EB-2015-0089

Milton Hydro Distribution Inc.

Application for electricity distribution rates and other charges

effective May 1, 2016

FINAL SUBMISSIONS OF THE

VULNERABL ENERGY CONSUMERS COALITION

(VECC)

Michael Janigan
Counsel for VECC

April 15, 2016

Introduction

1. The applicant, Milton Hydro Distribution Inc. ("Milton", "the Company") and the intervening parties have concurred with the proposed resolution of all issues with the exception of the amount of expenses attributed for OM&A, the costs of the applicant's newly purchased building located at 200 Chisholm Drive in Milton, and the treatment of CDM savings in the LRAMVA account. The latter issue has been adjourned pending the conduct of a generic hearing to determine the regulatory treatment of the issue by the OEB.

2. VECC submits that that the level of planned expenditures for OM&A is not appropriate and is not in keeping with an amount calculated by applying appropriate benchmarks to the utility. As well, VECC submits that the new building project has not been planned and executed in a fashion that would generate the most efficient result for Milton's ratepayers, and the full cost implications of the new building should not be included in rate base and thus should not be fully reflected in revenue requirement,

3. In VECC's view, the two issues represent a similar pattern of management decision making that focuses almost exclusively on the demands of the here and now without looking at the big picture with respect to costs and effects on rates. Individual expenditure decisions may look reasonable in the context of their possible future usefulness. The problem is that these decisions taken together don't always seem to add up to an overall conclusion of prudence in utility management based on the use of relevant benchmarks and other comparisons.

4. .In coming to its submissions as to the appropriate disposition of the two remaining issues, VECC has been very much guided by the assessment of the outcomes of the decisions taken by Milton in terms of their overall effect on the reasonable expectations of customers as to rates derived from benchmarks and an objective application of recognized cost factors.

5. In VECC's view, the Milton approach to the planning and resolution of the remaining issues has been very much compartmentalized. The explanation for worsening financial performance by the utility is justified by a variety of explanations, principally the effects of "super growth" and the lumpiness of the expenditures required to meet the demands of super growth, as well as the particular characteristics of the utility's franchise area and its influence on personnel and real estate purchasing decisions.

6. In turn, what appear to be adverse results are papered over by the assertion that Milton is still a low cost utility in relation to its peers. In VECC's view, this performance does not meet the very reasonable standard of continuous improvement that is expected.

7. Because regulated utilities lack the effect of market discipline on the operations, the regulatory approach should be primarily guided by outcomes of the revenue requirement, and

whether those outcomes represent necessary maintenance of, and improvements to utility service.

Milton Utility Characteristics

7. In the examination in chief, Milton's witness Ms. Corkum lays out the premise of Milton's uniqueness that has apparently been the principal driver to understanding the utility's escalating revenue requirement (Tr. Vol.1 pp. 12-13). The principal aspects of this uniqueness includes rapid growth, a predominantly rural territory, and yet, despite the large rural service area, there is a proximity to the GTA that drives up the cost of skilled labour. An examination of some of the implications of some of the aspects of uniqueness is required.

8. Milton sets out in Exhibit K1.2, the fact that the number of its customers per square km .of its territory is 94.6 per square km, well below the average of its selected peer group of 318.3 customers per sq.km. This statistic requires some investigation, however, as it is somewhat misleading.

9. While 85% of Milton's franchise area is rural, the urban 15% contains 95% of the customers. This is also the area where the intensive customer growth is occurring increasing in numbers from 20,418 in 2006 to some 34,676 in 2016. This means that Milton's urban area of intensive growth of some 56 sq. kms has a customer density of 619 customers per square km. almost double the average of its chosen peer group in Exhibit K1.2. While the 5% of rural customers in the remaining 315 sq. km area may impose a greater cost burden per customer than their urban counterpart, the overwhelmingly percentage of customers and the growth in the urban numbers make the 619 customers per sq. km. vs. the rural 6.34 customer per sq. km the controlling statistic . (Tr. Vol 1 p. 57)

> MR. JANIGAN: Yes. Okay. But the total service area doesn't really give a true impression of your customer base, which is almost 95 percent urban. Is that correct?
>
> MR. MCKENZIE: The majority are urban; that's correct.
>
> MR. JANIGAN: And that's where the growth is occurring, correct?
>
> MR. MCKENZIE: That's where the growth is occurring, yes.

