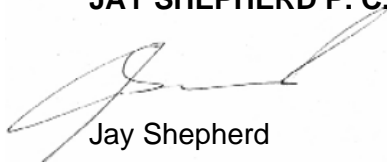
For that reason, HVAC Coalition submits that the Board should proceed with rates for 2016 without adjusting for any subsidy of the Competitive Affiliate, but declare those new rates interim. A Phase II of this proceeding would then take place once the study is filed. HVAC Coalition may also, if permitted by the Board, file expert evidence on the costs of the Competitive Affiliate. The Board can then, after discovery, etc., reach a determination on whether there is in fact any subsidy, and if so how much. We believe that this can be done by April at the latest, if the parties continue to pursue the schedule diligently.

We note that, while HVAC Coalition thinks it is more likely that this issue will be contested than resolved, that possibility has not been ruled out. In the best case, the completion of the study, and perhaps the provision of evidence from HVAC Coalition, will allow the Applicant and the intervenors to reach a consensus on allocations to the Competitive Affiliate, and present it to the Board for the Board's consideration. If no consensus is reached, the Board will still be in a position, with a proper record, to determine whether rates are in fact just and reasonable.

All of which is respectfully submitted.

Yours very truly,

**JAY SHEPHERD P. C.**



Jay Shepherd

cc: Martin Luymes, HVAC (email)  
Interested Parties

### **Information Required to Review the Draft Study**

1. All information available on any benchmarking work done by Grant Thornton as part of the study, including:
  - a. A breakdown of the expected costs of the affiliates given normal industry cost ranges;
  - b. A revised draft of the study incorporating the industry information provided by HVAC consultant Ron Coleman.
  - c. Any other benchmarking analyses or information used to test the reasonableness of the allocations.
2. Information on the cost and management structure of Sandpiper and OHESI, including:
  - a. The most recent full financial statements of the relevant affiliates, with a breakout of the HVAC businesses if other businesses are included.
  - b. A breakdown of the costs of Sandpiper and OHESI with the same level of granularity as in the industry standard information provided to you by HVAC Coalition.
  - c. A full org chart of Oakville Enterprises Corporation showing how the relevant affiliates fit into the overall management structure (including identifying which positions are included in the costs of the regulated utility, and which positions are paid and costed solely by the unregulated affiliates).
  - d. A detailed breakdown of the allocation of all regulated utility costs to each of the affiliates (all affiliates, not just Sandpiper and OHESI), with a reconciliation back to the total costs of the regulated utility, and with details of the cost drivers used to do each allocation.
  - e. For each cost that is allocated on the basis of time spent, the original time dockets and other information used by the consultant to establish or confirm that allocation.
  - f. All other information in the possession of Oakville Hydro that has been seen by the consultant and used to justify the cost allocations proposed, or that would assist HVAC Coalition in assessing the study's conclusions on the allocation of various categories of overheads.
3. Information related to occupancy costs:
  - a. The square footage and rental rate for each of the Town of Oakville and Rogers.
  - b. A breakdown of the 71,254 square feet of space of the regulated utility used as a denominator in the space allocation, including at least a breakdown between private offices, common office areas, warehouse space, fleet facilities, and other uses. Given the square footage in which other, much larger, LDCs operate, we will also require an explanation as to the high square footage apparently used by Oakville Hydro.
  - c. A similar breakdown of the 686 square feet of space of Sandpiper and OHESI, with similar categories. An explanation of the small size of the space allocation is also required.
  - d. All market information used by the consultant to test the reasonableness of the occupancy costs proposed.
  - e. All other data available that will assist HVAC Coalition in assessing the study's conclusions on occupancy costs.