EB-2015-0089

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application by Milton Hydro Distribution Inc. pursuant to the *Ontario Energy Board Act* for an Order or Orders approving rates for the distribution of electricity commencing May 1, 2016

FINAL ARGUMENT
OF THE
SCHOOL ENERGY COALITION

April 19, 2016

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1 GENERAL COMMENTS

1.1 *Introduction*

1.1.1 On August 28, 2015 the Applicant Milton Hydro Distribution Inc. filed an Application to set just and reasonable rates for the distribution of electricity for the period commencing May 1, 2016. The Application describes the problems associated with Ontario's fastest-growing electricity distributor, and proposes a rate increase (after subsequent adjustments to requested OM&A), of just over 7%.

1.1.2 The parties worked diligently to settle almost all of the issues in this proceeding, and filed a Settlement Proposal with the Board on February 9, 2016. As a result of the Settlement, the proposed rate increase is now 3.82% based on the forecasts of the Applicants for the unsettled issues.

1.1.3 Two issues were dealt with by way of oral hearing: the level of OM&A for the Test Year, and the prudence of the expenditures claimed with respect to the Applicant's new head office building.

1.1.4 The Applicant's Argument-in-Chief was delivered orally on April 5, 2016. This is the Final Argument of the School Energy Coalition.

1.1.5 The ratepayer groups who intervened in this proceeding have worked together closely throughout the hearing to avoid duplication, including exchanging drafts or partial drafts of their final arguments. We have been assisted in preparing this Final Argument by that co-operation amongst parties. On some components of the issues we have relied on other intervenors rather than re-do their analyses.

1.2 *Summary of Submissions*

1.2.1 ***Central Recommendation of SEC.*** This utility is in a period of transition, and the fundamental problem is that those governing its direction – likely the board of directors – failed to identify and respond to that transition early enough, and with an appropriate plan. As a result, the utility is still making decisions like a small utility, when in fact that approach is less and less appropriate.

1.2.2 SEC submits that the central issue is not whether the disputed costs will have to be incurred in the Test Year. Some of them will be incurred. The central issue is, to the extent that they are incurred, who should bear those incremental costs: the customers, or the owners?

1.2.3 ***OM&A***. No matter how you look at the forecast OM&A, it is at least $800,000 higher than can be justified based on the empirical evidence[1]. Some increases are justified by

[1] Some metrics make it $2.5 million, or $1.3 million, too high on an annual basis.

improved outcomes for customers. Most – at least $800,000 – are not producing benefits for the ratepayers, and should be disallowed.

1.2.4 ***Expenditures for the New Building.*** The evidence shows that revenue requirement is increasing by almost $1.1 million per year (about 6.5% when translated into rate impact) as a result of the move from Lawson to Chisholm. Some of that is legitimately driven by growth, and so is paid for by increased revenues from a greater number of customers. Some of it is driven by an unsuitable choice of solution, and a suboptimal implementation of that solution.

1.2.5 The end result is that revenue requirement should be reduced by two components of the building costs, totaling $355,000:

(a) $280,000 for the revenue requirement impact of office and ops space that is too big for the Applicant's needs, and has not been configured to allow reductions of annual costs; and

(b) $75,000 for the revenue requirement impact of lack of outside storage, and excess inside storage, creating an annual cost differential.

2 A UTILITY IN TRANSITION

2.1 *Introduction*

2.1.1 This is an unusual LDC in one specific respect: it is the fastest-growing LDC in Ontario, and has been for the last decade. The Applicant calls this "super growth mode[2]", and attributes some of its cost pressures to this external reality.

2.1.2 SEC agrees that the rate of growth is a significant challenge for this utility, and also agrees that the Board should take this into account in assessing the actions of utility management, and the impacts of those actions on revenue requirement and rates for the Test Year.

2.1.3 However, we note that the underlying assumption of the utility – that the transition to a larger utility is fundamentally about spending more money – is not the primary impact here. This is not as much about loosening the purse-strings. It is more about recognizing that a different approach to serving customers is required when the organization gets larger. A more formal process for making decisions is necessary, with documentation and the use of experts.

2.1.4 This is not about becoming bureaucratic. It is, rather, about recognizing that management is a step further away from the issues, and the stakes are higher as the dollars get bigger. It is about recognizing that, in a small utility, you really can have your finger on the pulse of everything that is happening[3], but as the utility gets bigger that is no longer possible. Just as Milton Hydro needs to move to a control room approach to maintaining and overseeing its distribution infrastructure[4], so too its other decisions require less "seat-of-the-pants", and more disciplined analysis. As the numbers get bigger, and the issues get more complex, and there are more people involved in the process, the addition of more formal approaches is essential.

2.1.5 This is seen clearly in both of the areas that remain unsettled, and were discussed in the oral hearing.

2.2 *The Premises Decision*

2.2.1 This utility has recently faced the largest capital decision in its history[5], and responded by buying a new building that is demonstrably unsuitable for its needs, both in size and configuration. How this was done is discussed in some detail later in this Final

[2] K1.2, slides 2 and 10, among other places.
[3] "The CEO still climbs poles", as one utility famously declared.
[4] Tr.1:113.
[5] Tr.2:60.

Argument[6].

2.2.2 What is clear is that:

(a) At no time did the Applicant seek the advice of experts with respect to the present and forecast needs of the LDC.

(b) At no time did the Applicant do a formal internal analysis of the present and forecast premises needs.

(c) The Applicant never at any time did a rigorous calculation of the impacts of the decision they were making on their ratepayers.

(d) The sense that the Applicant "had no other options" permeated the final decision-making.

(e) During the critical period, management made the decision without any recorded meetings, input, or other guidance.

(f) Once the main decision was made, no thought was given to how to minimize the impact on rates, nor how to optimize the building that had been selected. For example, while they make a point of noting that they targeted a LEED Silver standard, they neither sought to comply with that standard formally (which would have improved the value of the building), nor calculated the costs and benefits of the efficiency approach they took[7].

(g) The configuration selected prevents the utility from reducing the impact on ratepayers over the next ten to fifteen years.

2.2.3 The obvious reason for these shortcomings is that the Applicant was still acting like a small utility, where a formal, disciplined decision-making process is, frankly, overkill. You can do that when you are deciding whether to replace the poles on Feeder 1 or Feeder 7 first, and you only have ten or fifteen feeders. You can't do that when you're spending $15 million on a new building.

2.3 ***Control of Operating Costs***

2.3.1 If anything, this effect is worse when it comes to operating costs. For example, when asked why other local LDCs have lower OM&A per customer than Milton Hydro, the CEO just didn't know, and made clear that they had not investigated to determine why that would be the case[8].

[6] Section 4.3.
[7] Tr.1:107.
[8] Tr.1:91.

2.3.2 Later, questioned by Board Member Thompson, the utility denied that its OM&A performance was deteriorating, in the face of clear evidence showing the opposite. The following exchange is enlightening[9]:

> *"MR. THOMPSON: …The Board is adopting an outcomes approach to evaluate utility revenue requirement requests, and dealing with your OM&A costs and taking the historic period, 2011 to 2015, there's been a lot of examination on line items and that kind of thing. But do you accept or do you not accept that the outcomes over that time frame, in terms of cost per customer, OM&A cost per customer are deteriorating?*
> *MR. MCKENZIE: As part of our Exhibit 1, we filed the cost drivers table and we did match it up with the outcomes that we anticipate as a utility, that were determined by strategic sessions with the Board and senior management.*
> *I wouldn't say our costs have deteriorated. When we did our customer survey, which was important to us and customers gave us good feedback. Generally, they were supportive of Milton Hydro. They understood the cost increases were there and that rates were going to go up. But they did accept that to continue with reliability, that costs changes and rate increases were a requirement.*
> *MR. THOMPSON: So the number for 2014 actual was in the $240 range, and you tell us that for 2016, it's in this the 270-something-dollar range. In your mind, is that evidence of some deterioration?*
> *MR. MCKENZIE: No, I would say not. It's evidence of additional programs that we have implemented, software that will help us improve and meet some of our outcomes of reliability, customer satisfaction, customer communications. And I mentioned before that we've implemented SCADA outage management systems and GIS system, which going forward will help us to meet and improve on those outcomes for customers."[emphasis added]*

2.3.3 This response is despite previous testimony that very little of that additional spending per customer was actually going to provide those better outcomes. Reliability will not improve; customer satisfaction will not improve.

2.3.4 Later, both Mr. Thompson and Chair Dr. Elsayed pursued the issue of benchmarking to local utilities further:

> *"MR. THOMPSON: …In terms of those neighbouring utilities, do you share information on ongoing basis with respect to your respective benchmarks like your OM&A cost per customer and that kind of thing? Is there some sharing -- so would you, for example, know informally what the 2015 numbers of those utilities are?*
> *MR. MCKENZIE: No, not 2015.*

[9] Tr.1:140-1.

MR. THOMPSON: You don't have a protocol of getting together with those people to measure how you're doing versus how they're doing?
MR. MCKENZIE: No, not at the present time."[10]
"DR. ELSAYED: Thank you. Just a follow-up on that last question. I guess in your slide 12 you do show a number of utilities that have OM&A per customer lower than yours, some in the extreme lower by as much as maybe 20, and just reading roughly the graph 20 to 25 percent lower than yours.