10. As well, the solid growth of employment areas shown in Exhibit K1.2 means that Milton is attracting customers who can generate higher volumes of usage per customer in the areas surrounding the urban core, further allowing Milton to generate more revenues from the larger employer customers in the General Service and Large User class. The "super growth" described by Milton may have had impacts on the size of capital and operational expenditures to service the growth, but the location of the growth and the accompanying growth of larger customer

employers should have provided opportunities for greater productivity or efficiencies that should be being realized, particularly in its O&M expenditures.

11. And while the proximity to the GTA may help set employment compensation at big city levels, Milton can draw upon a large pool of potential staff given its location offering employment much closer to reasonable residential accommodation. The prospect of security of such employment given company growth levels seems somewhat assured, a fact that must ameliorate Milton's position in the search for skilled labour at reasonable compensation levels. .

12. VECC will discuss in the next section its conclusion that, while the fast pace of growth may provide challenges, it also offers opportunities for continuous improvement that should be being realized by Milton.

OM&A

13. Milton presents a contented outlook on its proposed test year OM&A expenditures that it hopes to recover in rates largely on the basis that it has been coping with super growth and that it continues to be among the industry leaders in providing value for service. While its spending has not been profligate, there is little reason for the Company to be given a pass on an OM&A budget that does not fall in line with Board policy and customer expectation of increased productivity in performance.

14. Milton is a monopoly electricity distribution company and should enjoy the advantages of decreasing unit costs and economies of scale. This is particularly true when its customer growth is occurring in a small urban core of its franchise area.

15. As can be seen from a more rigorous study of the numbers provided by Milton, the application of this well-accepted maxim for monopoly utilities does not seem to be evident. For example in Exhibit K1.2 , Milton provides data on the OM&A per customer between 2006 and the 2016 Test Year. The slide shows an increase of 19.2% in OM&A per customer, which is 1.5% higher than inflation noted at 17.7% .

16. Milton appears to intend the slide to show minimal change in OM&A, despite the 80% customer growth that is set out therein. In fact, it shows the opposite, because the measurement is of the growth of OM&A costs per customer not the growth of OM&A.

17. What these numbers mean is that after allowing for inflation, it costs Milton slightly more for a customer added in 2016 than it did in 2006. This is despite the fact that it has almost doubled the size of its customer base. Lumpiness of expenditures required to accommodate

growth in a utility of this size cannot provide sufficient explanation for these results (see Tr. Vol 1, p.20) particularly as the growth in customers has slackened. (Exhibit K1.5 Table 4-12).

18. There appears to be no marked improvement in its reliability statistics. , Table 1.1-1 shows much variability in these statistics. In fact, the SAIDI and SAIFI indices from 2010 to 2014 show in fact a worsening performance, even when loss of supply from the ice storm is excluded. Milton promises a better result in 2015, but a causative link between greater than normal expenditures to improve customer satisfaction is a difficult stretch. (Tr. Vol.1 p.69)

> MR. JANIGAN: And you're saying at the end of the period over the next few years your OM&A per customer in relation to the rest of the utilities is likely to be reflective of what it was back in 2011?
>
> MR. LASOWSKI: That's very hard to say. The only one comment I do want to make with respect to what you've been commenting on, reliability, is our 2015 reliability numbers -- MR. JANIGAN: Yes.
>
> MR. LASOWSKI: -- are very much in line with 2010. So it's not saying that that will be continuous through, but it does say that in a year where you do not have any sort of abnormal events, our reliability actually will improve.

