Ontario

Ontario Energy Board
Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2015-0089

MILTON HYDRO DISTRIBUTION INC.

Application for electricity distribution rates and other charges beginning May 1, 2016

Before: **Emad Elsayed**
Presiding Member

Ken Quesnelle
Vice Chair and Member

Peter C. P. Thompson, Q.C.
Member

July 28, 2016

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1 INTRODUCTION AND SUMMARY

Milton Hydro Distribution Inc. (Milton Hydro) provides electricity distribution services to about 35,000 customers in the Town of Milton. Milton Hydro asks the Ontario Energy Board (OEB) to approve changes to its electricity distribution rates effective May 1, 2016. The OEB is asked to re-base Milton Hydro's current 2015 rates to allow the utility to recover its budgeted 2016 base revenue requirement.

Energy Probe Research Foundation (Energy Probe), School Energy Coalition (SEC), and the Vulnerable Energy Consumers Coalition (VECC) sought and were granted intervenor status in this proceeding. At a settlement conference held following Milton Hydro's responses to many interrogatories, these parties resolved most of the issues that the OEB had listed for determination.

The terms of this settlement are contained in a settlement proposal dated February 9, 2016 and an addendum thereto dated April 7, 2016. Collectively, these agreements are referred to as the Partial Settlement. OEB staff supports the Partial Settlement.

The OEB finds that the Partial Settlement produces outcomes that benefit ratepayers and approves its terms for use in determining Milton Hydro's 2016 rates.

The remaining disputed issues addressed in this Decision and Order are:

(i) Whether Milton Hydro's budgeted 2016 Operation, Maintenance and Administration (OM&A) expenses are appropriate (OM&A Expenses Issue); and
(ii) Whether recovery in rates of all of the 2016 revenue requirement related to the land and building at 200 Chisholm Drive is appropriate (200 Chisholm Drive Issue).

In deciding these disputed issues, the OEB describes and applies the principles embedded in its performance-based outcomes approach to rate regulation.

Following an analysis of the facts related to the OM&A Expenses Issue, the OEB finds that the total amount requested of $10,122,448 is too high by $550,000. About $50,000 of the excess is for OM&A expenses attributable to portions of the 200 Chisholm Drive property that the OEB finds to be of no value to Milton Hydro's customers. The remaining $500,000 is primarily attributable to the incompatibility of Milton Hydro's recent performance metrics with the continuous improvement and other objectives of the OEB's performance-based approach to rate regulation.

Its analysis of the facts related to Milton Hydro's acquisition and renovation of the 200 Chisholm Drive property leads the OEB to find that the building has been configured to provide 6,800 square feet of excess office space and 36,000 square feet of inside storage for use as a substitute for, but at a "premium" cost that materially exceeds the cost of outside storage. The OEB finds these outcomes to be of no value to Milton Hydro's customers.

After adjusting for Milton Hydro's inappropriately low sale value for the property rendered redundant by the purchase of 200 Chisholm Drive and the inappropriate regulatory treatment of the capital gain realized on that sale, the OEB reduces the value of rate base to be used in determining 2016 rates by about $1.935 million and eliminates Milton Hydro's proposed base revenue offset of $87,975 derived from a portion of the capital gain on the sale of the redundant property.

The 2016 rates that the OEB approves in this Decision and Order are based on the OEB's determination of the level of revenue required by Milton Hydro to cover reasonably incurred costs of operating and maintaining the distribution system at a service level that meets the needs of its customers.

The overall effect of the OEB's findings is a 2016 gross revenue requirement reduction, in addition to that specified in the Partial Settlement, of about $619,000[1]. Because ratepayers cannot benefit from accumulated depreciation related to rate base disallowances, the accumulated depreciation related to the $1,405,426 of depreciable assets in disallowed rate base will be eliminated for rate making purposes. The accumulated depreciation related to the $1,405,426 of depreciable assets being disallowed will also be eliminated for rate making purposes. The OEB estimates that about $33,000 of accumulated depreciation will be eliminated from 2016 opening rate base. The OEB estimates that the result of this decision will be a reduction in the gross revenue deficiency to be recovered in 2016 rates of about $634,000.[2]

As a result of the Partial Settlement and the adjustments made by the OEB in this Decision and Order, the impact on Milton Hydro's existing distribution rates and the total electricity bill is expected to be relatively minor. The exact amount will be confirmed in the next step of this proceeding through the rate order process.

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[1] The $619,000 estimate is derived from applying the approach used by Milton Hydro in its spreadsheet that accompanied its response to Undertaking J2.2 to the rate base amounts for un-renovated office space, renovated office space, the storage space premium, and the capital gain on the sale of the Fifth Line and Main Street property.

[2] The $634,000 estimate is derived from adjusting the Revenue Requirement Work Form (RRWF) attached to the Partial Settlement for the findings made in this Decision and Order including the reversal of an accumulated depreciation amount of about $33,000.

2 THE PROCESS

Milton Hydro filed a cost of service rates application (the Application) with the OEB on August 28, 2015 under section 78 of the *Ontario Energy Board Act, 1998*, seeking approval for changes to the rates that Milton Hydro charges for electricity distribution, to be effective May 1, 2016.

The OEB published a notice to customers of Milton Hydro on September 24, 2015 in the Milton *Canadian Champion* newspaper. Energy Probe, SEC and VECC were approved as intervenors in the proceeding.

On November 2, 2015, the OEB hosted a community meeting in Milton to provide an opportunity for individual ratepayers to ask OEB staff and representatives from Milton Hydro about the Application. On November 17, 2015 Milton Hydro presented a summary of its Application to the OEB, OEB staff and intervenors at the OEB offices.

The Issues List for this case was approved by the OEB on January 20, 2016. After an interrogatory process, a settlement conference was held on January 25 and 26, 2016. Milton Hydro filed a settlement proposal on February 9, 2016 reflecting a partial settlement among all parties on the majority of issues. Three issues were not settled:

1. The OM&A Expenses Issue;
2. The 200 Chisholm Drive Issue; and
3. The recovery of the 2011-2014 Lost Revenue Adjustment Mechanism Variance Account (LRAMVA).

The OEB determined that it would not deal with the LRAMVA issue in the present proceeding as the issue was to be addressed on a generic basis in another proceeding.

In the Settlement Proposal, the parties agreed that the effective date of the rates arising out of the proposal, and out of the OEB's decision on the outstanding matters, should be May 1, 2016. In the event that it were not possible for the OEB to issue its Rate Order in time for May 1, 2016 implementation, the parties agreed to a rate rider to refund/recover to or from ratepayers the difference in revenue collected from the effective date of May 1, 2016 through to the actual implementation date as determined by the OEB.

On April 7, 2016, Milton Hydro filed an addendum to the Settlement Proposal. This further agreement between Milton Hydro, Energy Probe, SEC, and VECC addresses an

OEB staff submission regarding the bill impact for the Sentinel Light class. OEB staff supports the addendum.

The OEB held an oral hearing on April 4 and 5, 2016 to hear testimony from Milton Hydro's witnesses on the OM&A Expenses and 200 Chisholm Drive Issues. Milton Hydro presented an oral Argument-in-Chief on April 5, 2016. OEB staff and intervenors filed their written submissions on April 19, 2016 and Milton Hydro filed its written reply submission on April 26, 2016.

The OEB issued an interim rate order on April 29, 2016, declaring Milton Hydro's current rates interim as of May 1, 2016 pending the OEB's final rate order.

3 STRUCTURE OF THE DECISION

In its October 18, 2012 report entitled *Renewed Regulatory Framework for Electricity Distributors: A Performance Based Approach* (RRFE), the OEB adopted an outcomes based approach to rate regulation. This approach is applied in this case to determine the questions requiring resolution, namely;

(i) Whether the terms of the Partial Settlement produce outcomes that are compatible with the RRFE;

(ii) Whether Milton Hydro's budgeted 2016 OM&A Expenses are appropriate; and

(iii) Whether recovery of the entire 2016 requested revenue requirement related to the building and property at 200 Chisholm Drive is appropriate.

Matters relevant to each of these questions are described in the chapters that follow.

Chapter 4, entitled "Guiding Principles", summarizes the outcomes approach to regulation established by the RRFE.

Chapter 5, entitled "Settled Issues", contains a short narrative about the parties to the Partial Settlement and briefly explains why the terms of the Partial Settlement among those parties produce outcomes that are compatible with the RRFE and in the interests of all Milton Hydro's ratepayers.

Chapter 6, entitled "Disputed Issues", describes facts relevant to each of the contested OM&A Expenses and 200 Chisholm Drive Issues. The OEB applies the outcomes approach to these facts in making its findings on each of these disputed issues.

Chapter 7, entitled "Lost Revenue Recovery Rate Rider" stems from Milton Hydro's request for an effective date of May 1, 2016 for its 2016 rates and the OEB's April 29, 2016 Order declaring current rates interim as of May 1, 2016 pending the OEB's final rate order.

The OEB's instructions regarding the filing of a draft rate order, along with matters related to its implementation, are presented in Chapter 8, entitled "Implementation and Order".

4 GUIDING PRINCIPLES

In the 2012 RRFE report, the OEB adopted an outcomes approach to rate regulation and promoted the achievement of four performance outcomes to the benefit of existing and future electricity customers and the public interest.

The RRFE describes the public interest outcomes that customers value as follows:

(i) Customer Focus: services are provided in a manner that responds to customer preferences;

(ii) Operational Effectiveness: continuous improvements in productivity and cost performance are achieved, and utilities deliver on system reliability and quality objectives;

(iii) Public Policy Responsiveness: utilities deliver on obligations mandated by government (e.g. in legislation and in regulatory requirements imposed further to Ministerial directives to the OEB); and

(iv) Financial Performance: financial viability is maintained, and savings from operational effectiveness are sustainable.

Accordingly, the RRFE policy confirms a performance-based outcomes approach to rate regulation that supports cost effective planning along with the efficient operation of a distribution network. As stated in the OEB's 2015 Hydro One decision, "The OEB intends that the policy provide an appropriate alignment between a sustainable, financially viable electricity sector and the expectations of customers for reliable service at a reasonable price".[3]

Under this approach, the OEB determines just and reasonable rates having regard to its assessment of the facts related to each of the four categories of utility performance described in the preceding paragraph. Continuous improvements in all of the categories of performance are expected.

As the OEB indicated in its RRFE Scorecard Report:

> For distributors, a focus on delivering value will put a greater emphasis on understanding customer satisfaction and the cost/value trade-offs that customers are willing to make. This will help them to better plan their investments to focus on improvements valued by their customers. Distributors

[3] EB-2013-0416/EB-2014-0247 Decision, March 12, 2015, p. 8.

> are expected to achieve continuous improvements that reduce costs and deliver service levels that their customers value. For customers, the Board's performance-based approach aims to encourage distributors to operate effectively, continually seek ways in which to improve their productivity and performance and, importantly, better engage with their customers to better understand and respond to their needs, and demonstrate the value that they deliver.
>
> The Board remains committed to continuous improvement within the electricity sector. Individual distributors achieve continuous improvement through their ongoing efforts to improve services and/or processes that are valued by their customers. Over time and collectively, distributors will advance continuous improvement in the sector through achievement of benchmark performance on valued services and/or processes.[4]

Cost of service rate setting under this approach has transitioned to an output and program focused review with an emphasis on value for customers.

The OEB expects distributors to set their performance targets having regard to the continuous improvement objectives of the RRFE, their own historic year-over-year achievements, and the cost trends and other outcomes that their exemplary peers are achieving.

Utility performance in both planning for and achieving public interest outcomes that customers value will influence the assessment of the reasonableness of revenue requirements that the OEB is asked to approve. Generally speaking, utilities that objectively demonstrate measureable and sustainable continuous improvements in each of the performance categories can reasonably expect to have their test period revenue requirement requests approved without material disallowances.