Why is it then that if there is that much difference you wouldn't take a more formal benchmarking approach to find out what they do differently?
MR. MCKENZIE: From my experience, typically distributors have not shared that type of information. I don't know if we get it through operations councils or anything like that. No.
MR. LASOWSKI: One of the things that Milton has done is -- and they are listed in sort of that group, but there is a group of ten utilities which consists of the four Halton utilities, Kitchener, Waterloo, Guelph, Niagara Falls, and Kingston, and we have gotten together formally to try to find mechanisms to offset some of those OM&A costs, so we are looking at joint purchasing, we're looking at joint inventory, we're doing a lot of those things. We don't necessarily benchmark it, but we're looking at, where can we do it, so another example of it, you know, basically the ice storm, we now have a joint emergency response that if one of us runs into problems we can rely on each other.

So we are doing things along those lines, as opposed to just sort of benchmarking and saying this is the number."[11]

2.3.5 These responses show an approach to cost control that does not rely on empirical analysis, and does not set an external standard. It is anecdotal, not disciplined. Seeking information on best practices is valuable, no question. It is not benchmarking.

2.3.6 This is a theme throughout: lack of discipline. When asked why the costs of engineering were going up dramatically, the witnesses in oral evidence said it was primarily because of the shift from CGAAP to MIFRS[12]. When asked to provide details by way of undertaking, it turned out that the accounting change was only a small component of the increase. The biggest increase was adding more people[13]. The difference is several hundred thousand dollars, something that should have been top of mind for utility management.

2.3.7 Similarly, the witnesses claimed that their large rural area, and thus relatively low density compared to other LDCs, is a reason for upward cost pressures. Then, faced with the fact that their density is almost dead-on the industry average[14], they were

[10] Tr.1:143-4.
[11] Tr.1:144-5.
[12] Tr.1:108.
[13] J1.9.
[14] Tr.1:95.

simply unaware of that fact. They had been assuming they had a legitimate justification for cost increases, when in fact that justification did not hold water[15].

2.3.8 The evidence is replete with these examples. The fact is that, as their operating costs are increasing, and their business is becoming more complex, Milton Hydro's management are not applying a more rigorous approach to management and decision-making. They are continuing to manage as if this is still a small utility.

2.4 ***The Board's Response: Outcomes***

2.4.1 This all sounds very critical, and that is not actually the point. The point is that this is a utility in transition, and that transition involves, for want of a better word, growing pains.

2.4.2 ***What is the Problem?*** SEC submits that the main failure here was one of governance.

2.4.3 Management, and of even more importance, the board of directors have failed to recognize the change that is happening, and respond strategically. Faced with "super growth mode", those in charge of the utility should have immediately designed and implemented a plan for the required transition. That should have included getting outside assistance to identify issues and plot the trajectory of change. It should have included reviewing how other LDCs have responded to their own super growth mode, and the mistakes they made.

2.4.4 We say this was the responsibility of the board of directors because that is precisely why you have a board of directors. The point is for that group of people to identify the higher level issues, and get in front of them.

2.4.5 On the evidence before the Board, that is not what happened. Instead, the board of directors does not appear to have taken any leadership, but left the challenges of handling super growth mode to management, to fit in between their tasks of actually running the utility on a day to day basis. That is fundamentally unfair to management, and essentially guarantees an ad hoc approach to this critical transition period. When we discuss the "crisis management" that led to the purchase of 200 Chisholm, it is this failure of governance that is the root cause of that situation.

2.4.6 ***What Should the Board Do?*** Once it is accepted that the extra costs being proposed for the Test Year and beyond are the result of a failure of governance, the Board still has to decide who bears the cost of that failure. The Applicant proposes that the ratepayers bear that cost. SEC believes that is not the appropriate result.

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[15] It got even worse when the witnesses argued that they should be compared to the whole industry, including Toronto Hydro and Hydro one, which of course would make Milton Hydro about 12 times as dense as the industry average. Faced with that, all they could say is that they would have to do more analysis. Tr1:94-5.

2.4.7 Here is why this matters. In the next two sections, we will show that forecast OM&A is too high by $800,000 per year or more, and we will show that more than $300,000 of annual costs of the new building are imprudent.

2.4.8 On the other hand, some of that extra OM&A will indeed have to be spent. It doesn't matter if it could have, or should have, been avoided. The jobs still need to get done. We are where we are.

2.4.9 Similarly, all or most of that $300,000 or more excess building costs will still be incurred. The Applicant cannot go back and change the configuration of the building so that the office space waste is reduced. Buying land for outside storage is no longer a viable option. This money has been spent.

2.4.10 The issue, it is submitted, is not whether the utility should spend any of this extra money, whether on OM&A or on building costs. The issue is whether the additional costs should be borne by the ratepayers, or the shareholder.

2.4.11 In our submission, the essence of the outcomes-based approach is that the utility is accountable to provide customer value for extra dollars spent. Where additional value cannot be delivered, prices should prima facie not be increased. Providing better communications during outages is an improved outcome for customers, and they should pay for that if it is something they value (which they do). Providing 24/7 control room so that response times are improved and made more efficient is something that benefits the customers, and which they value.

2.4.12 On the other hand, bringing the AMI in-house, at a substantial additional cost (which was a surprise, as it turns out), or housing the staff in a bigger and fancier building, are not improved outcomes for customers. These are not things for which the customers should be paying more.

2.4.13 The fact that much of the reason for the higher OM&A and the excess building costs, is based on a failure to get in front of the transition to a larger utility, simply proves that result. The transition should have been an opportunity to provide better outcomes to customers, while keeping costs down. It was not.

2.4.14 The Applicant will ask the Board to respond to the question: "Can the utility operate effectively on lower OM&A or lower building costs?" In our submission, that is the wrong question. The right question is "If this extra money is going to be spent, who should pick up the tab?"

3 OM&A

3.1 ***Introduction***

3.1.1 The Applicant proposes a substantial increase in OM&A compared to the amounts currently included in rates. There are a number of justifications for the increases (including line by line and in general), but the central foundation of the request is captured quite clearly in the following quote, which expresses a certain approach to running an electricity distributor[16]:

> *"MR. SHEPHERD: All right. Have you taken any action, Mr. Lasowski, to ask your executive team, your increased -- your expanded executive team, which I'm not objecting to. I don't think that's a bad idea. But have you taken any action to ask them to look at these cost increases and figure out how to reverse these trends?*
>
> *MR. LASOWSKI: What we have done, and when we do our annual budgets, is we try to only include those costs that we feel are totally necessary. We do not put in, as has been indicated earlier, bodies and costs for the sake of, you know, saying it'll make it easier down the road. We do tend to do as much as we can, and then when we need another body we add the body. A lot of these costs you're talking about are bodies." [emphasis added]*

3.1.2 In this section of our Final Argument, we first look at the general justifications the Applicant has provided for increasing costs. Then, we look at the total OM&A proposed by the Applicant for the Test Year, relative to appropriate benchmarks of reasonable OM&A levels for this LDC.

3.1.3 SEC has had an opportunity to review the very detailed top-down analysis of OM&A levels prepared by Energy Probe. This methodology, which most people in the industry have seen by now (it has been used, particularly in ADR situations, for at least two years and at least forty LDCs), is robust and reliable. SEC believes it produces results that are indicative of reasonable levels of OM&A based on benchmarking to the past history of the LDC being reviewed.

3.1.4 SEC has reached a similar conclusion as Mr. Aiken, but using a more simplistic approach. We are not for a minute suggesting that our analysis is as sophisticated as the Energy Probe model. Rather, we are offering our analysis as a simpler alternative, but still consistent with the more detailed approach provided by Energy Probe.

3.2 ***Justifications Based on Uniqueness***

3.2.1 The Applicant has offered two general justifications for the level of their OM&A

[16] Tr.1:124.

costs: "super growth mode", and the large rural component of their service territory.

3.2.2 ***Super Growth Mode.*** The Applicant's takeaway from the fact of "super growth mode" is that they can't be compared to any other LDC. No-one is growing as fast as they are, and therefore the Board should not compare them in any way to other LDCs[17]. It brings to mind the ubiquitous phrase "everyone is special in their own way". There is little doubt this is true in the case of Milton Hydro, but what does that mean?

3.2.3 In our submission, Milton Hydro offers a service – distribution of electricity – that is in most respects identical to the service being offered by about seventy other companies in Ontario, and thousands of entities around the world. Many aspects of their business are rigidly controlled, whether by the government, by the regulator, or by the laws of physics.

3.2.4 Further, although they are the only utility that is fully in super growth mode right at this minute, many others in Ontario have been through that transition, and are now at the post-super-growth stage. This includes several of the LDCs in Milton Hydro's peer group, such as Burlington, Oakville, Waterloo North, Kitchener, Guelph and others.

3.2.5 So, while the day to day challenges faced by Milton Hydro's management may well be specific to their service territory today, they are not operating their utility on Mars. They are travelling a well-trod path, and do not need to reinvent wheels to get there.

3.2.6 What the Board can see from other utilities that have been down this road is that the addition of the functions and capabilities that come with growth do not have to result in higher costs. In fact, they can result in lower costs, as economies of scale kick in. The Applicant's own evidence[18] of their preferred peer group shows that they were dead on the peer group average OM&A per customer, despite the fact that most of the LDCs have already been through super growth, and survived it. Of those that have experienced high growth, Kitchener and Newmarket are lower than Milton, while Burlington, Oakville, Guelph and Waterloo are higher.

3.2.7 SEC agrees that super growth mode carries with it cost pressures. What the Applicant fails to take into account, though, is that it also brings with it opportunities for cost savings.

3.2.8 ***Density***. The Applicant makes the point that their service territory is 85% rural[19], and rural areas are much more expensive to serve.

[17] K1.2, slides 2 & 10.
[18] K1.2, slide 11.
[19] K1.2, slide 3, 24.