As the table in question already makes allowances for the effects of the ice storm, it is difficult to understand the point that Milton is making. (Tr. Vol 1 p.62)

19. In VECC's view, the appropriate approach to setting of the OM&A for the test year must involve an envelope approach to the same for the following reasons:

> (a) There is often great difficulty in separating out expenditures driven by growth and that required for the normal operation of the utility or of a one- time nature (Tr. Vol 1 pp 65,66);
>
> (b) Expenditures incurred for productivity purposes seldom reflect the savings expected to be generated going forward (Tr.Vol.1,62 dealing with additional FTEs):
>
>> MR. JANIGAN: But all those should be generating official efficiency improvements, should they not?
>>
>> MR. MCKENZIE: And they do. That's why the OM&A cost per customer remains below average for the industry.
>>
>> MR. JANIGAN: It's going up rather than going down, notwithstanding the fact that you're in super growth mode.

MR. MCKENZIE: That's correct. This is additional cost to the organization.

MR. JANIGAN: I mean what we have, let’s say two -- you're adding additional costs that are supposedly inducing efficiencies and allowing you to do more with less. And as well you're adding customers, which allows you to spread the whole network cost over a larger base of customers, and yet we're seeing fairly dramatic increases in OM&A per customer.

MR. MCKENZIE: What you're seeing with OM&A per customers in different years depends on when we hire the staff that we require.

So if we don't have any staff or any positions required in one year, but the following year we bring in two additional people, that will increase the OM&A costs per customer in the years that they're brought in. So it's a step effect of when employees get hired, for example those twelve new positions.

MR. JANIGAN: At some point in time, however, if the employees are matching the customers, you should see a leveling off of that, or at least a diminishment. It doesn't matter when you hire them. Eventually, the number associated with OM&A per customer should be going down.

MR. MCKENZIE: As a growing utility, we're not at that stage where we're into a leveling off period. So they will change.

(c) In any utility, it must be assumed that necessary expenditures are carefully planned to be incurred in a manner that is reflective of a reasonable trend and that it tries to smooth financial commitments.

(c) As noted in the final submissions of SEC herein, the building acquisition, dealt with in greater detail later in this VECC submission, has a proposed incremental revenue requirement impact of $1,054,714 representing a 6.47% increase in rates. Even if the adjustments suggested by the intervenors herein to the size of the impact of building expenses on the revenue requirement is accepted, it is certainly not the time to embark on an escalation of OM&A beyond the bounds of a reasonable envelope.

(d) A reasonable envelope described in (c) above will contain expectations based on objective costing norms and observations based on overall performance of utilities across the province. This kind of focus on outcomes rather than individual costing items has been encouraged in OEB decisions.

(e) Milton shows a worrisome trend of failing to realize economies of scale as their customer base has grown. This includes a significant lowering in its stature among other Ontario utilities with respect to OM&A per customer according to its own Exhibit (K1.2) and a retreat to 2007 levels in the measurement of FTEs per 1000 customers demonstrated in Undertaking J1.12, as well as the 25% increase in FTEs since 2011 (Tr. Vol 1 p.78) which is greater than the percentage increase in customers. Given the relative time length of these trend lines, it is difficult to believe that this will be self-correcting.

(f) The exposition of the MIFERS adjustment proposed to be made by Milton to the 2016 test year figures is difficult to accept for the purpose of making it a simple adder to the COS projections, or for the purpose of comparison to the 2011 Board allowed OM&A . This amount is a substantial addition of $1,455,845 to the increase to the OM&A in the test year. There is a problem reconciling that number with 4-Staff-50 and Undertaking J1.8, It appears that an error has been made that should reduce the required MIFERS adjustment to $823,507. This MIFERS Capitalization adjustment will be discussed further below. has been added which will be described further herein.

(g) It is preferable to allow for management itself to make the required changes to effect the needed adjustments to the utility that is determined by the application of a reasonable envelope.

20. VECC has had the benefit of reviewing the submissions of Energy Probe (EP) herein and its suggestion as to the construction of an appropriate envelope referenced above. VECC cannot improve on the appendices that EP has set out in its final submissions as possible aids to the Board in fashioning the appropriate envelope.