Under the outcomes approach, recovery from ratepayers is limited to the OEB's determination of amounts that satisfy the operational effectiveness and other performance objectives of the RRFE. The fact that a utility either spends or plans to spend money does not, in and of itself, lead to a finding that the amount is recoverable from ratepayers. The Supreme Court of Canada has recently held that utility spending does not, in and of itself, give rise to a presumption of prudence.[5] Rather, the onus is on the utility to demonstrate to the satisfaction of the regulator that the money was spent wisely to achieve outcomes that customers value.

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[4] EB-2010-0379, Report of the Board: Performance Measurement for Electricity Distributors: A Scorecard Approach, March 5, 2014, p. i.
[5] *Ontario (Energy Board) v. Ontario Power Generation Inc.*, 2015 SCC 44, paras. 102 to 105.

The foregoing principles guide the OEB's assessment of the Partial Settlement and its findings for both of the disputed issues in this case.

Moreover, in assessing recoverable costs related to a major utility project for which no prior OEB approval was required, such as the 200 Chisholm Drive project, the OEB considers many of the same criteria that are taken into account in a major project case for which prior OEB approval is required. These include need; alternatives considered; design; rate impacts; and any other matter relevant to the public interest. These factors are considered in the context of the principle that ratepayers should only be expected to pay for things that are of demonstrable value to them.

In the chapters that follow, these guiding principles are applied to determine just and reasonable 2016 test year rates for Milton Hydro.

5 SETTLED ISSUES

5.1 Facts

Energy Probe, SEC and VECC (Intervenors) are the parties to the Partial Settlement with Milton Hydro. These Intervenors have many years of experience with OEB rate-making. OEB staff supported the Partial Settlement. The Partial Settlement resolves all issues except the OM&A Expenses and 200 Chisholm Drive Issues.

The OEB notes that the parties to the Partial Settlement expressly recognize that the determination of the OM&A and 200 Chisholm Drive Issues is expected to have other impacts on other components of revenue requirement.[6]

The OEB has determined that within the ambit of the unresolved 200 Chisholm Drive Issue are the questions of the appropriateness of the regulatory treatment that Milton Hydro proposes for the capital gain realized on the sale of the property that became redundant with its purchase of 200 Chisholm Drive, and the value of the redundant property at the time it was sold.

The outcomes of the Partial Settlement include:

(i) A reduction in the applied for base revenue requirement of $76,851, from $16,998,621 to $16,921,770; and in the grossed up revenue deficiency of $99,292, from $721,186 to $ 621,894, a reduction of about 13.8%.

(ii) Acknowledgements from the participating parties that;
  (a) customer feedback and preferences were taken into account;
  (b) Milton Hydro’s capital expenditure plans are appropriate and include sufficient rationale for the planning and pacing of capital investment projects; and
  (c) all elements of the base revenue requirement, except for the OM&A and 200 Chisholm Drive components, have been correctly determined in accordance with OEB policy;

(iii) Milton Hydro’s express recognition of the importance of improving reliability, service quality, bill impacts, and compatibility with historic expenditure levels;

(iv) The acceptance of Milton Hydro’s customer forecast, loss factors, and Conservation and Demand Management (CDM) adjustments and that the resulting billing determinants are appropriate and an accurate reflection of the energy and demand requirements of its customers;

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[6] Settlement Proposal, February 9, 2016, p. 9.

(v) An agreement that the accounting procedures used by Milton Hydro, including changes in accounting standards, policies, and adjustments, have been properly identified and recorded and that the rate-making treatment of each of these impacts is appropriate;

(vi) Acceptance of Milton Hydro’s cost allocation and rate design proposals which will be used to determine final rates once the disputed issues are adjudicated; and

(vii) A consensus that the balances and disposition of deferral accounts proposed by Milton Hydro are appropriate (except for the LRAMVA which the OEB removed from the ambit of this proceeding as this will be addressed on a generic basis in another proceeding).

These outcomes benefit all of Milton Hydro’s customers. Rates will be lower than those requested in the Application. Costs associated with a prolonged rate hearing will be avoided.

5.2 Findings

Recognizing that the scope of the 200 Chisholm Drive Issue is as previously described and that all matters in the Partial Settlement linked to the disputed issues will be updated as a result of the OEB’s determination of those issues, the OEB finds that the terms of the Partial Settlement produce outcomes that are compatible with the operational effectiveness and other applicable performance objectives of the RRFE. The OEB approves the terms of the Partial Settlement for use in the determination of Milton Hydro’s 2016 rates.

6 DISPUTED ISSUES

6.1 Introduction

(a) Factual Context for Outcomes based Rate Regulation

Under the OEB's performance-based outcomes approach to rate regulation, the focus is on facts related to a utility's historic and prospective performance in relation to outcomes that customers value. There are four categories of facts to be considered. They are facts related to customer focus, operational effectiveness, financial performance and public policy responsiveness, if applicable in the particular case under consideration.

In this case, on the OM&A Expenses Issue, the parties, including Milton Hydro, devoted most of their examination time to facts related to historic and prospective operational effectiveness. Such facts included comparisons of the historic and prospective trends in Milton Hydro's year over year OM&A costs per customer and historic year over year comparisons to the OM&A costs per customer of its peers. Facts related to Milton Hydro's rapid growth, its urban and rural service territory, and other metrics were examined in detail.

These facts are of significance in the OEB's assessment of whether Milton Hydro's current and prospective performance satisfies the continuous improvement goal of the RRFE's performance objectives.

(b) Historic and 2016 Base Revenue Requirement Context

After adjusting for the benefits of the Partial Settlement, Milton Hydro seeks to re-base its current 2015 rates to recover a budgeted base revenue requirement for 2016 of $16,921,770. Milton Hydro's current rates stem from the OEB's application of its Incentive Price Cap Rate Methodology to Milton Hydro's OEB approved 2011 cost of service rates. The approved base revenue requirement for 2011 was $13,005,179,[7] an amount of about $427 per customer for the 30,461 OEB approved customer numbers for 2011. Since only 29,814 customers were actually served in 2011, the actual 2011 revenue was about $12,730,578.

[7] Exhibit 1, p. 33, Table 1-8.

Revenue being recovered under the 2015 current rates is $16,299,876.[8] Under the Incentive Price Cap methodology, and having regard to its rapid growth, Milton Hydro is recovering $3,569,298 or about $3.570 million of revenue incremental to its 2011 actual base revenue. This incremental revenue included an estimated amount of about $1,529,398 of OM&A costs incremental to the OM&A costs embedded in the 2011 base rates at an OM&A cost per customer of about $215.[9] The derivation of this $1,529,398 estimate is described below.

Under the auspices of the Price Cap plan, Milton Hydro's 2011 rates escalated between 2011 and 2015 by about 4.21%.[10] Applying this total escalator of 4.21% to the OM&A cost per customer embedded in 2011 rates of about $215 produces an estimated value of the OM&A cost per customer embedded in current 2015 rates of about $223. With the addition of 6,858 customers between 2011 and 2016, from a 2011 level of 29,814 customers to the estimated 2016 level of 36,672 customers,[11] the OM&A costs embedded in the incremental revenues of about $3.570 million attributable to customer additions and escalation of the 2011 rates is estimated at $1,529,334 (6,858 times $223). Milton Hydro's incremental revenues related to customer growth are discussed in further detail in Section 6.2 subsection I.

(c) Accounting Policy Adjustment

The OM&A expenses budget included in the requested 2016 base revenue requirement is $10,122,448. This amount is materially more than the $6,300,000 OM&A expense budget that the OEB approved for 2011. However, the two amounts are not comparable because, for Milton Hydro, the Canadian Generally Accepted Accounting Principles (CGAAP) accounting policy that prevailed in 2011 was replaced by the Modified International Financial Reporting Standards (MIFRS) methodology as of 2013. The 2016 budgeted amount must be adjusted to reflect this change in accounting policy in order to derive a 2016 budgeted amount comparable to the 2011 approved amount of $6,300,000.

Relying on the opinion of its auditors with respect to its 2015 results, and its own incremental MIFRS adjustment of $234,375 for 2016, Milton Hydro calculates the cumulative MIFRS adjustment for 2016 to be $1,455,845.[12]

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[8] See Revenue Requirement Work Form attached to the Partial Settlement, Revenue Deficiency/Sufficiency form at line 2.
[9] For 2011 OM&A cost per customer of $214.56 see Table J1.12 (2) for years 2006-2016.
[10] The escalation factors determined by the OEB were 0.88%, 0.48%, 1.40% and 1.45% for the years 2012, 2013, 2014 and 2015 respectively for a total escalator over the period of 4.21%.
[11] For customer numbers, 2011 to 2016, see table cited in footnote 7.
[12] Milton Hydro response to Undertaking J1.8, April 12, 2016.

SEC argues that this adjustment amount of $1,455,845 should be lower but does not quantify what it regards as the appropriate or reliable adjustment amount.[13] VECC argues that the adjustment amount should be $823,507[14] rather than $1,455,845.[15] Energy Probe and OEB staff appear to accept Milton Hydro's calculation.

In the Partial Settlement, all of the parties agreed that Milton Hydro's evidence properly identified and recorded the impacts of changes in accounting standards and policies.[16]

The OEB accepts Milton Hydro's calculation of the MIFRS adjustment of $1,455,845 and finds that the amount of the 2016 OM&A Expenses budget that is comparable to the $6,300,000 OEB approved amount for 2011 is $8,666,602. This amount is $2,366,602 or about 37.6% more than the 2011 approved amount of $6,300,000. Table 1 below shows Total OM&A for the years 2011 to 2016 inclusive adjusted for CGAAP.

Table 1
OM&A Adjusted to CGAAP
2011 to 2016

	OEB Approved 2011	Actual 2011	Actual 2012	Actual 2013	Actual 2014	Unaudited 2015	Forecast 2016
	CGAAP	CGAAP	CGAAP	MIFRS	MIFRS	MIFRS	MIFRS
OM&A	$ 6,300,000	$ 6,396,763	$ 6,761,992	$ 8,435,973	$ 8,543,897	$ 9,898,207	$ 10,122,448
MIFRS Adjustment				-$ 1,273,132	-$ 1,261,505	-$ 1,315,032	-$ 1,455,845
OM&A Adjusted to CGAAP	$ 6,300,000	$ 6,396,763	$ 6,761,992	$ 7,162,841	$ 7,282,392	$ 8,583,175	$ 8,666,603
			5.7%	5.9%	1.7%	17.9%	1.0%
Source: Undertaking J1.12							

(d) OM&A Expenses Issue

Intervenors and OEB staff contend that the total OM&A budgeted amount of $10,122,448 is incompatible with the performance objectives of the RRFE and should be reduced by as much as $970,000. The OM&A Expenses Issue is addressed in the next section of this Decision and Order.

(e) 200 Chisholm Drive Issue

The other disputed matter relates to Milton Hydro's purchase and renovation of the land and building at 200 Chisholm Drive. Milton Hydro purchased this property and

13 SEC Argument, April 19, 2016, pp. 13-15.
14 This is a number that appears in SEC's submission at p. 14 in para. 3.3.8 which SEC does not urge the OEB to adopt as a reliable amount – see p. 15, para. 3.3.16.
15 VECC Argument, April 15, 2016, p. 7.
16 Settlement Proposal, February 9, 2016, p. 27.

renovated the building to satisfy its need for land and building space to house the administration, operations and outside storage requirements of its electricity distribution business. The 200 Chisholm Drive location replaced the leased premises that Milton Hydro occupied at 8069 Lawson Road until December 31, 2015, when the lease expired.

The property at 200 Chisholm Drive also replaced and rendered redundant the land located at the intersection of Fifth Line and Main Street. Milton Hydro purchased this land in 2009 for the purpose of using it as the location for its new office and service centre.

The portion of the $16,921,770 base revenue requirement attributable to 200 Chisholm Drive is calculated by SEC to be almost $1,700,000.[17] Intervenors and OEB staff contend that a materially lower revenue requirement amount should be used in the OEB's determination of Milton Hydro's 2016 rates.