3.2.9 This is not, in fact, a way in which Milton Hydro is different from other LDCs. On density, Milton Hydro is very close to the average.

3.2.10 This can be looked at two ways.

3.2.11 First, the Board can look at the customer density of LDCs in Ontario. Milton Hydro quite correctly points out that its density is 94.64 customers per square kilometer[20]. If the Board compares that to all LDCs in the province, the weighted average density is actually 7.34 customers per square kilometer[21]. That number, however, is unfair to Milton Hydro, because Hydro One and Toronto Hydro skew it disproportionately. When those two large utilities are taken out of the calculation, the weighted average density of electricity distributors in Ontario is 97.94 customers per square kilometer. Milton Hydro is already very close to that, and with their growth rate will actually be at 98.85 customers per square kilometer in the Test Year[22].

3.2.12 Second, the Board can look at the density question by considering the ratio of rural to urban service territory. Milton is 85% rural, which seems high. For the industry as a whole, it is 99% rural[23]. However, that is again skewed by Hydro One and Toronto Hydro. If you remove those two utilities, the weighted average percentage rural for all Ontario LDCs is 81%. Milton, with a growing urban area, may already have reached the industry average.

3.2.13 SEC submits that the density argument does not fly. Milton Hydro may have once been a low density rural distributor. Growth has overtaken it, and Milton Hydro is now almost exactly average in that category.

3.2.14 Further, it won't be long before growth results in Milton Hydro being a relatively high density LDC. For example, based on the 2020 customer forecast of 42,672, the Applicant will at that point be serving 115.0 customers per square kilometer, likely well above the industry average at that time. Using the Applicant's own logic, at that point its OM&A costs should be lower than average, because it has a higher density service territory.

3.2.15 SEC submits that neither of the justifications Milton Hydro has provided for increasing costs is a true justification for higher OM&A per customer. The first, growth, should produce both cost pressures and savings. The second, low density, is no longer true of this LDC, and today if anything justifies lower OM&A, not higher.

[20] K1.2, slide 4.
[21] 2014 Electricity Distributors Yearbook.
[22] 36,672 customers divided by 371 square kilometers.
[23] 2014 Electricity Distributors Yearbook.

3.3 ***Effect of MIFRS Capitalization***

3.3.1 The Applicant specifically relies on a large impact of MIFRS to justify much of its increase in OM&A. The evidence on this point is problematic, and SEC submits that the Board cannot rely on the numbers put forward by Milton Hydro.

3.3.2 ***The Applicant's Number.*** The Applicant claims[24] that the impact of the change to MIFRS from CGAAP for capitalization of overheads is to increase OM&A by $1,455,845 in the Test Year. This is almost certainly not correct, as their own evidence demonstrates.

3.3.3 In 4-Staff-50, the Applicant set out a comparison of 2016 OM&A under MIFRS and CGAAP. The difference in OM&A, after capitalization, is $785,925[25], not $1,455,845.

3.3.4 When this discrepancy was brought to the Applicant's attention in cross-examination[26], the witnesses did not understand why it was the case, and said they would reconcile 4-Staff-50 with their Appendix 2-JB. Undertaking J1.8 is that response.

3.3.5 Sadly, J1.8 is even more in error than the first evidence. In J1.8, the table that supposedly replicates 4-Staff-50 double-counts the MIFRS capitalization, thus reducing the CGAAP OM&A after capitalization by an extra $823,507. This is apparent because the OM&A before capitalization in the table should be the same under both MIFRS and CGAAP (as it was in 4-Staff-50). The point of the table is to show the differential impact of capitalization, so the starting point has to be the same.

3.3.6 Instead, the Applicant appears to have used, as OM&A before capitalization, the figures for MIFRS after capitalization. This can be seen by comparing the total at the bottom of the column second from the right, with the first sub-total on the right hand column. These two figures cannot be the same.

3.3.7 One possible explanation could be that the capitalized OM&A figures for CGAAP purposes are intended to be increments over the MIFRS capitalization amounts. Aside from being inconsistent with the format of the table, it cannot in any case be true. That would require, for example, that under CGAAP all of Fleet and Stores are capitalized, where in fact in 2012 it is clear that under CGAAP less than 20% was capitalized. It would also imply that the total CGAAP capitalized OM&A[27] would jump to 21% from past years of 14-15%, which is clearly not realistic, and in any case is inconsistent with the evidence of the Applicant throughout the Application.

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[24] Tr.1:18,74.
[25] $9,903,387 less $9,117,462.
[26] K1.6, p. 11; Tr.1:96-8.
[27] $1,455,845 + $823,507, on this theory.

3.3.8 In fact, it is clear based on the Applicant's evidence that the capitalized portion of OM&A for the Test Year decreases, under MIFRS, from $1,455,845 to $823,507, a net of $632,338[28].

3.3.9 This has two effects.

3.3.10 First, the CGAAP OM&A per customer for the Test Year in J1.12(2) is likely wrong. Instead of being $236.33, it may actually be as high as $258.78. This dramatically changes the OM&A per customer trajectory of the Applicant.

3.3.11 Second, the Applicant's Appendix 2-JB, which is supposed to explain the drivers of increases in OM&A, is now missing more than $800,000 of explanations. This was supposed to be part of J1.8, but because the Applicant made an error that apparently balanced 4-Staff-50 and 2-JB (but did not), the Applicant did not respond to the second part of the undertaking, i.e. restating the 2-JB.

3.3.12 ***Is There Other Evidence?*** There are two other pieces of evidence that can help shed light on this, but ultimately do not produce a reliable number.

3.3.13 First, it is possible to look at a top-down analysis of OM&A increases year over year using CGAAP and MIFRS independently. While the dollar and percentage figures for each will be different, since they account for things differently, absent any unusual events the pattern of increases year by year should be similar.

3.3.14 If you do that, you find that there is a big jump in OM&A in 2015 in both CGAAP and MIFRS models, and the prior years also adjust in similar ways. This suggests that, up until 2015, CGAAP and MIFRS capitalization impacts as described by the Applicant are correct. Then we get to 2016. The CGAAP increase is 0.97%, but the MIFRS increase, with the adjustment described above, is more than 10%. Conversely, if the Applicant's figure is treated as the total of $1,455,845 and $823,507, the MIFRS increase is 2.27%. This is more realistic.

3.3.15 Second, Undertaking J1.1 seeks to explain the increase in capitalization impact in 2016. It appears to show that MIFRS capitalization in the Test Year is $823,507, and it would be $2,279,352 under CGAAP. This would imply that the total amount

[28] SEC remains concerned about the state of the evidence on this point. The Applicant does not explain, in J1.8, what caused the CGAAP capitalization amounts in that response to be different (lower, in fact) from the capitalization amounts in 4-Staff-50. Despite changes to the OM&A before capitalization, due to the $219,060 increase in OM&A by way of update, the MIFRS capitalization does not change, but the CGAAP capitalization goes down, and none of the figures balance to anything outside of J1.8. This evidence would have benefitted from further cross-examination to get to the bottom of it. That having been said, the evidentiary phase of this proceeding is complete, and the Applicant's case is what it is. That case says that the 2016 impact of MIFRS capitalization is $632,338.

capitalized in 2016 under CGAAP would be 21.2%, up from 14.9% in 2012[29]. This is further exacerbated by the fact that 2012 capitalization under CGAAP included 89% of engineering costs[30], whereas in 2016 only 24% of engineering costs are said to be capitalized under CGAAP[31], a difference of more than $600,000.

3.3.16 ***Conclusion.*** The point of this lengthy analysis is not to produce a reliable number. On the evidence before the Board, that is not possible. SEC, in its analysis below, has used the 2016 CGAAP OM&A figure provided by the Applicant, $8,666,602. That number is not likely to be correct, given the various problems identified above. However, it is the most conservative approach.

3.3.17 As a result, in our submission the explanations provided by the Applicant, and the conclusions set out below, in each case likely miss some hundreds of thousands of dollars of unexplained extra OM&A that exceeds what the Applicant really should be spending.

3.4 ***Benchmarking of Reasonable OM&A***

3.4.1 Reasonable OM&A levels can be calculated empirically in two ways. The utility can be benchmarked to its own past performance, with escalators built in to model reasonable cost pressures. The utility can also be benchmarked to other LDCs with similar characteristics, or econometrically to dissimilar LDCs with the appropriate adjustments.

3.4.2 ***Time Series Self-Benchmarking.*** A starting point for calculating a reasonable OM&A level for the Applicant is the actual OM&A spending for a previous year, then adjusting it for external factors that should increase or decrease OM&A. This can be done on a per-customer basis, or overall with a growth adjustment. The key adjustments that should be made are:

(a) Inflation.

(b) Growth in customers.

(c) Stretch or productivity.

3.4.3 Of course, once the top-down analysis is done, it is still necessary to analyze the difference between calculated "optimal" and the proposed OM&A, to determine if there are legitimate reasons why OM&A should increase more rapidly than the external drivers would suggest. This would be the case, for example, if OM&A is

[29] J1.8.
[30] J1.8.
[31] J1.1.

increasing to drive better outcomes for customers[32]. However, before you get to the explanation part, it is necessary to find the starting point empirically.

3.4.4 In the analysis below, SEC has used the inflation figures in the second table of J1.12(2), which are the Board's inflation factors as supplied by the Applicant. The percentage growth in customers is also calculated, for each year, using the data in J1.12(2). We then use the .44 factor used by Pacific Economics Group to infer the percentage increase in OM&A that should arise from a given percentage increase in customer numbers. For stretch or productivity, we have used only the Board's stretch factor, in this case 0.3%.