21. VECC arrives at that conclusion for the following reasons:

(a) EP has used growth factor that is based on multiple input years and reflects an average of the same. It provide confidence in the prediction.

(b) EP has used the inflation factors, base productivity, stretch factors based on OEB policy.

(c) EP has noted the growth factor of .44% associated with the Board-approved PEG model then applied the model's prediction of a specific Milton growth factor of .4582% for every 1% change in the number of customers.

(d) EP has made the required adjustments to the OM&A envelope both to recognize justifiable increments such as the control room services changes and adjustments to remove one-time costs of the financial system upgrade, the ice storm expenses, excessive regulatory costs, and rent and building expenses.

(e) EP's Appendices pick multiple starting points for each analysis. This avoids any possible unfairness based on a conclusion derived from one snapshot in time.

(f) EP has tried to resolve uncertainty about the required MIFERS adjustment by doing a projection in its Appendix 2 based upon only the data from 2013 onward. That calculation produces a result that suggests a reduction of close to $800,000

(g) EP provides in Appendix 3 an analysis that shows that Milton's proposed OM&A , without adjustments for productivity, stretch factor and the economies of scale represented by the PEG model growth factor still requires a reduction in OM&A of some $315,000.[1]

22 In the result, Milton's OM&A should be reduced by 800,000 to 900,000 based on the calculation of a reasonable envelope that reflects objective norms for utility operation in general and Milton in particular.

The Milton New Building at 200 Chisholm

23. VECC has had the opportunity review the final submissions of the School Energy Coalition (SEC) and concurs with its exposition, analysis and recommendations on the following points:

(a) The computation of the incremental revenue requirement associated with Milton's relocation to the Chisholm avenue building of $1,054,714;
(b) The analysis of the reasonable space requirements associated with current and future use within a reasonable time frame. This analysis shows that 12,500 square feet of office space should be or should have been available if Milton had pursued a course of action with respect of the building to provide the best value for its ratepayers.

[1] Milton seems to be of the view that its rapid growth shields it from the application of a growth factor (Tr. Vol1 p.73:

MR. MCKENZIE: I don't understand -- well, I understand the calculation. I would say Milton Hydro is not your average utility as far as the PEG report goes. We're completely different in customer growth. So I wouldn't say the .44 is even relative to Milton Hydro.

MR. JANIGAN: When you say you're completely different in customer growth, what you're saying is that the rate of growth is faster?

MR. MCKENZIE: That's correct.

(c) The exclusion of the cost of the building and renovations associated with excess office space from Milton's revenue requirement as the preferred option for arriving at a result that is fair for Milton's ratepayers.The total disallowance would be $2,490,000. VECC accepts SEC's calculation of the reduction associated with 2016 test year revenue requirement to be 280,000.

(d) VECC also accepts an alternate solution in the SEC submission of attribution of market rental revenue and operating costs for the excess space to Milton in the amount provided of $257,000

24. There are some additional observations that VECC would offer with respect to Milton's assertion of the prudence of its acquisition and renovation of the premises at 200 Chisholm Ave. The first deals with the comparisons provided by Milton in Ex K. 1.3.

25. Milton has set out the amount of additional outside storage that other utilities have obtained with their building purchase in Exhibit K3.1. For example, Waterloo North obtained 228,100 sq ft. of outside storage with its purchase.

26. However, when a comparison of costs is made in the Milton slide in exhibit K.3 "Cost to Construct", no effort is made to factor in the difference between the amount of outside storage that was obtained with the Waterloo North purchase and that obtained by Milton (29,000 sq.ft). This makes the cost per square foot comparison for the respective acquisitions somewhat less informative, since, as we have seen, inside storage space can't be valueless. Milton's own initial estimate was that 65000 square feet of the same was required.

27. VECC has not been convinced that the decision to buy and convert the indoor warehouse area to function as the equivalent of outdoor storage was a prudent one. It is likely that it was yet another casualty of hasty and ad hoc planning.