(f) Overlap between the OM&A Expenses and 200 Chisholm Drive Issues

Included in the disputed $10,122,448 OM&A expenses amount for 2016 are land and building operating costs related to 200 Chisholm Drive of about $467,000. The question of whether all of these land and building OM&A costs are recoverable from ratepayers depends upon a determination of matters related to the 200 Chisholm Drive Issue. Accordingly, this component of the OM&A Expenses Issue will be addressed in the section of this Decision and Order that deals with the 200 Chisholm Drive Issue.

(g) Structure of the Decision on Disputed Issues

As a result of the foregoing analysis, the order of topics addressed in the sections that follow will be:

(i) The OM&A Expenses Issue; and

(ii) The 200 Chisholm Drive Issue, including its 2016 rate base, revenue requirement and OM&A Expenses implications.

[17] SEC Argument, April 19, 2016 at p. 26 where the total revenue requirement related to the land and building is estimated at $1,688,707. Milton Hydro did not challenge this calculation in its Reply Argument. The OEB accepts the calculation as a reasonable estimate.

6.2 OM&A Expenses

A. OM&A 2016 EXPENSES BUDGET

1. Amount Requested

Milton Hydro seeks approval for a 2016 OM&A Expenses budget of $10,122,448.[18] This amount is a $3,822,448 increase over the $6,300,000 amount that the OEB approved for Milton Hydro's 2011 test year, the year when Milton Hydro's rates were last set by the OEB on a cost of service basis.

The $3,822,448 requested increase includes the MFIRS accounting policy change that Milton Hydro adopted in 2013. The MFIRS accounting policy adds $1,455,845 of OM&A expenses in 2016 compared to the CGAAP accounting policy that prevailed in 2011. Intervenors and OEB staff acknowledge that $1,455,845 of the requested increase, being the amount attributable to the accounting policy change to MIFRS, is recoverable from ratepayers.

2. 2016 Increase Over 2011 OEB Approved OM&A Expenses Excluding the MIFRS Amount

As shown in Table 1 above, after adjusting the 2016 expense budget to eliminate the increase attributable to MIFRS, the 2016 OM&A amount of $8,666,603 is an increase of $2,366,603 over OEB 2011 approved expenses of $6,300,000. In percentage terms, this is an increase of about 37% or, on average about 7.5% per year.

3. 2016 Increase Over 2013 OM&A Expenses Excluding the MIFRS Amounts

The information presented in Table 1 shows that, from 2013 to 2016, total expenses (excluding the MIFRS policy amounts) increased by $1,503,762 from $7,162,841 to $8,666,603. This is an increase of about 21% or, on average, about 7.0% per year.

4. 2016 Increase over 2013 OM&A Expenses Including the MIFRS Amounts

In 2013, when the MIFRS accounting policy was first adopted, Milton Hydro's total OM&A expenses were $8,435,973. This amount included a MIFRS related increase of

[18] In Exhibit J1.3, Milton Hydro reduced a budget amount of $200,000 for electricity, water/sewer and gas request by $33,000. In its Reply Argument, Milton Hydro made some further changes including a reduction of $72,460 for preparing the Application. Offsetting this reduction was an increase of $61,400 mentioned for the first time in Milton Hydro's Reply Argument related to the 2016 OEB cost assessment that exceeded the budgeted amount. The net reduction of these items is an amount of about $44,060. The OEB assesses the appropriateness of Milton Hydro's $10,122,448 request without specifically bringing this net reduction $44,060 into account.

$1,273,000.[19] The total 2016 OM&A Expenses budget of $10,122,448 that includes a MIFRS amount of $1,455,845 is $1,686,475 or about 20% higher than the 2013 amount. This equates to an average yearly increase of about 6.7%.

5. Summary

The foregoing five and three year analyses indicate that, regardless of whether the MIFRS amounts are included or excluded, the OEB is being asked to approve a very significant percentage and dollar amount increase in the level of Milton Hydro's OM&A expenses for recovery from ratepayers. An increase of this magnitude requires careful scrutiny.

B. THE ISSUE

The elements that the OEB considers when assessing whether the Milton Hydro's 2016 OM&A expenses are compatible with performance based outcomes of value to customers are described under the OM&A Expenses Issue that the OEB framed at the outset of this proceeding. The OM&A Expenses Issue is as follows:

> Is the level of planned OM&A expenditures appropriate and is the rationale for planning and pacing choices appropriate and adequately explained, giving due consideration to:
>
> - customer feedback and preferences;
> - productivity;
> - compatibility with historical expenditures;
> - compatibility with applicable benchmarks;
> - reliability and service quality;
> - impact on distribution rates;
> - trade-offs with capital expenditures;
> - government mandated obligations; and
> - the objectives of the applicant and its customers.

Facts falling within the ambit of these matters are addressed in the sections that follow.

[19] Milton Hydro Reply Argument, April 28, 2016, p. 5.

C. INFORMATION TO ASSIST OEB RATEMAKING

Over the years, the OEB has allocated significant resources to have independent consultants and its own staff compile statistical and other information for consideration in the determination of just and reasonable rates that produce outcomes of value to customers. Such materials include:

(a) A method for prospectively estimating, in each year, the annual rate of inflation;

(b) Productivity allowances as an offset to inflation, currently ranging between zero (0)% for the most efficient to 0.6% for the least efficient utilities; and

(c) Specified measures for presenting annual information for each electricity distributor, in a scorecard format so that the information can be used to monitor and assess the year-over-year performance of a particular utility in relation to its own past performance and the performance of other reasonably comparable electricity distributors.

In addition to inflation and productivity, the utility-specific metrics that this material enables the OEB to consider include: OM&A cost per customer; number of customers per full time equivalent utility staff (FTE); OM&A cost per kilometer of line; and overall efficiency. This material allows utilities to be grouped in cohorts according to their size and other characteristics and ranked from the least to the most costly and from the most to the least efficient.

The material that the OEB's consultants and staff compile and regularly update also includes estimates of the extent to which OM&A costs are likely to increase as new customers are added to the network. The most recent material indicates that, for the average distributor, total OM&A costs increase by about 0.44% for every 1% increase in the customer base[20]. This material states that it can be used to make a prediction of this factor for a particular utility. In its argument, Energy Probe applies this criterion to submit that the utility-specific factor for Milton Hydro is 0.4582.[21]

The purpose of the information compiled by the OEB's consultants and staff is to inform rate setting. Distributors are expected to give due consideration to all of this information when formulating the level of year-over-year increases in planned spending that they ask the OEB to approve for recovery in rates.

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[20] Exhibit K1.6, VECC Compendium, p. 5, excerpt from report "Empirical Research in Support of Incentive Rate Setting: 2013 Benchmark Update." Pacific Economics Group, July 2014.
[21] Energy Probe Argument, April 19, 2016, pp. 8-10.

D. MILTON HYDRO 2011-2020

At the hearing and in argument, Milton Hydro, Intervenors and OEB staff referred to facts related to the 2011 to 2016 year-over-year changes in Milton Hydro's total OM&A expenses as well as year-over-year changes in the utility's OM&A expense-related metrics to support their divergent positions on the OM&A Expenses Issue. These metrics include total OM&A cost per customer, customers per FTE and OM&A cost per FTE. Reference was also made to the metrics that stem from Milton Hydro's forecasts of OM&A expenses, total customers and total FTEs for 2017 to 2020.

Tables 2 and 3 below present Milton Hydro's total OM&A Expenses and other metrics that were examined during the course of this proceeding. Table 2 covers the period 2011-2016. Table 3 provides similar information covering the period 2014 to 2020.

Table 2
Operations, Maintenance & Administration Expenses
Customer Numbers & FTEs
2011 Approved/Actual to 2016 Test Year

	OEB Approved 2011	Actual 2011	Actual 2012	Actual 2013	Actual 2014	Unaudited 2015	Forecast 2016
	CGAAP	CGAAP	CGAAP	MIFRS	MIFRS	MIFRS	MIFRS
Total OM&A	$ 6,300,000	$ 6,396,763	$ 6,761,992	$ 8,435,973	$ 8,543,898	$ 9,898,208	$ 10,122,448
year to year percentage change	-		7.3%	24.8%	1.3%	15.9%	2.3%
3 years from 2013 to 2016							*20.0%*
Customer Numbers (ave. annual)	30,461	29,814	31,405	33,199	34,592	35,498	36,672
year to year percentage change	-		3.1%	5.7%	4.2%	2.6%	3.3%
3 years from 2013 to 2016							*10.5%*
FTEs (year end)	49	46	48	52	52	55	62
year to year percentage change	-		-2.0%	8.3%	0.0%	5.8%	11.8%
3 years from 2013 to 2016							*18.3%*
OM&A per Customer	$ 207	$ 215	$ 215	$ 254	$ 247	$ 279	$ 276
year to year percentage change	-		4.1%	18.0%	-2.8%	12.9%	-1.0%
3 years from 2013 to 2016							*8.6%*
Customers per FTE	622	648	654	638	665	645	596
year to year percentage change	-		5.2%	-2.4%	4.2%	-3.0%	-7.6%
3 years from 2013 to 2016							*-6.6%*
Ontario Inflation per OEB (%)	n/a	1.3	2.0	1.6	1.7	1.6	2.1
average of 5 years							*1.80*

Sources: March 24, 2016 Update, Table 4-13 (Appendix 2-JC), Table 4-12 (Appendix 2-L) and Undertaking J1.12(2).

Table 3
Operations, Maintenance & Administration Expenses
Customer Numbers & FTEs
Actuals and Forecast: 2014 to 2020

	Actual 2014	Unaudited Actual 2015	Test Year 2016	Forecast 2017	Forecast 2018	Forecast 2019	Forecast 2020
	MIFRS	MIFRS	MIFRS	MIFRS	MIFRS	MIFRS	MIFRS
Average Number of Customers	34,592	35,498	36,672	38,172	39,672	41,172	42,672
OM&A (per OEB Yearbook)	$ 8,543,897	$ 9,898,207	$10,122,448	$ 10,426,121	$ 10,738,905	$ 11,017,363	$ 11,347,884
OM&A Cost per Customer	$ 246.99	$ 278.84	$ 276.03	$ 273.14	$ 270.69	$ 267.59	$ 265.93
Number of FTEs (year end)	52	55	61.5	63.5	65.5	67.5	69.5
Customers per FTE	665	645	596	601	606	610	614
OM&A Cost per FTE	$ 164,306	$ 179,967	$ 164,593	$ 164,191	$ 163,953	$ 163,220	$ 163,279
Source: Undertaking J.1.12 (2)							

E. CUSTOMER BASE AND SERVICE TERRITORY

In 2011, when the OEB last determined a cost-of-service revenue requirement for Milton Hydro, the OEB approved customer base consisted of 30,461 customers. In that year, Milton Hydro actually served 29,814 customers located in its service territory. The service territory has an area of about 371 square km. While 315 square km or 85% of the service territory is rural, most of these customers are located within the densely populated 56 square km of urban space within the service territory.[22]

For 2016, it is estimated that the utility will serve 36,672 customers. This constitutes an increase of about 6,858 customers over the actual 2011 customer base of 29,814 customers. This constitutes about a 23% increase in the customer base over five years. The increase in total OM&A expenses over these five years of 37%, excluding the MIFRS amounts, is about 1.6 times the 23% increase in the customer base.

From 2013 to 2016, a total of 3,473 customers were added to the customer base. This is about a 10.5% increase in the 2013 customer base of 33,199. The increase in total OM&A expenses from 2013 to 2016 of about 20% is almost double the 10.5% increase in the customer base over those years.

[22] Exhibit K1.2, pp. 3 and 6.

The percentage increases in Milton Hydro's total OM&A expenses (other than those related to the adoption of the MIFRS accounting policy) are significantly outpacing the percentage increases in the customer base.