3.4.5 ***CGAAP Analysis.*** For longer term comparisons, it is necessary to use CGAAP figures, as there are no MIFRS figures prior to 2013. CGAAP OM&A trajectories can be calculated as far back as 2006.

3.4.6 The first OM&A analysis, starting with 2006 actual OM&A, is reproduced below.

#	Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
1	Customers	20,418	21,810	23,911	26,252	28,233	29,814	31,405	33,199	34,592	35,498	36,672
2	Growth Percentage		6.82%	9.63%	9.79%	7.55%	5.60%	5.34%	5.71%	4.20%	2.62%	3.31%
3	Growth net of Scale		3.00%	4.24%	4.31%	3.32%	2.46%	2.35%	2.51%	1.85%	1.15%	1.46%
4	Inflation	1.67%	1.90%	1.90%	2.30%	1.30%	1.30%	2.00%	1.60%	1.70%	1.60%	2.10%
5	Stretch/Productivity		0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%
6	Total Expected Increase		4.60%	5.84%	6.31%	4.32%	3.46%	4.05%	3.81%	3.25%	2.45%	3.26%
7	Expected OM&A	$4,117,744	$4,307,148	$4,558,626	$4,846,175	$5,055,543	$5,230,663	$5,442,402	$5,649,947	$5,833,356	$5,976,413	$6,170,956
8	OM&A per customer	$201.67	$197.49	$190.65	$184.60	$179.07	$175.44	$173.30	$170.18	$168.63	$168.36	$168.27
9	Proposed OM&A/Cust.	$201.67	$209.86	$213.98	$204.40	$198.08	$214.56	$215.32	$215.76	$210.52	$241.80	$236.33
10	Forecast/Actual	$4,117,744	$4,577,106	$5,116,396	$5,365,810	$5,592,517	$6,396,763	$6,761,992	$7,162,841	$7,282,392	$8,583,175	$8,666,602
11	Increases		11.16%	11.78%	4.87%	4.23%	14.38%	5.71%	5.93%	1.67%	17.86%	0.97%
12	Excess OM&A		$269,898	$557,850	$519,734	$536,849	$1,166,228	$1,319,723	$1,513,069	$1,448,952	$2,607,003	$2,495,646

3.4.7 This shows that the Applicant was actually achieving some economies of scale (slightly less than expected, but still substantial) until 2010, but then in its 2011 rebasing there was a large jump in OM&A per customer. After that, there continued to be some economies of scale (still not as much as expected), until another big increase in 2015. In total, this calculation would imply that proposed OM&A for 2016 should, all other things being equal, and subject to any explanations, be $2.5 million lower than proposed (assuming CGAAP accounting).

3.4.8 It is reasonable to argue, however, that whatever increases were allowed in the 2011 rebasing have already been approved by the Board, and so a calculation starting with 2011 Board-approved OM&A is more appropriate[33]. That is reproduced below:

[32] Customers are willing to pay more for a better cell phone, but not for the same cell phone.
[33] 2011 Board-approved customer count and OM&A are taken from the Applicant's Appendix 2-L in this proceeding.

#	Year	2011 Approved	2012	2013	2014	2015	2016
1	Customers	30,461	31,405	33,199	34,592	35,498	36,672
2	Growth Percentage		3.10%	5.71%	4.20%	2.62%	3.31%
3	Growth net of Scale		1.36%	2.51%	1.85%	1.15%	1.46%
4	Inflation		2.00%	1.60%	1.70%	1.60%	2.10%
5	Stretch/Productivity		0.30%	0.30%	0.30%	0.30%	0.30%
6	Total Expected Increase		3.06%	3.81%	3.25%	2.45%	3.26%
7	Expected OM&A	$6,300,000	$6,493,006	$6,740,615	$6,959,429	$7,130,103	$7,362,200
8	OM&A per customer	$206.82	$206.75	$203.04	$201.19	$200.86	$200.76
9	Actual/Proposed	$214.56	$215.32	$215.76	$210.52	$241.80	$236.33
10	Forecast/Actual	$6,300,000	$6,761,992	$7,162,841	$7,282,392	$8,583,175	$8,666,602
11	Increases		7.33%	5.93%	1.67%	17.86%	0.97%
12	Excess OM&A		$269,119	$422,401	$322,879	$1,453,314	$1,304,402

3.4.9 What this shows – again on a CGAAP basis – is that if the 2011 Board approved is accepted as a reasonable starting point, the OM&A proposed for the Test Year is $1.3 million higher than the empirical data would appear to justify. OM&A should increase over that period by 16.9%. Instead, the Applicant proposes an increase of 37.6%, more than twice as much.

3.4.10 In our submission, these comparisons show that the Applicant has at least $1.3 million of additional OM&A spending that needs clear explanations. Those necessary explanations, in SEC's submission, are not explanations about how the money is to be spent. They are, instead, details of what the customers are going to receive for that additional spending, and why those improved outcomes are worth $1.3 million extra per year to the customers.

3.4.11 ***MIFRS Analysis.*** Despite the limited past time series, it is also somewhat useful to do an analysis based on MIFRS data, including the future years set out in response to J1.12(2). We do not have inflation figures for 2017 and subsequent years, but we have used 2.0% as a reasonable estimate, given the Bank of Canada inflation control protocols.

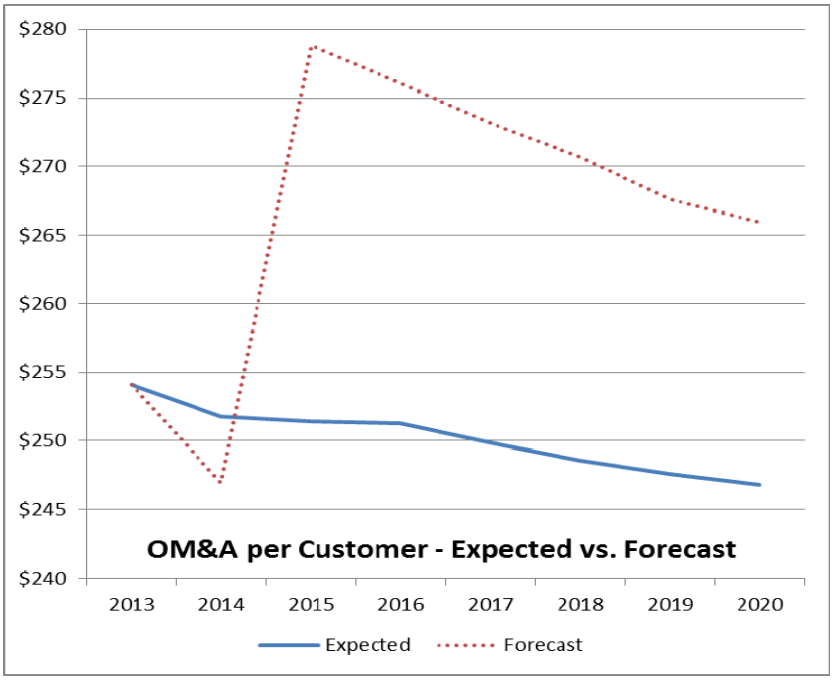
3.4.12 This approach to the analysis, which assumes that 2013 actuals, on a MIFRS basis, are reasonable, shows the following:

#	Year	2013	2014	2015	2016	2017	2018	2019	2020
1	Customers	33,199	34,592	35,498	36,672	38,172	39,672	41,172	42,672
2	Growth Percentage		4.20%	2.62%	3.31%	4.09%	3.93%	3.78%	3.64%
3	Growth net of Scale		1.85%	1.15%	1.46%	1.80%	1.73%	1.66%	1.60%
4	Inflation		1.70%	1.60%	2.10%	2.00%	2.00%	2.00%	2.00%
5	Stretch/Productivity		0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%
6	Total Expected Increase		3.25%	2.45%	3.26%	3.50%	3.43%	3.36%	3.30%
7	Expected OM&A	$8,435,973	$8,709,822	$8,923,422	$9,213,895	$9,536,357	$9,863,361	$10,195,129	$10,531,877
8	OM&A per customer	$254.10	$251.79	$251.38	$251.25	$249.83	$248.62	$247.62	$246.81
9	Actual/Proposed	$254.10	$246.99	$278.84	$276.03	$273.14	$270.69	$267.59	$265.93
10	Forecast/Actual	$8,435,973	$8,543,897	$9,898,207	$10,122,448	$10,426,121	$10,738,905	$11,017,363	$11,347,884
11	Increases		1.28%	15.85%	2.27%	3.00%	3.00%	2.59%	3.00%
12	Excess OM&A		-$165,943	$974,841	$908,677	$889,943	$875,453	$822,087	$815,888

3.4.13 The interesting conclusion from this is that, after the Applicant gets a net 13% extra increase from its 2015 and 2016 spending proposals, it expects to drive economies of scale in the future that are even better than the model predicts.

3.4.14 This is not, of course, what the Board should expect will actually happen. The OM&A forecasts of the Applicant, except for the 2019 anomaly, are clearly just 3% annual increases, rather than any line by line analysis of what is achievable. This is not a forecast of their actual spending patterns. It is a set of future budgets – which are in no way binding – that are specifically designed to produce the desired result.

3.4.15 In any case, based on the Applicant's evidence, the economies of scale that you would expect from a fast-growing utility are forecast to materialize. They just require a large increase in OM&A first. This is shown graphically as follows:



3.4.16 Once the big OM&A increase is accepted by the Board, the Applicant says it can drive its OM&A per customer down year by year until its next rebasing, and at a faster rate than would be expected if the OM&A per customer were based on empirical benchmarking. Of course, the result in 2020 would still be 7.75% higher than the benchmark number, due to the size of the initial increase. It is less difficult to perform better than expected economies of scale when your budget is already artificially increased.