28. In VECC's view, the cost of the indoor storage should be allowed in rate base at the cost of outdoor storage which was all that was and will be needed. Undertaking J1.3 provides some computational basis to make the appropriate reduction.

29. In J1.3 (Amended) Milton calculates the cost per sq.ft. of its current outside storage to be $32.41 per sq ft.[2] Its inside storage costs are $53.34 per square foot in that

[2] This price per sq. ft. is likely overestimated since included in the land costs are site preparation costs of $625,000 that likely relate to the building as $500,000 is attributed to storage site preparation

Undertaking. There is thus an additional $20.93 per sq. ft or $753,480 that was paid for the acquisition of inside space and conversion to serve outside storage needs.

30. It is far from clear that the consolidation of storage with other utility operations on one site was a necessary requirement for a new building, only that it wasn't seriously considered.. (Tr. Vol. 2 , pp 30,31) It may have been a convenient way to find a use eventuating from a wrong-sized building acquisition, and to provide some supervisory convenience, but it is VECC's submission that the improvisation reflects poorly on the choice of building to begin with.

31. VECC submits that there should be a $753,480 disallowance depreciated at the rate of 2% per year or $15,000 and reduced to $738,480. This should be removed from the amount that Milton has requested be recognized in rate base. A resulting reduction to revenue requirement of $74,048[3] will be obtained.

32. The additional observation that VECC wishes to make is on the process of planning and execution of the move to new premises that was occasioned by the expiry of the lease.

33. In its final submissions, SEC has set out what was rather an approach to the acquisition and refit of its new building that seemed to be made up on the fly. Each choice made by management had a rationale, but the problems and financial exposure that resulted seemed out of step with reasonable expectations for a utility executing its biggest capital project to date from a financial standpoint. It is not hard to submit that a more professional and foresighted approach would likely have had a more cost-effective result.

34. The reductions to the rate base suggested by VECC are not intended to be punitive, but rather to recognize the plain facts that ratepayers are being asked to pay for too much space and for storage space that is much more costly than it should be.

35. VECC would also suggest that new approaches are possible to accommodating utility needs, and at the same time eliminating unnecessary ratepayer costs. These approaches could be embarked upon by Milton without abandoning its new site and mitigating the financially adverse effects of the disallowances.

---

[3] $443,088 debt at 3.85%, - a reduction of $17,059 and $391941 at 9.19%equitya reduction of $36,019 plus PILs including a tax shield loss at 17.13%-$6170 for a total of $59,248. The $15000 reduction in depreciation expense should be added to this figure.

Conclusions

36. Milton's customer base has undergone strong growth with the expectation of further intensification in the future. This future growth is also likely to feature increases in the number of larger customers providing employment in the area of its urban core.

37. Unfortunately, Milton's costs associated with the OM&A required to service its new customer base has exhibited an alarming tendency to outstrip the most lenient yardsticks of reasonableness. It also seems impervious to realizing economies of scale. Milton's incurious approach to applying the Board's PEG model to discipline their financial commitments is worrisome in that regard.

38. The persistence of these trends require a regulatory fix that would make an adjustment in line with not simply an optimistic wish list from intervening ratepayer groups, but with solid fact-based models of reasonable costs based on Board policy and decisions.

39. As VECC has noted, these models, after the requisite adjustments have been made, argue for a reduction of $800,000 to $900,000 to the overall OM&A amount requested.

40. VECC has also noted the problems associated with Milton's planned incorporation of its building acquisition expense into rate base. The excess of 12,800 square feet of office space and the use of 36,000 sq. ft of building space for outdoor storage do not reflect prudent planning and operation . The overall disallowance in rate base suggested herein will produce a further reduction to revenue requirement of approximately $355,000.

Costs

41. VECC would request 100% of its costs in line with its responsible participation in this proceeding that should be of assistance to the Board in determining the issues.

All of Which is Respectfully Submitted this 19th Day of April, 2016