Looking ahead, Milton Hydro expects to add about 1,500 customers per year over the period 2017 to 2020. By 2020, the total customer count is forecast at 42,672. By 2026, the utility expects to be serving about 65,000 customers. By 2031, the customer base is expected to be about 76,000.[23]

Most of the customers that have been added over the past five years are located in the urban area.[24] While the costs of providing service to rural customers are higher than the cost of serving urban customers, this fact does not justify the very substantial increase in OM&A expenses that the OEB is being asked to approve.

F. MAGNITUDE OF THE REQUESTED INCREASE COMPARED TO INFLATION

The inflation statistics shown in Table 2 above indicate that the cumulative increase in inflation over the five years, 2012 to 2016 inclusive, is about 9%. Over that same timeframe Milton Hydro's total OM&A expenses (excluding increases related to the MIFRS accounting change) increased by about 37%, more than four times the cumulative increase in inflation.

For the three-year period beyond 2013, the cumulative increase in inflation derived from these statistics is 5.4%. The increase in total OM&A expenses in that period of about 20% is a multiple of about 3.7 times the increase in the rate of inflation.

Increases in Milton Hydro's total OM&A expenses (other than those related to the adoption of the MIFRS accounting policy) are materially outpacing increases in the rate of inflation.

G. TIMING AND CAUSES OF THE SIGNIFICANT EXPENSE INCREASES

Significant OM&A expense increases occurred in 2015 being the last year of the current Price Cap Incentive Regulation Mechanism (IRM) period. Excluding MIFRS amounts,

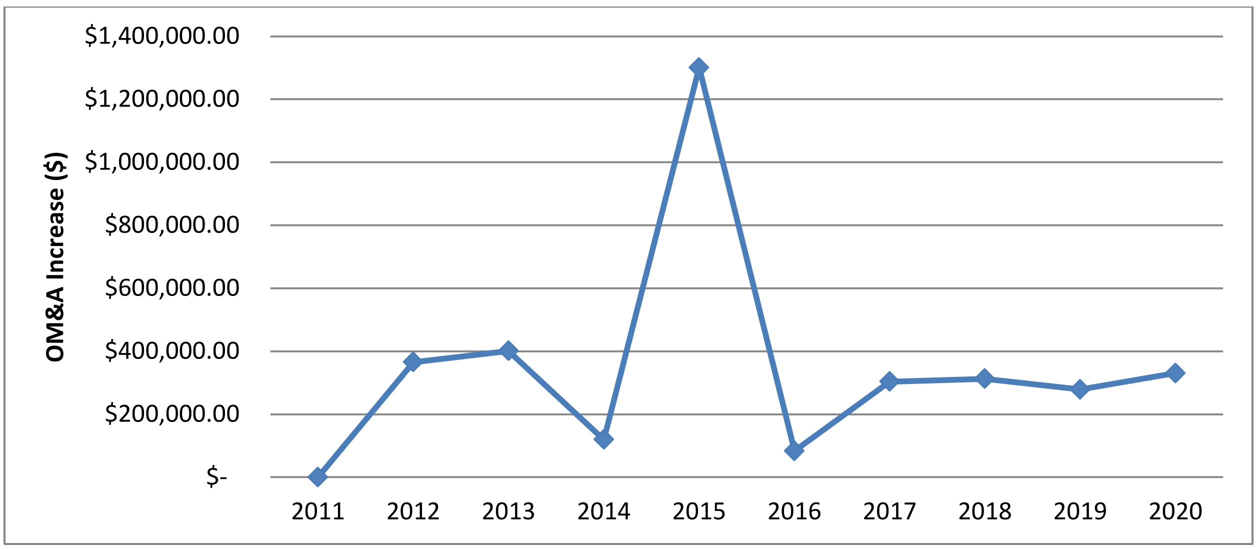
[23] Exhibit K1.2, pp. 7 - 8.
[24] Oral Hearing Transcript, Vol.1, pp. 54, 55 and 57 indicating that about 98% of the customers are located in the urban area in 2016, up from about 90% in 2006. The number of rural customers over the years has remained at about 2,000.

2015 OM&A expenses of $8,583,175 were $1,300,783 higher than the 2014 total expense level.[25]

In stark contrast to this $1,300,783 increase are the historic and test year-over-year increases in total OM&A expenses, excluding the MIFRS amounts. These year-over-year increases were as follows: for 2012 over 2011, an amount of $365,229; for 2013 over 2012, an amount of $400,849; for 2014 over 2013, an amount of $119,551; and for 2016 over 2015, an amount of $83,428.[26]

Looking ahead beyond 2016, the year-over-year increases in total OM&A expenses are forecast to be: for 2017 over 2016, an amount of $303,673; for 2018 over 2017, an amount of $312,784; for 2019 over 2018, an amount of $278,458; and for 2020 over 2019, an amount of $330,521.[27]

Figure 1
Year-Over-Year Increases in OM&A Expenses (2011-2020)



Sources: March 24, 2016 Update, Table 4-13 (Appendix 2-JC), Table 4-12 (Appendix 2-L) and Undertaking J1.12(2). *Excludes changes due to MIFRS transition*.

Figure 1 illustrates the extent to which total OM&A expense increases for 2015 to 2020 were not appropriately paced to spread them out more evenly over the planning horizon. The $1,300,783 of cost increases in the 2015 bridge year is more than three times higher than the next highest year-over-year increase over the 2012 and 2020 period ($400,849 in 2013). This evidence strongly suggests that excessive cost increases have been scheduled to occur in the 2015 bridge year to support an unreasonably high 2016 test year OM&A expenses budget.

[25] Milton Hydro response to Undertaking J1.12, April 12, 2016.
[26] *Ibid.*
[27] *Ibid.*

Intervenors and OEB staff contend that the level of Milton Hydro's OM&A expenses are too high because they fail to reflect the reduced level of unit OM&A costs for the 1,500 customers per year that are being added to Milton Hydro's already densely populated urban service territory. Even if one accepts that the total OM&A cost increases between 2015 and 2020 of $2,609,647 are appropriate, a uniform pacing of these increases at about $435,000 per year would produce a total OM&A expenses budget target for 2016 of about $9.6 million, about $500,000 less than the requested amount of $10,122,448.[28]

One of the objectives of an outcomes-based approach to rate regulation is to have utilities pace and manage the incurrence of additional OM&A costs in a way that produces sustainable savings that can be carried forward at the end of the IRM term. It is inappropriate for utilities to plan and incur very high OM&A cost increases in the last year of an IRM plan to support an excessive test year OM&A expenses budget. An excessive test year OM&A expenses budget provides a utility with an inappropriate opportunity to realize significant benefits for its shareholder during the ensuing IRM term with no consequential value to ratepayers because the benefits are attributable to cost savings and incremental revenues that turn out to be non-sustainable beyond the end of that IRM period.

In 2015, Milton Hydro continued to lease premises at Lawson Road and incurred additional OM&A expenses related to its property at 200 Chisholm Drive. It also continued to incur costs related to the property at Fifth Line and Main Street, which was being used for outside storage. Further increases in total OM&A over and above the very high 2015 amount are being planned for 2016, being the cost of service rebasing test year, even though Milton Hydro vacated the Lawson Road premises at the end of 2015 and sold the property at Fifth Line and Main Street. It is no longer incurring OM&A costs associated with these two business locations, yet its 2016 OM&A costs are still budgeted to increase above 2015 actual levels.

According to Milton Hydro, the significant cost increases relate to new systems (GIS, SCADA, Outage Management, Health and Safety Management). The test year expenses include the ongoing maintenance costs associated with these new applications. Milton Hydro maintains that these costs are incurred to support operations and customer billing systems and to provide benefits such as improved accuracy of customer bills, improved system automation and security, and enhanced customer service levels (shorter outages and customer response times). Reliance is also placed

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[28] The OM&A expenses increases from 2015 to 2020 inclusive are; $1,300,783 + $83,428 + $303,673 + $312,784 + $278,458 + $330,521 = $2,609,647. The average amount over the six years is $434,942 or about $435,000. To get the imputed 2016 budget amount, assuming even pacing over the years 2015 to 2020, start with the 2013 OM&A expense excluding MIFRS of $7,282,392 shown in Table 1, add $435,000 for each of the years 2015 and 2016 along with the 2016 MIFRS amount of $1,455,845. The total is $9,608,237 or about $9.6 million.

on the incremental costs of tree trimming, load/dispatching/control room and consulting services.

Increased staffing levels are also cited by Milton Hydro as a significant cause for the cost increases. Milton Hydro only hired three of the six planned staff additions in 2015 but intends to make these planned hires and others in the 2016 test year.

Milton Hydro maintains that its 2016 budgeted OM&A expenses reflect its investment in areas that its customers identified as priorities: maintaining and upgrading equipment; reducing the time needed to restore power; educating customers about energy conservation; investing more in the grid to reduce the number of outages; and proactive customer communication.

H. INFLATION, PRODUCTIVITY AND CUSTOMER GROWTH

In Appendix 1 of its written argument, Energy Probe presents the inflation factors, base productivity and stretch factors that the OEB has established to set the escalators for rate increases under its Price Cap IRM methodology. Energy Probe also uses the materials upon which the OEB relies to guide its rate-making to determine the customer growth factor for Milton Hydro of 0.4582. This statistically derived factor indicates that for every 1% increase in its customer base, the total OM&A costs for Milton Hydro are likely to increase by 0.4582%.

Applying these factors in various starting point scenarios, Energy Probe presents, in Appendices 1 to 4 of its written argument, a range of outcomes that indicate that Milton Hydro's 2016 OM&A expenses budget is excessive. Included in this presentation is a calculation showing that a reduction in the 2016 OM&A expenses budget of about $315,000 would be required even if one assumes that no productivity gains, no stretch factors and no economies of scale were available to Milton Hydro over the years 2011 to 2016. In this timeframe, there was a 23% increase in Milton Hydro's customer base as a result of the addition of more than 6,800 customers.

I. ECONOMIES OF SCALE AND INCREMENTAL REVENUES

The incremental revenues and economies of scale associated with Milton Hydro's continuing rapid rate of growth in the years 2017 to 2020 can be estimated on a revenue per customer basis.

One way of deriving such an estimate is to take the 2016 revenue requirement amount of $16,921,770, shown in Table 1 of the Partial Settlement, subtract from that amount the approximate $600,000 of revenue deficiency which the OEB disallows in this decision and divide the remainder amount of $16,321,770 by the 36,672 customers in 2016. This approach yields a revenue per customer amount of about $445.

Another approach is to take Milton Hydro's calculation of the revenues being recovered under 2015 current rates from the 36,672 customers for 2016 of $16,299,876[29] which produces a revenue per customer of about $444.

A third approach is to estimate the amount using, as the starting point, the $3.570 million of incremental revenue discussed in Section 6.1(b), subtracting from that amount the portion attributable to the 4.21% of escalations related to the 2011 revenues attributable to the 29,814 customers in 2011 (being an amount of about $536,000) and dividing the remainder of about $3.034 million by the 6,858 customers added in 2012 to 2016. This approach produces an amount of about $442 per customer.

In 2016 and beyond, Milton Hydro expects to add about 1,500 customers per year. At rates that generate about $445 per customer, these incremental customers will generate about $667,500 of incremental revenue in 2017. In 2018, the 3,000 additional customers will provide additional revenue of about $1,335,000. By 2020, the additional 6,000 customers will provide additional revenue of about $2,670,000. These additional revenues will be available to cover incremental OM&A and other costs that these additional customers cause the utility to incur.

Because of the economies of scale, the OM&A cost per added customer is expected to be less than the current embedded OM&A cost per customer. The statistical material prepared by the OEB's consultants indicates that the average OM&A cost per added customer should be 55% less than the OM&A cost per customer embedded in Milton Hydro's current rates.[30]

As a result of the combination of the incremental revenues and economies of scale associated with the continuing growth of its customer base, Milton Hydro will have, in 2017 and beyond, significant incremental revenues to cover customer growth related and other cost increases.