3.4.17 ***Benchmarking to the Rest of the Industry.*** The other way to approach empirical estimating of reasonable OM&A, instead of looking at the Applicant's own past, is to compare the Applicant to others in the industry.

3.4.18 The Applicant, while saying that they should not be compared to the rest of the industry, offered a comparison to their peer group that said they were, and had been for some years, almost exactly at their peer group average[34]. Then they provided a comparison to similarly-sized LDCs (with Milton Hydro smaller than the average), showing that the group (simple) average is $267.40 per customer, compared to Milton Hydro at $243.34, 9% lower[35].

3.4.19 Finally, they compare themselves to the industry average, $337.80, showing that Milton Hydro is 28% lower[36]. However, that industry average includes Hydro One and Toronto Hydro[37], which skew the weighted average[38].

3.4.20 Without Hydro One and Toronto Hydro, the industry average OM&A per customer is $258.36 in 2014. Milton Hydro is thus not 28% lower, but actually 6% lower. Further, since they propose increases of about 18% over 2015 and 2016, they will almost certainly be above the industry average if the Board approves their Test Year budget.

3.4.21 When this was put to Milton Hydro in cross-examination[39], it appeared to be news to them. SEC submits that an LDC should know where their proposals stand relative to other LDCs, and missing a key data point such as this is not appropriate.

3.4.22 If the overall comparison was selective, perhaps the first two were as well. It turns out, those were not weighted averages, as with the last one, but simple averages. The weighted average for the peer group in 2014 is actually $241.98, not $244.71, so Milton Hydro is actually already higher by about half of 1%. The weighted average for the similarly sized LDCs in 2014 is actually $264.44, not $267.40, so Milton

[34] K1.2, slide 11.
[35] K1.2, slide 12.
[36] K1.2, slide 13.
[37] Tr.1:92.
[38] All of these numbers, above and below are based on the Board's Electricity Distributors Yearbook, in this case up to 2014.
[39] Tr.1:93.

Hydro is about $21 lower, or 8.7%, rather than $24 lower, or 9.0%.

3.4.23 The point of these calculations is not to quibble about percentages. The point is that the benchmarking offered by Milton Hydro was selective, designed to show them in the best light. A fairer approach would have been to compare themselves to the broader industry, showing that they are proposing to go from about 6% below the industry average to about 6% above the industry average, despite the economies of scale that should be accruing due to growth.

3.4.24 Benchmarked to other LDCs, Milton Hydro does not do as well in the Test Year as it has in the past. If, instead of seeking a big increase, Milton Hydro were able to keep OM&A 6% below the overall industry average, that would be about $257.50 in 2016[40]. The difference between that benchmark, and the $276.03 proposed in the Application, is $680,000. Thus, even if all of the increases in Milton Hydro's OM&A per customer prior to 2015 are accepted as appropriate, the increase from 2014 to 2016 is still too high, relative to the rest of the industry.

3.4.25 ***Benchmarking Conclusion***. In part because of its growth, Milton Hydro is able to keep its OM&A costs down. The fact that it is in the middle of the pack is not a good thing, and the fact that its OM&A per customer is proposed to deteriorate even further is even worse.

3.4.26 The better approach to benchmarking a utility like Milton Hydro is self-benchmarking over a time series. We agree with the Energy Probe analysis that a reduction of $800,000 to $900,000 is appropriate in the Test Year to get to the level this benchmarking shows is reasonable. We reach that result using a simpler model, but the result is in the same range.

3.4.27 The alternative approach to benchmarking is comparisons to other LDCs. Using the fairest approach to that calculation, the reduction in Test Year OM&A would be $680,000.

3.5 ***Applicant's Explanations***

3.5.1 The Board and parties gave the Applicant ample opportunity to explain the improved outcomes that customers will get from the increases in OM&A expenditures. Much of the first day of the hearing was questions on just that point, including questions from the Board panel and from parties and OEB staff. An exchange with SEC counsel was typical[41]:

> *"MR. SHEPHERD: …But it's only fair to ask you, if you're asking the customers to pay an extra million dollars, what are they getting for it?*

[40] Assuming increases in the industry average of 3% in each of 2015 and 2016.
[41] Tr.1:101-4.

MR. MCKENZIE: Not all those costs, though, are customer-related. There are internal costs within the company that we have gone through and realized that we need. Customers have asked for a communications person. We know internally that we need HR resources, that everyone is handling their own hirings and firings.

So those are costs -- customer service reps. Those are costs that are required by Milton Hydro to continue into 2016. So they may not directly relate to what customers get, except from the point that they may receive better communications.

But by putting in the different systems -- SCADA, outage management, GIS -- it's our expectation that we will have improved reliability for customers. We will be able to provide better communications with outage maps and estimated times of repair.

MR. SHEPHERD: You haven't made any commitment to improve your reliability, have you?

MR. MCKENZIE: Well, that's all part of the work we're doing. It's always an endeavour to strive to improve reliabilities.

MR. SHEPHERD: It was a yes-no question. I heard the discussion about reliability, and I didn't hear anywhere that anybody in the company is saying we will improve our reliability over the next five years. Will you?

MR. MCKENZIE: That's our intention, yes.

MR. SHEPHERD: And you will improve your customer service metrics?

MR. MCKENZIE: They're pretty high now, so it's difficult to improve those. But we will strive to maintain them.

MR. SHEPHERD: Well, maintaining them should mean the same cost per customer, shouldn't it, or even less because it's not incremental, is it?

MR. MCKENZIE: If we need an additional CSR to maintain that, we will do so. If we need an additional engineer person for the systems that we have, we will do that. They all change, the costs.

MR. SHEPHERD: I understand that. I guess what I don't understand is why you would think that increasing a cost is okay, if the customers aren't getting something for it. I don't understand that.

MR. MCKENZIE: Well, that's not what we are implying. We have increased costs to run the business. We have costs that customers have asked for.

MR. SHEPHERD: And the communication specialist, I get that a hundred percent. You add a communication specialist because the customers want better communication. I don't have any problem with that at all.

But all the normal costs associated with the fact that you're growing and the fact that you have more customers, aren't those all included in the inflation rate and in the growth rate? Aren't they all included there?

MR. MCKENZIE: No, I don't agree. <u>There are costs we need as a company, as we transition into a larger distributor, being HR resources and the like. And those are costs that increase, and they serve us as a corporation.</u>

<u>They don't always necessarily serve the customer, except that we have the staff to maintain our levels."</u>[emphasis added]

3.5.2 Few details were provided. The theme is clear. Costs are going up. Whether the customers get something more for those additional costs is not the primary responsibility of the utility.

3.5.3 We hasten to add that SEC does not believe the management of this utility are cavalier about serving their customers. If Mr. McKenzie's comments above are read as not caring, that would be an incorrect interpretation. SEC accepts that management wants to do the best job they can for their customers.

3.5.4 What we do not accept is that management has, at this point, internalized the principle that higher rates require improved outcomes for customers. If you don't improve the product, you can't charge more. Milton Hydro is not yet operated on that basis.

3.5.5 ***Billing, Finals and Collections.*** There was a detailed discussion about this area of spending[42], which lead to Undertaking J1.10. What that shows is that, but for the increases in software licensing costs, including Trilliant, this area increased at about 31.5%, as compared to the 16.9% expected using inflation, growth, and productivity. The main component of this is additional staff, in excess of the additional requirements the increased customer count would imply. Some of that will be the result of increased billing complexity, as the company claims[43], but the bulk of it is unexplained. We know what they are spending the money on, but we don't know what benefit the customers are getting for that addition to their rates.

3.5.6 The situation is more problematic for the software increases, about $233,000. Most of that is the Trilliant charge, which the Applicant admits was just a mistake on their part. They thought when they brought this in-house, the maintenance charge would be small. Instead, it was an order of magnitude larger[44]. There was no customer benefit for this increase.

3.5.7 No explanation has been provided for the customer benefits for the rest of the software increase.

3.5.8 ***Communications.*** The Applicant is proposing to improve customer communications. SEC supports this goal.

3.5.9 ***Finance.*** Table 4-2 shows a $400,000 increase in OM&A from 2011 to 2016 relating to Finance[45]. Part of this is the same software maintenance contracts referred to in para. 3.5.5 above[46]. For the balance of it, most of the impact is the 400% increase in the cost of the board of directors.

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[42] Tr.1:118-20.
[43] Tr.1:119.
[44] Tr.1:37, 135.
[45] K1.6, p. 19.
[46] Not including the Trilliant component: Tr.1:105.

3.5.10 Given SEC's previous comments on the failure of this utility's board of directors to guide the transition to a larger utility, and the costs ratepayers are being asked to bear as a result of that failure, SEC does not believe that this increase in directors' costs is providing improved outcomes for the customers.

3.5.11 ***Reliability.*** At various times, the Applicant has said that they hope to improve their reliability metrics over the next five years[47]. However, under cross-examination from Mr. Janigan[48], the company appeared to say that the best they can hope for is to return base reliability to 2010 levels in the next few years.

3.5.12 While this does not appear to justify the increased costs proposed for the Test Year, it will, for example, justify the movement to a 24/7 control room, something that it appears all parties support. Customers value this additional level of system supervision, because it will produce better reliability over time.

3.5.13 Aside from the control room costs, it would not appear that there will be any incremental reliability benefits from the increased OM&A spending proposed.