J. ABILITY TO ACHIEVE SAVINGS TO ABSORB COST INCREASES

Subsection 1 of the trends analysis that follows provides the details of Milton Hydro's ability in the years 2013 and 2014 to manage its resources, including incremental revenues attributable to customer growth and cost savings, to absorb increases in costs and as well earn a return on equity in excess of the OEB's established equity return for

[29] See footnote 7.
[30] See footnote 20.

electricity distributors. Milton Hydro has the flexibility to achieve similar outcomes in the years 2016 and beyond.

K. TRENDS IN YEAR-OVER-YEAR METRICS

1. Total OM&A Cost per Customer

The total OM&A cost that Milton Hydro uses to compare its own performance from one year to the next is derived by dividing total OM&A expenses by the average number of customers in each year. However, to compare Milton Hydro's performance to other OEB regulated electricity distributors in a particular year, the denominator used in the calculation is the year-end number of customers in that year.[31] This explains why the OM&A costs per customer in Tables 2 and 3 and the exhibits referenced therein are a few dollars higher than the cost per customer for Milton Hydro in the peer comparison exhibits.[32]

Under CGAAP accounting, Milton Hydro's OM&A cost per customer was $207 in 2011, based on the OEB approved customer base of 30,461, increasing to $215 in 2012. Under MFIRS accounting, this metric was $254 in 2013, an increase of about $39 over the 2012 amount.[33] MIFRS accounting added about $1,273,000 to 2013 OM&A expenses. This amount represents a cost per customer of a little more than $38.[34] The $39 increase in the 2013 cost per customer is almost totally accounted for by the 2013 MIFRS amount.

Despite the increase of $1,673,981 in 2013 OM&A expenses over the 2012 amount of $6,761,992, Milton Hydro managed its resources to earn a return on equity of 10.60% being about 102 basis points above the OEB determined equity return for 2013 of 9.58%.[35] The ability to earn more than the OEB established equity return of 9.58% is evidence of Milton Hydro's considerable flexibility to manage its resources, including incremental revenues attributable to customer growth and cost savings, in a manner that is sufficient to prevent year-over-year OM&A expense increases, including those attributable to accounting policy changes, from impeding the achievement of an enhanced level of equity return to its shareholder.

Total OM&A costs in 2014 were higher than in 2013. However, the OM&A cost per customer metric declined from $254 in 2013 to $247 in 2014. The MIFRS amount in

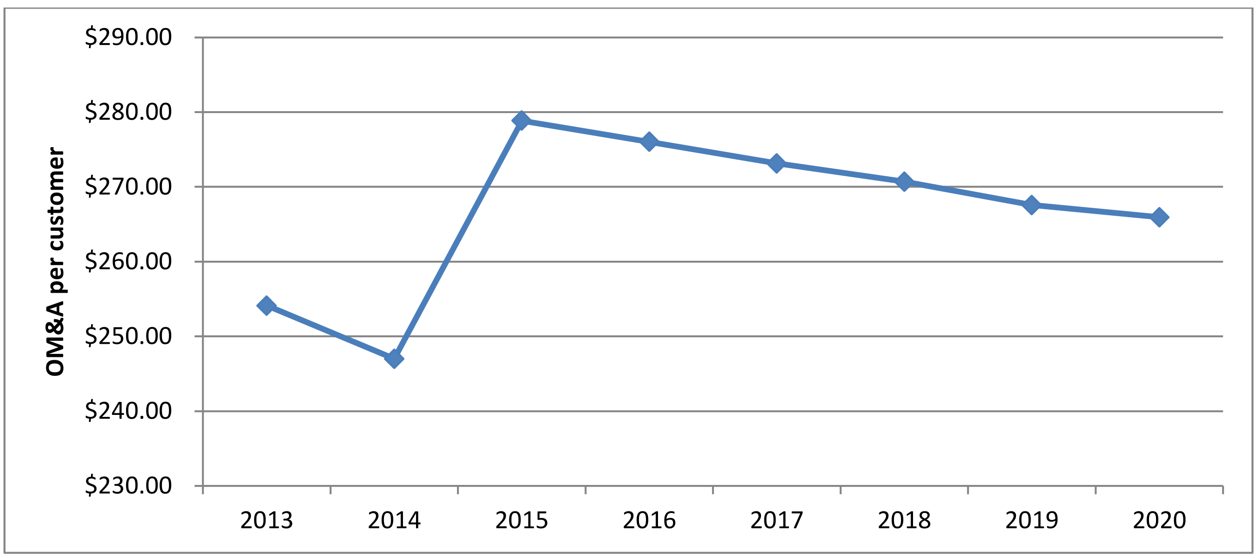
[31] Oral Hearing Transcript, Vol. 1, at pp. 88-89; and Exhibit K1.5 at p. 4.
[32] See for example Exhibit 1, p. 26, Table 1-4; and Exhibit K1.2 at pp. 11-13.
[33] See Table 2 above.
[34] $1,273,000/33,199 (average number of customers in 2013) = $38.34.
[35] Exhibit 1, p. 93.

2014 was slightly less than but almost the same as it was in 2013. Accordingly Milton Hydro was able to reduce OA&A costs per customer to its $247 level in 2014 by exercising its flexibility to hold other OM&A cost increases to a minimum while adding almost 1,400 customers in that year. In 2014 a cost per customer level of $247 was sufficient to cover the total 2014 over 2013 increase in OM&A expenses, the 2014 MIFRS amount of $1,262,000 and earn a 2014 return on equity of 10.29%, about 71 basis points higher than the OEB established equity return of 9.58%.

As shown in Table 2 above, the OM&A cost per customer metric rose sharply in 2015 by $32 per customer (almost 13%) to $279.

The OM&A cost per customer for 2016 is expected to be $276. For 2017 and beyond, the OM&A cost per customer metric is expected to gradually decline to about $273 in 2017 and down to about $266 in 2020.[36]

Figure 2
Summary of OM&A Cost per Customer (2013-2020)



Source: Milton Hydro response to Undertaking J1.12 (2).

Like Figure 1, Figure 2 again illustrates the extent to which total OM&A spending over the planning horizon has been inappropriately paced. Responses to circumstances giving rise to OM&A expense increases over the planning horizon should be planned and paced in a manner that reduces or eliminates material peaks and valleys in the OM&A cost per customer trend line. The pacing of such expenditures in Milton Hydro's case should be designed to produce a much smoother and gentler upwards slope in

[36] See Table 3 above.

that trend line to allow the incremental revenues and economies of scale associated with the addition of 1,500 customers per year over the planning horizon to help cover the expense increases.

The OEB expects Milton Hydro to consider the historic and prospective OM&A cost per customer trend line in its planning process and to both plan and pace increases in OM&A costs in a way that both flattens peaks and smooths the slope of that trend line.

2. Peer Group Comparisons

Because peer comparisons are based on an OM&A cost per customer derived from year-end rather than the average number of customers in each year, the cost per customer metric for peer comparison purposes will be a few dollars lower than each of the numbers shown in Tables 2 and 3 and Figure 2. For example, in 2014, the peer comparison metric is about $243 rather than the $247 amount shown in Tables 2 and 3 and Figure 2.[37] For 2016, the metric is about $270 compared to the $276 shown in those illustrations.

A comparison of Milton Hydro's OM&A cost per customer with its peer group (Mid-Size GTA Medium-High Undergrounding) shows that, while it was better than average in 2014 at about $243 per customer, this metric was about 30% higher than the same 2014 metric for Kitchener-Wilmot Hydro Inc. of about $187, and about 19% higher than the 2014 metric for Oshawa PUC Networks Inc. of about $205.[38]

In 2013, Milton Hydro ranked 19th out of all 73 distributors in Ontario with its OM&A cost per customer of about $247.[39] This ranking improved to 17th position in 2014 when the metric declined to about $243.[40] Milton Hydro shows this ranking slipping to 32nd position[41] in 2016 when the metric will be about $270 and the ranking was undoubtedly worse than that in 2015 when it peaked at an estimated amount of about $274.

Milton Hydro's position within these groups has likely deteriorated since 2014 as a result of the steep rise in its OM&A cost per customer in 2015 and the continuing high level of that metric in 2016.

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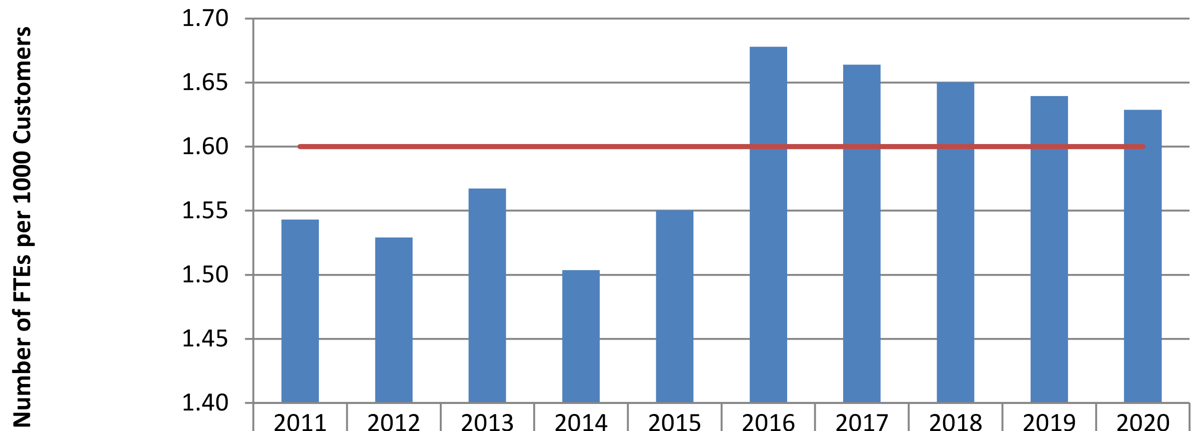
[37] See Exhibit K1.2 at p. 12.
[38] See Exhibit K1.2 at pp. 11-12.
[39] See Exhibit1 at p. 22.
[40] Exhibit K1.2 at p. 13.
[41] *Ibid.*

3. FTEs per 1,000 Customers

Milton Hydro's number of customers per FTE metric increases from 1.57 in 2013 to 1.68 in the 2016 test year. It then gradually decreases over the next four years to 1.63 in 2020.

Figure 3
Summary of FTEs per 1,000 Customers (2011-2020)



	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
FTE/1000 Customers	1.54	1.53	1.57	1.50	1.55	1.68	1.66	1.65	1.64	1.63
Average	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6	1.6

Source: Milton Hydro response to Undertaking J1, 12(2)

The information in Milton Hydro's response to Undertaking J1.12 (2) indicates that between 2015 and 2020, Milton Hydro plans to add 14.5 FTEs, 2.9 FTEs per year on average. However, it has paced 6.5 staff additions to occur in 2016 and another two FTEs per year in the four years that follow. If these FTE additions were more evenly paced, there would be 2.9 FTEs added in each of the years 2016 to 2020, being 3.6 FTEs less in 2016 and 0.9 FTEs more in each of the years 2017 to 2020.

Figure 3 illustrates the extent to which the incremental staff component of Milton Hydro's OM&A expenses budget has been inappropriately paced. Scheduling incremental staff hires more evenly over the planning horizon operates to dilute the upward movement in the trend line between 2015 and 2016 and to flatten the trend line thereafter over the course of the planning horizon. This is the type of "pacing" response that the OEB expects.

Under the performance-based outcomes approach to rate regulation, Milton Hydro is expected to plan staff additions at a pace that keeps the FTEs per 1,000 customers trend line at as flat a slope as is possible.

4. OM&A Cost per Kilometre

The OM&A cost per kilometre of line increases by about 18.8% from 2013 to 2016, far in excess of inflation over that time period.[42]

5. Overall Efficiency

In its evidence[43] and Reply Argument,[44] Milton Hydro recognizes that the level of its OM&A cost increases in 2015 and 2016 have caused its efficiency to decline from a Group 2 to a Group 3 factor in 2016 and beyond. Milton Hydro projects that this decline will be reversed but not until 2020.

6. Milton Hydro's Deteriorating Performance

This analysis of trends indicates a deterioration in Milton Hydro's OM&A expense metrics, particularly in 2015 which carries over into 2016. The expenses trend analysis also indicates that the peak OM&A cost per customer in 2015 is temporary. Beginning in 2016, that peak starts to decline. The decline in 2016 and beyond indicates that Milton Hydro will start realizing increasing incremental revenues and economy of scale benefits from the continuing rapid pace of its customer additions of about 1,500 per year. However, the decline in OM&A cost per customer from 2016 to 2020 is only 3.7% over four years compared to the increase of approximately 12.9% in 2015 alone.[45]

The benefits of the significant efficiencies achieved in 2013 and 2014, which were sufficient to absorb large OM&A increases attributable to the adoption of MIFRS accounting policy and produce earnings above the OEB established equity return, were not sustained beyond December 31, 2014. The trends analysis beyond 2016, showing a continuing decline in OM&A costs per customer in years 2017 to 2020, indicates that the 2015/2016 OM&A expenses peak is likely to produce similar opportunities for Milton Hydro to produce significant benefits for the utility owner in the next IRM period if the $10,122,448 amount is approved in full.

Rather than pacing a meaningful proportion of the significant growth related OM&A expenses incurred in 2015 for incurrence in 2016 to 2020 inclusive, Milton Hydro's approach of incurring most of the cost increases in 2015 and 2016 creates an opportunity for the utility to use the incremental revenues and economies of scale

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[42] Milton Hydro response to Undertaking J1.11.
[43] See Exhibit K1.4 at p. 7.
[44] Reply Argument, p. 17.
[45] Exhibit 1, p. 93.

associated with continuing customer growth to provide incremental benefits to the utility owner instead of providing the value of these benefits to utility customers.

L. SUBMISSIONS OF THE PARTIES

1. Milton Hydro

Facts upon which Milton Hydro relies to justify its budgeted OM&A expenses include:

- its rapid growth and transformation from a small to medium size utility
- its rural service territory which it says adds to the costs it faces compared to those utilities whose service territories are primarily urban
- the expenditures it is incurring in areas that its customers identified as priorities
- comparisons of its current and prospective OM&A costs per customer and other metrics to its own historical metrics and those of its peers which it says indicate that it continues to be a lean and efficient operator

Milton Hydro reiterated in its reply submission that the incremental costs that have been and are continuing to be incurred for new systems and the ongoing costs associated with these new applications could not be reduced or avoided. It maintained that all incremental amounts were necessary to support customer needs. It maintained that all of its planned staffing requirements for 2016 are necessary and resisted the suggestion that some of these items could reasonably be deferred to a subsequent year. Detailed tables were included in the reply submission showing expenditures and expected benefits to consumers.

Milton Hydro contends that any formulaic approach to determining the total amount of its 2016 OM&A expenses is inappropriate because it will not reflect material incremental costs not present in the starting point amount from which the formula is applied. It submits that such incremental costs must be considered as distinct costs and recognized independently of any model.

Milton Hydro argues that the recent trends in its year-over-year OM&A cost-related metrics are a consequence of the lumpiness of the incremental costs that it is incurring during the course of its transition from a small to medium size distribution utility. It notes that, in the years 2017 to 2020, these unfavourable trends will reverse and that it will then resume its status as a better than average distribution company to the benefit of all of its customers.

Milton Hydro rejects, as unreasonable, the approach that OEB staff asks the OEB to apply to what they characterize as “corporate transformation costs”. The utility submits that all costs so characterized are reasonable and appropriate. The OEB is asked to approve the total OM&A amount of $10,122,448 to enable Milton Hydro to continue to service its customers and achieve the outcomes customers expect.

Milton Hydro refers to the customer communication activities in which it engaged and notes the willingness of its customers to accept a distribution rate increase.

Milton Hydro in effect argues that, in its particular circumstances, it would be inappropriate for the OEB to refrain from approving the full amount of the 2016 OM&A budget of $10,122,448.

2. Intervenors and OEB Staff

While Intervenors and OEB staff generally accept that Milton Hydro is rapidly growing, they reject the characterization of this as “super growth”. They emphasize that, by far, most of the growth is concentrated in the already dense urban area of Milton Hydro’s service territory. They point out that adding significant growth to an already densely populated area maximizes the opportunities for benefitting from economies of scale.

Intervenors and OEB staff contend that the existence of Milton Hydro’s large rural service territory does not justify the very large OM&A cost increases in 2016 that the utility asks the OEB to approve.

While acknowledging that customer preferences are important, OEB staff submits that many components of the total requested increase are not directly traceable to the expression of customer preferences contained in responses to a written customer survey conducted on Milton Hydro’s behalf.

Intervenors and OEB staff point to the material deterioration in Milton Hydro’s OM&A cost metrics in 2015 and 2016, to support their requests that the OEB approve a total 2016 OM&A budget in an amount significantly lower than the amount requested.

To inform their recommended reductions to the total requested 2016 OM&A expenses, Intervenors and OEB staff apply, in various starting point scenarios, the inflation rates, productivity allowances and the OM&A cost increase factors for the average utility and for Milton Hydro that are contained in materials that the OEB and its independent consultant have compiled to assist performance-based outcomes rate making.

An analysis of the range of outcomes that these calculations produce is provided in Appendices 1 to 4 of the written argument submitted by Energy Probe. The total OM&A

expense reductions recommended by Intervenors and OEB staff range between $800,000 and $970,000.

Intervenors and OEB staff also focus on a number of categories of expenses and specific line item amounts as additional support for the total amount of their recommended OM&A expense reductions. Energy Probe provides an historic and more current comparison of Milton Hydro’s percentage increases in customers and FTEs to support a submission that the employee cost portion of the 2016 OM&A budget should be reduced by the value of five FTEs. The same intervenor contends that the compensation increases Milton Hydro proposes are excessive having regard to the external benchmark that the OEB uses for labour costs in its setting of the inflation rate. Line item amounts for OM&A building expenses, board of director costs, regulatory costs and the percentage of OM&A costs capitalized are also challenged by Intervenors and/or OEB staff.

OEB staff also question the FTE component in the 2016 budget in the context of the fact that Milton Hydro successfully operated in 2015 without three of the staff that it initially planned to hire in that year. Staff also question the magnitude of 2016 amounts budgeted for billings and collections, and tree trimming.

OEB staff identify a number of items of 2016 budgeted costs that they characterize as “Corporate Transformation Costs”. Staff argue that these items of cost are incurred solely to benefit the corporation in its transformation from a small to medium-sized utility. They submit that these items of cost have no value for customers. They contend that such corporate transformation costs that do not enhance service quality, should not be recoverable in rates set under the auspices of the OEB’s performance-based rate setting policy. OEB staff rely on this position as additional support for their total OM&A expenses reduction recommendation of $970,000.

The overall effect of the submissions made by intervenors and OEB staff is that the full amount of Milton Hydro’s $10,122,448 OM&A expense budget for 2016 is incompatible with the continuous improvement goal of the OEB’s performance-based outcomes approach to utility rate making. They contend that a material reduction is needed to bring the total amount into alignment with the objectives of the RRFE.

3. Essence of the Dispute

The essence of the matter to be decided is the appropriate level of 2016 OM&A expenses for Milton Hydro having regard to the performance-based objectives of the RRFE.

J. FINDINGS

1. Continuous Improvement in Performance is a Priority

Under the auspices of an outcomes approach to rate regulation, a convincing demonstration by a utility applicant of the extent to which a particular category of expenditures provides value to ratepayers is a high priority. Costs that are not providing outcomes that ratepayers value, including OM&A costs that are unjustifiably and materially out of alignment with the continuous improvement goal of the outcomes approach to rate setting, are not recoverable in OEB regulated utility rates.

2. OEB Guides to Inform Rate-Setting Apply to Milton Hydro

The OEB does not accept Milton Hydro's submission that the use of inflation, productivity and customer growth metrics contained in the extensive materials that the OEB has commissioned and prepared to guide utility ratemaking is inappropriate in the case of a rapidly growing utility. This submission is based on the contention that an application of these factors does not provide coverage of any incremental cost increases. This is incorrect. The price cap methodology does provide some incremental cost coverage through the added revenues that the utility recovers from each new customer. Because Milton Hydro is rapidly expanding, these added revenues are materially greater than they would be in the case of a slowly growing utility.

Rather than arguing that the formulas and metrics contained in these materials are inapplicable to its particular circumstances, Milton Hydro should use these metrics and materials to guide its planning and pacing of expected increases in OM&A costs over its five year planning horizon. If these metrics and formulas are considered to be deficient in their ability to adequately recognize some categories of incremental costs, then Milton Hydro should propose enhancements to the derivation of these guides to rate making that are capable of reducing or eliminating these alleged deficiencies rather than suggesting that they have no application to a rapidly growing utility.

The OEB finds that the results of applying inflation, productivity factors, formulas and other elements of the guides that it has provided to assist rate making in its performance-based outcomes approach are to be considered and taken into account when determining just and reasonable 2016 rates for Milton Hydro.

3. Reasonable and Appropriately Paced Transformation Costs Are Recoverable From Ratepayers.

The OEB staff submission that no corporate transformation costs are recoverable from ratepayers is too extreme. A “reasonable” level of corporate transformation costs should be recoverable provided that such costs are appropriately paced to avoid extreme increases in OM&A costs in a particular year. The matters to be considered relate to the reasonableness of the amounts and the appropriateness of the pacing of such costs. The OEB is satisfied that a reasonable level of appropriately paced transformation costs can contribute to continuous improvement in operational efficiency and other performance-based outcomes that customers value.

4. Customer Tolerance for a Rate Increase Does Not Justify Excessiveness

The OEB finds that Milton Hydro’s reliance on the willingness of its customers to accept a distribution rate increase is misplaced. Milton Hydro must first satisfy the OEB that its proposed 2016 OM&A expenses budget is compatible with performance based outcomes that customers value. Customer tolerance for a rate increase does not justify a budget that is incompatible with these outcomes.

5. Milton Hydro’s 2016 OM&A Budget is $550,000 Too High

The OEB finds that, including the $50,000 disallowance of OM&A property expenses related to 200 Chisholm Drive that is addressed in the next section of this Decision and Order, Milton Hydro’s proposed 2016 OM&A budget is too high. For 2016 rate-making purposes, the budget shall be reduced by $550,000, from $10,122,448 to $9,572,448. This finding is based upon the following considerations:

- Milton Hydro is seeking a significant increase (20%) in OM&A over the 2013-2016 period with little, if any, demonstrable gain in operational efficiency.

- The requested OM&A spending increase significantly outpaces predicted customer growth which is claimed to be the primary driver of the increase. Moreover, the OEB sees the growth of Milton Hydro’s customer base as a contributor to cost reduction because of the combined effect of the incremental revenues and economies of scale associated with that growth.

- Although Milton Hydro’s layout in terms of rural territory lends itself to a higher cost utility, it does not either explain or justify more than a minuscule portion of the total increase.

- Milton Hydro's OM&A cost per customer has deteriorated over time relative to its own historic performance and to other utilities.

- Comparison of Milton Hydro's OM&A cost per customer with its "peer group" shows that, while it is slightly better than average, certain utilities in this "peer group" have OM&A costs per customer that are below that of Milton Hydro.

- Milton Hydro's projected improvements in OM&A cost per customer and OM&A cost per FTE over the 2017-2020 period are significantly lower than the proposed percentage increases in 2016 relative to the 2013/2014 levels indicating that the projected future performance improvements are not expected to compensate for the increases in 2015 and 2016.

- The allocation and scheduling of more than $1.3 million of cost increases for 2015 and further increases in 2016 was inappropriate. These cost increases should have been more appropriately paced over the planning horizon between 2015 and 2020 so that the combined effect of incremental revenues and economies of scale associated with customer growth in those years provides value to ratepayers by being applied more towards cost increases and less towards the enhancement of equity returns.