3.5.14 ***Premises OM&A***. Offsetting the increases in other areas is a reduction of $85,000 in OM&A costs relating to occupancy[49]. This is not an actual reduction in costs, just a shift in costs from OM&A to capital once a utility-owned building is used.

3.5.15 ***Conclusions***. SEC does not see, in the evidence, spending on improvements for customer outcomes that exceed the $85,000 premises reduction by any more than, at maximum, $100,000. Even that is probably generous.

3.5.16 SEC notes that the Applicant was given the opportunity, time and time again, to provide details of improved outcomes resulting from its increased spending. Few details have been provided.

3.6 ***SEC Recommendation***

3.6.1 SEC recommends that the Board approve an OM&A for the Test Year, on a MIFRS basis, of $9,322,448, a reduction of $800,000 from the figure proposed by the Applicant.

[47] E.g. Tr.1:114.
[48] Tr.1:62 et seq.
[49] K2.2, p.2.

4 THE NEW PREMISES

4.1 *Introduction*

4.1.1 The Applicant is seeking to include in rate base, for the first time, its new office and warehouse building at 200 Chisholm in Milton. The impact in 2016 resulting from this change in location is $1,054,714 additional revenue requirement, which by itself causes a 6.47% rate increase (see analysis below)[50].

4.1.2 SEC believes that the Applicant's process that led to the spending of more than $15 million, their largest ever capital project[51], was flawed. As a result, the decision may not have been the best one, and, even if it was, it was not implemented in a prudent manner.

4.1.3 Our analysis looks at this in steps:

(a) What is the actual impact on rates of this new head office, and how did the Applicant take that rate outcome into account in its decision-making?

(b) Did the Applicant's decision process in selecting the 200 Chisholm option proceed on an appropriate and prudent basis?

(c) How did the Applicant design the new space for its use?

(d) How did the Applicant ensure, in its implementation of the plan, that the impact on the ratepayers was minimized?

(e) If the result for ratepayers is inappropriate, how should the Board adjust rates to ensure they are just and reasonable?

4.2 *Impact*

4.2.1 ***The Applicant's Calculations.*** The Applicant has done a number of calculations of the impact of the new premises. These calculations are generally not reliable.

4.2.2 A good example is the calculation of the revenue requirement associated with the 5,000 square feet of mezzanine that has been closed off and is not in use. The calculation[52] is misleading in at least four ways:

[50] Without this impact, there would in fact be a sufficiency, even before adjusting OM&A to a more reasonable level. This is as it should be, given the economies of scale, and the increasing revenues, of the Applicant.
[51] Tr.2:60.
[52] J2.2.

(a) The calculation assumes that no part of the cost of the land or building should be allocated to that 5,000 square feet, as if the vendors had simply thrown that part in for free. In fact, if that part is allocated its share of the purchase price, the regulated return on that is about $35,000 including PILs.

(b) The PILs component on $19,900 is understated by about $3,000.

(c) The calculation assumes that the share of OM&A for that 5,000 square feet is 5,000/91,818 (the full size of the building) times the total OM&A, $467,634, which would be $25,465, and then reduced by some additional factor to get to $14,191. In fact, the most reasonable approach is to calculate the OM&A cost per square foot for the built-out space (i.e. excluding the outside storage moved inside, so net 55,818), and apply that to 5,000 square feet. That produces an annual cost, including property taxes, of $8.38 per foot, or $41,889 for the 5,000 square feet.

(d) The assumption is that the renovations of the 5,000 feet will last for 50 years, when in fact the nature of those items (painting and lighting, for example) suggest a more reasonable life of 20 years. The depreciation should therefore be $14,127 rather than $5,651.

4.2.3 When these corrections to the calculation are made, the total annual cost to ratepayers of the excess 5,000 square feet is about $114,000 rather than $40,000. This is consistent with our calculation, later in this Final Argument, that the real excess space in the built-out area, 12,800 square feet (at a minimum), has a rental value of $192,000 plus operating costs, and a rate base value of about $215,000 plus operating costs.

4.2.4 In J1.3 (amended) the Applicant has calculated the impact of moving from outside storage to inside storage. This suggests that the sole incremental cost associated with inside storage is a capital cost of $20.93 per square foot for 36,000 square feet, a total of $753,480[53]. This is clearly understated by itself, and then does not include any OM&A cost for that part of the building at all[54].

4.2.5 In the SEC second information request[55], the Applicant has also calculated the overall revenue requirement impact of the new building, and comes up with a number of $512,320. This is also clearly wrong, as we demonstrate below.

4.2.6 SEC's conclusion is that the Board cannot rely on any of the premises-related calculations provided by the Applicant[56]. Where it is relevant to the Board's decision,

[53] As discussed in VECC's Final Argument, with which we agree.
[54] E.g. property taxes, heating, etc. This part of the building was included in calculating the OM&A associated with the 5,000 square feet, discussed above, but then when looking at the cost of the storage, OM&A is ignored.
[55] Which does not appear to have an exhibit number that we can find.
[56] Another example is the cost per square foot, $158: Tr.1:156. By including the entire warehouse area, they made this seem much lower than it really was. Their calculations of space use sought to exclude the outside storage area

the Board is effectively forced to go back to the raw data, and recalculate the figures with more reasonable assumptions.

4.2.7 ***Corrected Calculations***. SEC has done the math to determine the incremental cost proposed in rates resulting from the move from Lawson to Chisholm. That calculation, the components of which have been put to the Applicant[57], is as follows:

Comparative Occupancy Costs - Capital and Income							
Category	**Rate Base**	**Cost Type**	**%**	**Rate**	**Old Cost**	**New Cost**	**Source/Notes**
OM&A (excl. rent)					$197,618	$467,634	K2.2, p. 2
Rent					$355,273		K2.2, p. 2
Old Land	$1,109,265	Debt	60%	3.85%	$25,624		2-EP-4, Table 2-9
		Equity	40%	9.19%	$40,777		
New land	$4,040,000	Debt	60%	3.85%		$93,324	2-EP-4, Table 2-9 and Tr.2:46
		Equity	40%	9.19%		$148,510	
New Building	$10,290,400	Deprec.		2.00%		$209,200	2-EP-4, Table 2-10
		Debt	60%	3.85%		$237,708	
		Equity	40%	9.19%		$378,275	
New Furniture	$360,000	Deprec.		10.00%		$40,000	2-EP-4, Table 2-9
		Debt	60%	3.85%		$8,316	
		Equity	40%	9.19%		$13,234	
PILs				36.05%	$14,702	$92,506	26.5% + gross up; new CCA shield $283,446
Totals					$633,993	$1,688,707	
Incremental Revenue Requirement						**$1,054,714**	**6.47% rate increase**

4.2.8 ***The Applicant Did Not Know the Impact***. The most surprising aspect of this is that the Applicant and its management team never knew the impact of all or any portion of its premises decisions when it made them.

4.2.9 In their direct evidence, the Applicant provided slides to demonstrate that the costs of their building and related spending were reasonable[58], having calculated all of those impacts after the fact, not at the time. At no time, before or after the fact, did the Applicant talk about the impact on rates.

4.2.10 Then, under cross-examination, SEC put the impacts to the witnesses[59]. After we walked through the components of the costs, we put the totals to them, which led to the following exchange[60]:

"MR. SHEPHERD: … So here's what I get. I get old costs, 636,000 for

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and other warehouse components. When it comes to cost per square foot, those are included. That is simply misleading.

[57] Tr.2:44 et seq.
[58] K1.3, slides 16 and 17.
[59] Tr.2:44 et seq.
[60] Tr.2:50.

> *occupancy, new cost 1,838,000, so a-million-two increase, which is a 7.4 percent rate increase. Were you aware that that was the case?*
> *MR. MCKENZIE: No, we hadn't done those calculations.*
> *MR. SHEPHERD: Mr. Lasowski, did you know in going to this new building, you were going to ask your ratepayers to have a 7.4 rate increase just for the building?*
> *MR. LASOWSKI: As Cameron said, we did not do the calculation."*

4.2.11 It wasn't just a question of not having done the calculations. As the Board saw in the faces of the witnesses during that cross-examination, that was the first time they ever realized the magnitude of the increase they were asking of their customers for this new building. It was news to them.

4.2.12 Not only did the Applicant have no idea how much it would be asking its customers to pay extra for this big new building, but there followed an explanation of the reason why, i.e. it didn't matter[61]:

> *"MR. MCKENZIE: We were in a situation where we did not have an alternative choice but to move out of Lawson Road."*

4.2.13 It turns out the impact was not 7.4%, but 6.5%, as calculated above. It was still substantial, and, with the filing of this Final Argument, it is still news to the company.

4.2.14 In our submission, it is not acceptable for utility management to make a major decision like this one, without "doing the calculation" to see what it means to their customers.

4.3 ***Decision Process***

4.3.1 A review of the "Relocation Committee Documents"[62], which are made up of the minutes of the meetings of the Relocation Committee, a management committee, and the reports by the CEO to the Board of Directors, shows a utility that at no time was able to get on top of their space problem. It is, instead, a lesson in crisis management.

4.3.2 Milton Hydro had a problem. They had been forced to leave their long-time rented (from the Town) head office in 2009 on relatively short notice. They were able to lease premises on Lawson Road for five years, but concluded that in the longer term they should own their own facility. The Lawson Road lease was therefore intended to be an interim measure, until a permanent location was found. The Applicant's last rebasing application was filed on that assumption[63].