- The OEB finds that the reduction in 2016 OM&A expenses that stems from a consideration of a more appropriate pacing of the significant cost increase in 2015 that is carried forward into 2016,[46] as well as the reduction of $315,000 calculated by Energy Probe for the hypothetical scenario of no productivity gains, no stretch factors and no economies of scale (i.e. only accounting for customer growth and inflation), provides a good starting point for determining the appropriate level of the 2016 OM&A for Milton Hydro.

- At the other end of the spectrum, the OEB finds that the $800,000 to $970,000 reduction in the 2016 OM&A suggested by Intervenors and OEB staff does not fully take into account the fact that Milton Hydro's transition to a larger utility would realistically take place over a period of time with the costs to be paced and the benefits of Milton Hydro's new systems including the GIS, SCADA, Outage Management Systems, to be realized over time.

The OEB considers a reduction of $550,000 in total OM&A expenses to be appropriate with the expectation that Milton Hydro will perform in 2016 and beyond, as it did it 2013 and 2014, by actively managing its resources to achieve

[46] See Figure 1.

performance levels consistent with its historical levels and those of the best performing LDCs.

6.3 200 CHISHOLM DRIVE ISSUE

A. OVERVIEW

The sections that follow summarize the facts relevant to the OEB's consideration of Milton Hydro's proposed regulatory treatment for the costs related to its acquisition and renovation of the premises at 200 Chisholm Drive.

The OEB applies an "outcomes-based" approach to resolve questions that the 200 Chisholm Drive Issue raises. For the reasons described below, Milton Hydro's proposal to provide ratepayers with a share of the capital gain realized on the sale of the land at Fifth Line and Main Street by way of a revenue requirement offset of $87,975 is reversed and replaced with a rate base reduction in the full amount of the capital gain of about $506,000.[47]

The OEB disallows the rate base values for excess office space in the building[48] and for the capital cost "premium" differential between inside and outside storage for the 36,000 square feet of indoor building space that Milton Hydro uses for outside storage.[49]

Including the capital gains reduction of about $506,000, these rate base value reductions total about $1.935 million.[50] In addition, OM&A building related costs are reduced by about $50,000.[51] The net effect of these findings is a modest reduction in the 2016 revenue requirement related to 200 Chisholm Drive that the OEB estimates to be about $119,000.[52]

[47] See Section 6.3.D subsection 8 of this Decision and Order.
[48] See Section 6.3.D subsection 3 and 4 of this Decision and Order.
[49] See Section 6.3.D subsection 5 of this Decision and Order.
[50] Capital gain in full - about $505,950; excess office space - $675,772; capital cost differential between inside and outside storage - $753,480; Total - about $1,935,000.
[51] See Section 6.3.D subsection 6 and 7 of this Decision and Order.
[52] Revenue requirement components: un-renovated office space - about $25,000; renovated office space - about $36,000; inside storage space premium - about $59,000 and capital gain - about $37,000 for a total of about $157,000. Subtract elimination of revenue offset of about $88,000 for a net of $69,000 and then add the $50,000 of building related OM&A disallowances for a total of $119,000.

B. CHRONOLOGY

1. Office and Operations Building Space and Outside Storage as of 2011

Milton Hydro requires indoor building space for two purposes: office use, and operations space for inventory management and vehicle storage. The utility also requires land for outside storage of other materials that it uses in its operations.

As of 2011, when its rates were last rebased to its test year cost of service, Milton Hydro's office and operations space requirements were being met at premises it leased at 8069 Lawson Road. That lease had an initial five year term, expiring at the end of November 2014. That term was subsequently extended to expire on December 31, 2015. At Lawson Road, Milton Hydro had between 12,775 and 15,000 square feet of office space and between 22,000 and 24,000 square feet of industrial/operations space.[53]

The land at the Lawson Road site was insufficient to satisfy all of the utility's outside storage requirements. Milton Hydro used its vacant land at Fifth Line and Main Street to fulfill its remaining outside storage needs.[54] Together the land space available at these two separate locations was more than sufficient to satisfy Milton Hydro's needs for outside storage.

2. Decision to Own and Build Instead of Leasing

Milton Hydro's decision to acquire land and build its own facilities, rather than continue to lease them, was made in 2009.[55] Upon making that decision, Milton Hydro purchased about 6.4 acres of un-serviced land located at the corner of Fifth Line and Main Street. The land was purchased from the Town of Milton for $2,218,530. The Town had acquired that land from Hydro One.[56] Hydro One owned another property adjacent to

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[53] The evidence about the amount of office space at Lawson Road is imprecise. The Lawson Road plans filed as Exhibit K2.3 show about 12,775 square feet of space. See Oral Hearing Transcript, Vol. 2, at pp. 73-74. An internal presentation made at Milton Hydro on November 14, 2012 shows 15,000 square feet of office space at Lawson Road, see Milton Hydro response to Interrogatory I-SEC-14, attachment at p. 752 of 901. At pp. 57-58 of the Oral Hearing Transcript, Vol.2, the Milton Hydro witness estimated the office space at 16,000 square feet but also acknowledged that the amount of office space at 200 Chisholm Drive doubled the amount of office space held at Lawson Road. In this Decision and Order, the OEB uses an office space area at Lawson Road ranging between 12,775 and 15,000 square feet for the purpose of its analysis.

[54] Exhibit 1, p. 30.

[55] In Exhibit 1 at page 30 Milton Hydro incorrectly states that the property was acquired in 2008. The Relocation Committee Minutes, the evidence and settlement proposal in the EB-2010-0137 proceeding and Milton Hydro's January 7, 2014 letter to the OEB requesting a one year deferral of its 2015 cost of service application referenced at Exhibit 1 page 32 all confirm that the property was purchased in 2009.

[56] Letter to OEB, January 7, 2014.

this property. There was also a privately owned adjacent parcel of land about 1.3 acres in size.

In proceedings under docket number EB-2010-0137, the OEB established 2011 cost of service rates for Milton Hydro on the basis of a settlement proposal dated December 17, 2010. In that agreement, the intervenors and Milton Hydro acknowledged that the land at Fifth Line and Main Street would be the site for Milton Hydro's future office/service centre. These parties also agreed that only 50% of the value of the parcel would be used and useful in the 2011 test year. As a result, it was agreed that 50% of the cost of that land would be excluded from the opening capital for the 2010 bridge year in order to calculate the 2011 average opening and closing fixed assets.[57] The expectation then was that Milton Hydro would be able to acquire the additional land it needed for its project at Fifth Line and Main Street from either Hydro One or the private owner of the adjacent land.

3. Benefit/Cost Analysis of Own/Build versus Leasing

Milton Hydro presents an estimate of $15,605,000[58] for the total costs of acquiring the necessary land and building its own facilities at the Fifth Line and Main Street site. This estimate lacks detailed support and it is unclear when the estimate was prepared. Milton Hydro relies on this estimate to demonstrate that the total costs it incurred of $14,460,000 to acquire and renovate the premises at 200 Chisholm Drive are lower than its estimated costs of completing the project at the Fifth Line and Main Street location. A comparison of the costs of the 200 Chisholm Drive project to a hypothetical own and build scenario does nothing to demonstrate that ratepayers will benefit from the trade-off of OM&A leasing costs for the Lawson Road premises or some other leasing option for the capital costs of the 200 Chisholm Drive premises.[59] No evidence was adduced to demonstrate that the costs and benefits to Milton Hydro's ratepayers of the own and renovate option at 200 Chisholm Drive was more favourable than the leasing option.

The 2016 impact on ratepayers of the 200 Chisholm Drive acquisition and renovation is clearly negative. That project is estimated to add about $1,000,000 to the 2016 base revenue requirement compared to the lease option at the rents being paid for the

[57] EB-2010-0137, Proposed Settlement Agreement, December 17, 2010, p. 10.
[58] Exhibit K1.3, p. 5.
[59] The capital expenditure issue that the OEB framed called for Milton Hydro to give due consideration for the trade-offs with OM&A spending in the planning and pacing of its capital expenditures.

Lawson Road premises.[60] There is no evidence showing if or when that impact turns positive in the years ahead.

Neither intervenors nor OEB staff questioned the lack of an own versus lease cost/benefits analysis. The completion and presentation of such an analysis should be a pre-requisite for every utility that wishes to switch from leasing to acquiring land on which to construct its own office and operations facilities. It appears that all participants in this proceeding, including Milton Hydro, assumed that such a cost/benefit analysis would demonstrate that, over the longer term, the own and renovate option is of material benefit to Milton Hydro's ratepayers.

4. Current Estimate of Building Space and Outside Storage Requirements for Milton Hydro

The minutes of meetings held by Milton Hydro's Relocation Committee indicate that, by November 2012, the utility quantified its building space needs, for the longer-term planning horizon commencing as of the end of 2014, at 26,000 square feet of office space and 34,000 square feet of warehouse/operations space.[61] The slide presentation made by Milton Hydro at the April 2016 oral hearing in this case states that these needs were subsequently quantified as being 9-10 acres of land, 26,000 square feet of office space, 37,000 square feet of operations space and 65,000 square feet of outside storage.[62]

Apart from the visits that were made to recently constructed facilities of other electricity distributors and discussions held with those utilities about their "lessons learned", there does not appear to be any further evidence explaining how these requirements were derived.[63] There are no details of the future scenario(s) on which the estimates are based.

There is a paucity of information that explains why the office space requirements, at 26,000 square feet, should be almost double the 12,775 to 15,000 square feet at Lawson Road, or why 22,000 to 24,000 square feet of operations space at Lawson Road should be increased to 37,000 square feet. The FTE level at 2014 of about 52 is expected to increase by about 33% to 69.5 FTEs by 2020. Customer numbers in 2014

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[60] SEC Argument, April 19, 2016, p. 26. SEC's estimate of the negative impact at about $1 million was not questioned by Milton Hydro in its Reply Argument. This estimate appears to be compatible with the table in Milton Hydro's response to SEC's Information Request 2 for Oral Hearing, which shows the 2015 revenue requirement to be almost $1 million less when the revenue requirement related to 200 Chisholm Drive is eliminated.

[61] Minutes of Relocation Committee meeting, November 14, 2012, attached to Milton Hydro response to Interrogatory, 1-SEC-14, p. 758 of 901.

[62] Exhibit K1.3, p. 3.

[63] Oral Hearing Transcript, Vol. 2, pp. 54-59.

of 34,592 are expected to be about 42,672 in 2020; an increase of about 23%.[64] These metrics do not support the level of increased office and operations requirements on which Milton Hydro relies.

5. Decision to Buy and Renovate 200 Chisholm Drive Premises

Despite its consideration of various alternatives over the course of more than four years, from 2010 to the spring of 2014, Milton Hydro quite suddenly decided, in May of 2014, to offer to purchase the land and building at 200 Chisholm Drive.

Preceding this decision was a January 7, 2014 request from Milton Hydro to the OEB for a one-year deferral, from 2015 to 2016, of its application for a cost of service rebasing of its current rates. This request was based on the difficulties Milton Hydro was then having in relation to the Fifth Line and Main Street property. This request noted the $15,000,000 amount that Milton Hydro had budgeted to spend on its project in 2014 and 2015 and expressed concern with the exclusion of this level of expenditure from a cost of service re-setting of its rates.[65] In expressing its commitment to file a cost of service application for 2016, Milton Hydro effectively imposed on itself an obligation to be moved into new premises by the end of 2015. In subsequent reports to its board of directors, this obligation was characterized as “our Regulatory expectation of move in by end of 2015.”[66]

During the course of the several years that Milton Hydro had been considering alternatives for its building space and outside storage requirements, many properties were identified as options. The 200 Chisholm Drive property did not surface as a possibility until the end of April 2014.[67] The evidence indicates that Milton Hydro immediately offered the property owner a letter of intent to purchase the premises. No evidence was adduced to demonstrate that any thorough assessment of the compatibility of these premises with Milton Hydro’s requirements was made before making this offer.