4.3.3 ***Relocation Committee.*** The minutes of the Relocation Committee show that they met

[61] Tr.2:50.
[62] 1-SEC-14, Attachments.
[63] EB-2010-0137.

regularly, every few months, until June of 2013. At that time, they had identified land and building owned by Magna, and another parcel owned by Nexan, as suitable candidates for their new premises.

4.3.4 For this period until mid-2013, what is most striking is that there are no reports, or analyses, or input from external experts. The utility was making the biggest capital decision in its history, and all of it appears to be very ad hoc. For example, there is a conclusion that the company needs 26,000 square feet of offices, and 34,000 square feet of warehouse space[64], but there is no analysis to show why that is the case. Instead of spending $50,000 to have a space consultant look at the operations, and provide an expert opinion on what they required, they decided, without any disciplined analysis or expert advice, that their 36 office staff would require more than 700 square feet each.

4.3.5 As we have noted earlier, this likely happened because fast-growing Milton Hydro was still thinking and acting like a small utility, instead of like the larger one it was becoming. The fact that this decision had an extra zero before the decimal point did not prompt a change in strategy.

4.3.6 There is an unexplained gap from June 2013 until August 2014, when the Relocation Committee apparently did not meet. When it reconvened in 2014, the Magna and Nexan options were already gone, and the company had already agreed to purchase 200 Chisholm.

4.3.7 ***Reports to the Board of Directors.*** The story can be picked up in the interim from the reports Mr. Lasowski provided regularly to the Board of Directors. Those reports started as far back as 2009, but there are many of them from mid-2013 to the end of 2014.

4.3.8 What the reports to the Board of Directors reveal is that the company could have renewed its Lawson lease for a further five years in August of 2013, and could have leased three additional acres of land at its 5th and Main property from Hydro One in November 2013. These were then viable options.

4.3.9 Those reports also reveal that the Magna property was the most suitable option, but the company decided to walk away from that, and Magna ultimately put it on the open market[65]. It is not clear what happened to the Nexan property.

4.3.10 The first time 200 Chisholm was mentioned is the April 28, 2014 report to the Board of Directors, saying it was available but had problems. The report suggested that there

[64] 1-SEC-14, Attachments, p. 767 of 901.
[65] In their presentation to the Board, at slide 4, the Applicant says that they couldn't proceed with the Magna deal because there was a problem with getting industrial zoning, and there would be delays. That does not appear in the reports to the board of directors. For their own board, they allude to the fact that some local ratepayers object to the zoning of the land, but they do not portray it as in any way a deal-killer.

was adjacent land available for purchase, but otherwise did not comment on the problem with insufficient outside storage.

4.3.11 ***In the next report to the Board of Directors, three weeks later on May 21, 2014, the company had already agreed to buy the 200 Chisholm property***, despite its obvious unsuitability. There is no discussion of the land problem, nor any analysis of the excess size and how to deal with it. The deal had been done, but the problems with the deal had not yet been addressed.

4.3.12 ***Analysis***. There is little doubt Milton Hydro had a problem. It had to find a permanent home at some point. It had a number of options, including extending its lease at Lawson, expanding 5th and Main, and buying the Magna site. All appear, on the evidence, to have been viable alternatives in 2013.

4.3.13 By 2014, these alternatives were all either gone, or deemed unsuitable, and the company had made no arrangements to have a home after December 2014. At this point, it appears that the company reverted to crisis management, jumping on the first opportunity that came along, 200 Chisholm. After agonizing and negotiating on the other deals for several months each, in a couple of cases years, the company bought 200 Chisholm in 23 days. There were no recorded meetings, discussions, reports, debates, analyses, or anything else.

4.3.14 As the Board will have seen from the oral evidence[66], the Applicant and their management believed they were out of options, and they had to get something or they would run out of time.

4.3.15 This is not how you spend $15 million of ratepayer money.

4.3.16 ***Not the Real Problem***. SEC believes, however, that the rush to purchase Chisholm was not the primary problem here. Whether or not the Applicant could have handled its options better in 2013 and 2014, and could have ended up with a better choice, that did not happen.

4.3.17 Was the purchase imprudent? Perhaps, but that is not the essence of SEC's argument. Milton Hydro was a relatively small utility trying to grapple for the first time with a big transaction. Should they have retained experts to advise them? Clearly they should have. It doesn't even take hindsight to see that. Should they have thought more laterally about some of the other options, to see if they could have been modified to be successful? Again, probably yes.

4.3.18 However, in May 2014, having bought this building with obvious issues, management still had the ability to minimize those problems. As we note in a later section, they did not. Instead, they decided to build out their new building with the luxury of much

[66] Tr.2:50.

more space than they needed. It is in the implementation, in our view, that they clearly failed to act prudently and in the best interests of their customers.

4.4 *Size and Use of Space*

4.4.1 ***Overall Amount of Space.*** On an overall basis, the new office space is not only significantly larger than the previous space, but also larger than anything that could be used by the Applicant in the foreseeable future. It is a fast-growing utility, but not that fast.

4.4.2 In 2009, the Applicant was in space owned by the Town, and had 9,731 square feet of office space, plus 14,800 square feet of industrial space[67]. At that time, the Town needed to demolish the building to build a new arts centre, and the Applicant moved to Lawson on a five year lease. That was 12,775 square feet of office space[68], an increase of 31% over the previous space. Given that Milton Hydro had been stuck in that 9,731 square feet for 10 years, that was not unreasonable. The industrial space at Lawson, which appears to be either 22,000 or 24,000 square feet, was a 49% (or more) increase, but that again appeared reasonable given the utility's rate of growth.

4.4.3 The new space is 32,800 square feet of office space, a 157% increase after just five years, a huge increase. The 59,000 square feet of industrial space is a 168% increase. Even if some of that is being used as if it were outside storage, it is still a massive expansion.

4.4.4 ***Sizes of Individual Functions and Components.*** SEC went to the drawings, to see how this new space is being used.

4.4.5 To calculate the sizes of various things, SEC had to extrapolate the scale of the drawings. For Lawson, the distances in feet are on the drawings, so K2.3 is no problem. For Chisholm, they are not. In the oral hearing, the Applicant said the scale of the Chisholm drawings was 1 cm = 1 metre. That may well have been true on the original drawings, but after being reduced when filed in evidence, and then blown up again by SEC in K2.4 and K2.5, it was no longer true. Working from K2.4, the first floor drawing, SEC determined that the scale is 1 cm = 1.33 metres[69], or 4.3635 feet. However, the second floor drawing, when filed, was not to the same scale. SEC has determined that it is now 1 cm = 1.11 metres, or 3.6363 feet[70].

4.4.6 Once the scales are known, it is possible to make some comparisons between particular parts of the old and new space, as follows:

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[67] EB-2010-0137, SEC IR#6.
[68] K2.2 and Tr.2:xx.
[69] Which the Applicant has confirmed by a letter to the Board.
[70] These scales track to the known square footages. For example, applying these scales to K2.4 and K2.5 respectively, produces 10,000 square feet on each floor for the triangular office space, and 12,800 square feet on each floor for the mezzanine and ops areas. This is consistent with the evidence of the Applicant.

Comparison of Building Components				
Component	**Lawson**	**Chisholm**	**Plus**	**Comments/Notes**
Boardroom	750 ft^2	1,160 ft^2	55%	
CEO Office	215 ft^2	390 ft^2	80%	Plus closet in both
Engineering Dept.	2,560 ft^2	5,260 ft^2	105%	
Lunch Room	700 ft^2	1,350 ft^2	90%	Dimensions of old ops lunch room not known
Training Rooms	0 ft^2	1,400 ft^2	NA	Two rooms in new space, 665 ft^2 and 735 ft^2.
Ops Area	???? ft^2	12,800 ft^2		Breakdown at Lawson not known
Corridors min. width	5 ft 4 in.	7 ft 5 in.	40%	
Corridors max. width	6 ft 4 in.	9 ft 9 in.	55%	

4.4.7 Some of the above do require caveats, however:

(a) The evidence of the Applicant is that, at Lawson Road, there was a second lunch room for the operating staff, so the real increase in size is not 90%. However, given that the administrative staff are about 2/3 of the total, the increase is still substantial.

(b) There may have been a training room of some kind in the industrial component of Lawson, for which no floor plans were provided.

(c) Similarly, the size of the ops area at Lawson is not known. What the Board knows is that the Applicant was using 37,000 square feet at Lawson[71], of which 12,800 was office space[72]. The remaining amount, about 24,000 (listed as 22,000 in the Applicant's internal documents) was all of the warehouse, garage, and ops space. It is clear that the ops space at Lawson was only a fraction of the current 12,800 square feet at Chisholm.

4.4.8 Even with those caveats, it is clear that the extra space available to the Applicant was put to use by having larger and more grandiose premises than they needed. By way of example:

(a) The Applicant already had quite a large Boardroom, at 750 square feet[73]. No reason has been given as to why its board of directors, which didn't change in size, suddenly needed a 55% larger room[74], at 1160 square feet. The Boardroom at the new Enersource head office, for example, is only 1000

[71] 1-SEC-14, Attachment, at p. 752 of 901.
[72] Shown in K2.2. The documents at the time said the office space was 15,000 square feet, but now that we have the plans it is known to be 12,775. The fact that the old office space was about 12,800 square feet, and the new mezzanine space, and ops space, is 12,800 square feet, appears to be co-incidental.
[73] Larger than the OEB's main boardroom.
[74] Larger, it would appear, than the West Hearing Room.

square feet[75].

(b) The CEO of the utility had a fairly small office for a CEO, but still probably comparable to many other utility presidents. The new CEO office is large, even by the standards of large utilities[76]. Given the many additional meeting rooms and other facilities in the new space, it is surprising that the CEO would need to almost double the size of his office.

(c) Almost all of the corridors are much wider in the new space. While a 5'4" wide corridor is quite narrow, it is quite normal in many offices (such as some parts of the OEB). A corridor 9'9" wide is quite surprising.

(d) There are numerous empty areas, or areas in which, while they are used, they are "sparsely populated" by a few filing cabinets or such things[77].

4.4.9 ***Locations of Staff.*** Perhaps the most striking "use of space" evidence, however, is in J2.4. The Applicant was asked[78] to identify where on the floor plans there are actual people working. The first floor triangle area has some empty space, but is mostly full. The second floor triangle area is similar. The 12,800 square feet of mezzanine has one person working there, plus the large Boardroom.

4.4.10 ***Square Footages.*** This is not the first time the Board has considered evidence on the size of a utility head office. Other utilities, such as PowerStream, Enersource, Hydro Ottawa, and Waterloo North, have also built or purchased new head offices. The square footage needed for each employee is fairly clear, and has a reasonable range.

4.4.11 PowerStream, for example, moved 250 employees into 92,000 square feet of office space, a net of 368 square feet per employee. Enersource moved 150 employees into 79,000 square feet of office space, a net of 527 square feet per employee.

4.4.12 The Board, in considering the Enersource proposals, did its own comparison of PowerStream and Enersource, including forecast increases in number of employees, and found that "*inadequate overall control to protect the interests of ratepayers was applied to space planning for the project*"[79]. In reaching that conclusion, the Board used its own "five-years-out" calculation of 418 square feet per employee for Enersource, and 341 square feet per employee for PowerStream.

4.4.13 Milton Hydro, on the other hand, has a move in ratio of 781 square feet per

[75] EB-2012-0033, Tr.4:29-46. The Board implied in its Decision that this may already be too large: see. p. 12-13 of the Board's Decision and Order dated December 13, 2012.
[76] It is larger, for example, than the Enersource CEO office, which is 380 square feet: EB-2012-0033, Tr.4:29-46.
[77]
[78] J2.4.
[79] Decision and Order, EB-2012-0033, p. 16.

employee[80], and projects a "five-years-out" ratio of 698 square feet per employee[81]. Even if the 5,000 square feet of unrenovated office space is excluded, the ratios are 662 square feet per employee today, and 591 square feet per employee in five years. Milton Hydro proposes to have, for some considerable period of time, almost twice as much office space per employee as either of Enersource or PowerStream, and the former was criticized for failure to control its space planning.

4.4.14 We note that this should not be surprising. Milton Hydro more than doubled its office space in one fell swoop. No amount of "super-growth mode" will use up that much space in a reasonable time.

4.5 ***Impact Reduction Strategy***

4.5.1 The Board will have seen that, in cross-examination, SEC was focused on how the Applicant approached its responsibility to minimize the impacts of this new head office on ratepayers. The bottom line is, not only did they fail to act, but they failed to even consider the problem.

4.5.2 ***Experts.*** Did the Applicant retain experts to look at their space use, and how to optimize it? No evidence has been provided.

4.5.3 Did the Applicant seek any advice on how to use its excess space in a manner that would reduce the impact on customers? No evidence has been provided, and in fact the witnesses say they didn't even consider this.

4.5.4 ***Options.*** There is, in fact, no evidence that the Applicant, after buying a building that was admittedly too large, even considered any options to reduce the impact on ratepayers. They were focused, instead, on filling up the space with offices and furniture.

4.5.5 ***Prudence.*** In SEC's submission, it is not prudent, faced with excess space, to leave it empty, or to provide staff and functions with more space than they need because the extra space is available. In our submission, utility management has an ongoing and positive obligation to manage the utility with a view to keeping the impact on customers as low as possible. That is what is expected in the competitive market, where failure to pay attention to that obligation results in loss of customers. The same must be expected in a regulated utility.

4.5.6 In this case, the Applicant made a rushed decision, and then abdicated its responsibility to make the best of it once they were on that road. It is not an appropriate response to a difficult situation to expand the size of the Boardroom by 55%, or the size of the CEO's office by 80%, or the size of the lunchroom by 90%. In

[80] 32800 square feet for 42 employees.
[81] 32800 square feet for 47 employees.

so doing, the Applicant made imprudent decisions, the cost of which should be borne by the shareholder.

4.6 ***SEC Recommendation***

4.6.1 SEC submits that the Board should reduce the $1,054,714 revenue requirement impact of the new building on ratepayers, as the evidence clearly demonstrates that the Applicant did not purchase and renovate its new head office building in a prudent manner, consistent with its regulatory responsibilities and its responsibilities to its customers. The net cost of the built-out space to the ratepayers is thus significantly higher than it should be.

4.6.2 We note that there is an additional problem of the decision to use inside space for what is normally outside storage. We have had an opportunity to review the Final Argument of VECC on this point, and while we think their assessment of the value differential of about $75,000 is quite generous to the Applicant, we support the VECC conclusion. That disallowance would be in addition to the calculation below for the built-out component of the space.

4.6.3 There are, it is submitted, two possible approaches the Board can take to rectify the problem of the admin/ops space. First, it could impute rent on the excess space, but otherwise leave it in rate base. Second, it could exclude the excess building from rate base (and related operating costs) because it is not all used and useful for the ratepayers.

4.6.4 ***Imputed Rent.*** SEC proposed the use of imputed rent in EB-2012-0033, but the Board decided not to use that approach in that case. This case is different, though, so it is appropriate to include this as one possible approach.

4.6.5 It appears clear that, at the very least, 12,800 square feet of office space in the 200 Chisholm building is excess of current and reasonable future needs. The Applicant was using 12,775 square feet of office space at Lawson, and it was tight but adequate. The previously existing office space at Chisholm was 20,000 square feet, a 57% increase. This should have been more than enough for now, and for at least the next five to ten years[82]. The large spaces, and the lack of personnel in the 12,800 square feet on the second floor, is evidence this conclusion is correct.

4.6.6 It would be reasonable, therefore, for the Board to treat that 12,800 square feet as rentable. Most of it has already been built out, so those costs are included in rate base today, and any additional changes can be paid by a tenant.

4.6.7 There is a lack of evidence on what would constitute a reasonable rent. The Applicant says it should be $6.75 per square foot, plus some amount of additional rent, but that

[82] Although clearly the Applicant's management didn't think so: Tr.1:154.

does not appear to SEC to be a reasonable number. It is the rent quoted for a building that was 20,000 square feet of office, and 71,828 square feet of warehouse. The rent for an office would be significantly higher.

4.6.8 What the Board does know is that, in 2009, Milton Hydro was paying $13.00 per square foot to the Town of Milton for their office space, and $8.50 per square foot for warehouse space, which they claimed were fair market rents. The Lawson Road office space increased by 1.3% per year, and was higher in the first place. That would make a reasonable office rent in 2016 about $15.00 per square foot.

4.6.9 SEC therefore believes that, in the event that the Board determines that imputing rent is the best solution, the Board should impute other revenue of $192,000 representing 12,800 square feet at $15.00 per square foot. In addition, it should be assumed a tenant would pay an appropriate share of operating costs, in this case 14% based on the total square footage of the building[83]. With operating costs of $467,634, this would be further imputed revenues of $65,000, for a total reduction in revenue requirement of $257,000.

4.6.10 ***Disallowance of Rate Base.*** The alternative approach, which the Board took in EB-2012-0033, is to disallow a proportion of the addition to rate base as having been made imprudently. Given that the land is probably about the right size, the disallowance would be for the building costs only. That is fairly calculated as follows.

4.6.11 The building itself cost $3,390,000[84]. It has 91,800 square feet, of which at least 12,800 is excessive. That ratio is 14%, which would result in a disallowance of $475,000 of the purchase price.

4.6.12 The renovations of the 32,800 square feet of office space cost a further $5,162,200[85]. Of that, 12,800 is excessive, which is 39%. That would result in a disallowance of $2,015,000 of renovation costs.

4.6.13 The total disallowance would be $2,490,000, all of which is depreciated at a rate of 2% per year for accounting purposes. Thus, Test Year depreciation expense would be reduced by $50,000. In addition, the cost of capital including PILs on the rate base equivalent is about $165,000[86], making the total impact of the capital disallowance $215,000. That is higher than the rent because typically returns on rentals are lower than the allowed weighted average cost of capital of a utility.

4.6.14 In addition, it would be appropriate to disallow the same 14% of operating costs for

[83] Which likely understates the reasonable impact.
[84] K1.3, Slide 18.
[85] K1.3, Slide 18.
[86] $2,465,000 rate base is $1,479,000 debt at 3.85% ($56,942), $986,000 equity at 9.19% ($90,613) plus PILs including a reduction for the tax shield loss, at 17.13% ($15,522). The total cost of capital impact is therefore $163,077.

the building, $65,000, as calculated above, for a total reduction in revenue requirement of $280,000.

4.6.15 ***SEC Recommendation***. Given the Board's decision in EB-2012-0033, SEC recommends that in this case the Board disallow $2,490,000 of the building cost in rate base, and associated operating costs, and thus reduce allowed revenue requirement by $280,000. In addition, consistent with the submissions of VECC, SEC recommends that the Board reduce rate base by a further $738,480 in the Test Year with respect to the inside storage space, thus reducing allowed revenue requirement by a further $75,000.

5 OTHER MATTERS

5.1 *Costs*

5.1.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible

All of which is respectfully submitted.

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Jay Shepherd
Counsel for the School Energy Coalition