By May 21, 2014, the solicitors for Milton Hydro and the vendor were drafting a purchase agreement which was still being fine-tuned in June.[68] By August 25, 2014, the purchase agreement had been signed, conditions precedent in it in favour of Milton

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64 Milton Hydro response to Undertaking J1.12, April 12, 2016.
65 Letter to OEB, January 7, 2014 referenced in Exhibit 1 at page 32.
66 Relocation Update, April 28, 2014, attached to Milton Hydro response to 1-SEC-14, p. 836 of 901.
67 *Ibid.*
68 Relocation Update dated May 21, 2014 for the May 26, 2014 board meeting, and Relocation Update dated June 17, 2014 for the June 23, 2014 board meeting, both attached to Milton Hydro response to 1-SEC-14, pp. 837 and 839 of 901.

Hydro had been waived, and the deal scheduled to close within 30 days.[69] The purchase was completed on September 24, 2014.[70]

The OEB finds that Milton Hydro's planning process for long-term accommodation of its needs to be lacking both in terms of timing and scope. There is a lack of clarity about the range of options considered and the timely evaluation of these options (e.g. constructing at Fifth Line and Main Street and leasing space elsewhere for outside storage). According to the Milton Hydro witnesses, the sudden decision to buy 200 Chisholm Drive was based on the conclusion that there was no other option.[71]

6. Incompatibility Between 200 Chisholm Drive Premises and Milton Hydro's Estimated Requirements

Milton Hydro only needs building space for its office and operations functions. Its leased premises at Lawson Road contained 37,000 square feet of building space for office and operations functions. The building at 200 Chisholm Drive provides 91,800 square feet of indoor space, 36,000 square feet of which is being utilized for indoor storage. This leaves 55,800 square feet for office and operations space. The 55,800 square feet of space for office and operations is significantly larger than the 37,000 square feet that Milton Hydro had at Lawson Road for those purposes. The 91,800 square feet of building space at 200 Chisholm Drive also greatly exceeds the total increased office and operations space requirements that Milton Hydro had estimated at 63,000 square feet.[72] The selected building is far too large for Milton Hydro's office and operations needs.

The seven acres of land at 200 Chisholm Drive provides 29,000 of outside storage space, an amount materially less than the estimated outside storage space requirements of 65,000 square feet.

7. No Consideration of Ratepayer Impacts

Milton Hydro's witnesses acknowledge that they did not consider impacts on ratepayers when making decisions related to the acquisition of the 200 Chisholm Drive premises.[73]

No evidence was adduced to demonstrate how the decision to acquire the oversized building and an inadequate amount of land produces outcomes that customers value. Excess office space is an outcome that is of no value to customers. The increased

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[69] Relocation Update dated August 21, 2014 for the August 25, 2014 board meeting, attached to Milton Hydro response to 1-SEC-14, p. 841 of 901.
[70] Relocation Update dated September 21, 2014 for the September 29, 2014 board meeting, attached to Milton Hydro response to 1-SEC-14, p. 845 of 901.
[71] Oral Hearing Transcript, Vol. 2, p. 10.
[72] Exhibit K1.3, p. 3.
[73] Oral Hearing Transcript, Vol. 2, p. 50.

capital cost of treating inside storage as an equivalent to outside storage is an outcome of no value to customers.

8. Configuration of the Building Renovations

Without considering how best to optimize the use of the building and premises to achieve outcomes that its ratepayers value, Milton Hydro proceeded to renovate the building to create 32,800 square feet of office space. This amount of office space was more than double the 12,775 to 15,000 square feet of office space at Lawson Road. The 32,800 square feet of office space that was created exceeded the 26,000 square feet contained in the most recent version of the requirements calculations.[74]

The amount of office space that Milton Hydro created exceeded its reasonable requirements over the planning horizon. Milton Hydro recognized that at least 5,160 square feet of office space was excessive and not needed. This amount of mezzanine space has been left vacant and has been closed in as raw and empty space.

The renovations were made to provide 23,000 square feet of space for operations use, about the same amount of space that had been used for that purpose at Lawson Road.

About 36,000 square feet of building space was allocated for use as the equivalent of outside storage. Along with the 29,000 square feet of outside storage, this provides total storage capacity of about 65,000 square feet.[75]

With the unused 5,160 square feet of mezzanine space and the use of 36,000 square feet of expensive indoor storage for outside storage, the design of the building is less than optimal.

The option of making up to about 41,000 square feet of space[76] in the building available for lease to third parties was not pursued because of alleged inefficiencies in having outside storage at separate locations.[77] This was an obvious alternative to allocating 36,000 square feet of building space for use as the equivalent of outside storage and leaving 5,160 square feet of office space vacant and closed in. This option would require either the use of part of the land at Fifth Line and Main Street for outside storage or the acquisition by purchase or lease of additional land elsewhere to supplement the 29,000 square feet of outside storage at 200 Chisholm Drive. Milton Hydro had previously used a two location approach to outside storage with its Lawson Road and Fifth Line and Main Street outdoor storage locations. Milton Hydro has not

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[74] Exhibit K1.3, p. 3.
[75] Oral Hearing Transcript, Vol. 1, p. 153.
[76] 36,000 sq. ft. inside storage + 5,160 mezzanine space = 41,160 sq. ft.
[77] Oral Hearing Transcript, Vol. 2, p. 28.

demonstrated that the incremental cost “premium” incurred in using inside storage as a substitute for outside storage provides any value to its customers.

9. Total Capital Costs

The total project capital costs of the 200 Chisholm Drive premises including land, building, renovations and other costs are $14,460,000. Milton Hydro seeks to recover this amount in full from ratepayers. Milton Hydro calculates these total project costs at $158 per square foot. The denominator in the calculation is the full 91,800 square feet of building space even though 5,160 square feet of office space was not renovated and the 36,000 square feet of space treated as the equivalent of outside storage required little renovation compared to the 49,640 square feet of renovated office and operations space.[78]

SEC contends that by lumping renovated and un-renovated space together, the calculation of $158 per square foot is misleading.[79] Milton Hydro compares its calculated total project cost amount to calculations of the total project costs per square foot incurred by other utilities who have purchased and built their own office and service facilities. The amount of land acquired by these utilities is in some cases materially more than the seven acres acquired by Milton Hydro.[80] Moreover, land costs can vary significantly depending on their location and the market conditions at the time the land was purchased. The square footage of the buildings of the comparators is limited to office and operations usages. The denominators in the cost per square foot calculations for the other utilities materially differ from the denominator Milton Hydro uses for itself which includes a substantial amount of un-renovated space.

Milton Hydro heavily relies on the fact that the total cost per square foot of the lands, building and its renovation of $158 per square foot is less than the total costs per square foot incurred by other utilities to meet their land and building space requirements. Relying on this fact, Milton Hydro in essence urges the OEB to find that its costs are so low, in comparison to the costs of others, that they render moot the questions about outcomes that customers value and ratepayer responsibility for excess office space costs and the differential between the capital costs of inside and outside storage that the purchase of 200 Chisholm Drive raises.[81]

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[78] Exhibit K1.3, p. 17.
[79] SEC Argument, p. 25.
[80] Exhibit K1.3, pp.5-10.
[81] Milton Hydro Reply Argument, April 28, 2016, p. 33.

10. Inside and Outside Storage Capital Cost Differential

Milton Hydro calculates the difference in capital costs between 200 Chisholm Drive inside storage and outside storage to be about $20.93 per square feet. This translates into a rate base value of $753,480 for its 36,000 square feet of inside storage.[82]

11. Raw and Empty Office Space

Milton Hydro calculates the rate base value of the 5,160 square feet of office space that has been left raw, empty and closed in, at a value considerably less than $158 per square foot on the grounds that it was not renovated.[83] In Reply Argument it ascribes a rate base value of about $291,146 to the building and renovation components of that part of the property. With adjustments to the land and building components to reflect 5,160 square feet rather than 5,000 square feet the rate base value of the un-renovated space and related land is about $343,308 or about $66.50 per square foot.[84]

12. Land and Building OM&A Costs

The 2016 OM&A Costs of 200 Chisholm Drive, including property taxes, were presented as a total amount of $467,000. The property taxes component of that total is an amount of almost $120,000.[85]

In response to an undertaking during the oral hearing (Table J1.3), the electricity, water/sewer and gas costs were reduced from a total of $200,000 to a total of slightly more than $167,000. Electricity and gas costs total about $160,400. In calculating the revenue requirement amount related to the 5,160 square foot of office space that has been left raw, empty and closed in, Milton Hydro included OM&A costs related to that space for property taxes, gas and electricity.[86]

The total 2016 OM&A expenses for the land and entire building for property taxes, gas, and electricity are about $280,000. About 5.6% or about $15,738 of this amount is allocable to the 5,160 square feet of office space that has been left unfinished and vacant.[87]

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[82] Milton Hydro response to Undertaking J1.3 (amended).
[83] Milton Hydro response to Undertaking J2.2.
[84] Milton Hydro Reply Argument, April 28, 2016, p. 34.
[85] Exhibit K2.2, p.2.
[86] Milton Hydro response to Undertaking J2.2.
[87] Milton Hydro's calculation of this OM&A expenses amount of $14,191 appears to be understated. In the spreadsheet that was filed along with Undertaking J2.2, Milton Hydro uses gas and electricity costs totalling about $140,700 rather than the $160,400 shown in Undertaking response J1.3. The OEB has used the J1.3 numbers rather than the inexplicably lower spread sheet numbers.

The OM&A expenses related to the space being used as the equivalent of outside storage are, at most, a portion of the gas and electricity costs allocable to the 36,000 square feet of inside storage. As already noted, the total gas and electricity costs for the entire building are about $160,400.[88] The 36,000 square feet comprises about 39% of the total building area of 91,800 square feet. Accordingly, at most, about 39% of $160,400 or about $63,000 relates to the 36,000 square feet of inside storage space.

13. Capital Gain on Sale of Fifth Line and Main Street Land

Milton Hydro's agreement to purchase 200 Chisholm Drive premises was subject to a condition in its favour calling for its purchase of additional lands adjacent to that property. However, prior to August 25, 2014, a determination was made that, without any additional lands, the 200 Chisholm Drive site will suit Milton Hydro for the next 25 years.[89]

This determination made the property at Fifth Line and Main Street redundant. Relying on an appraisal from Colliers International Realty Advisors Inc. dated August 5, 2015, Milton Hydro sold that property to its affiliate (Milton Energy & Generation Solutions Inc.[90]) for $2.4 million. This appraisal states, in the "Final Estimate of Value" section, that "Given the Subject's location, development potential , land use controls in place and other influencing factors of employment land sites, a rate [per acre] in the range of $400,000 and $450,000 would be reasonable for the Subject Parcel". The "Executive Summary" section of the appraisal ascribes a "Rate per Acre" of $425,000 to the land having an area of 6.43 acres.

The appraisal inexplicably presents a chart for values per acre ranging between $350,000 and $400,000 rather than the $400,000 to $450,000 already found to be reasonable. The value of $2.4 million that Milton Hydro has used to derive the capital gain realized on the sale of the land falls well below the $2.73 million value that results from multiplying the appraiser's $425,000 "Rate per Acre" by the area of the parcel consisting of 6.43 acres. At a sale value of $2.73 M, the capital gain is $505,950 and not the amount of $175,950 used by Milton Hydro for rate-making purposes.[91] Milton Hydro proposes to deduct 50% of its calculation of the gain of $175,950 or an amount of $87,975 from the 2016 base revenue requirement.[92]

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[88] Milton Hydro response to Undertaking J1.3.
[89] Relocation Update dated August 21, 2014, for August 25, 2014 board meeting, attached to Milton Hydro response to 1-SEC-14, p. 842 of 901.
[90] Exhibit 1, Attachment 1-3.
[91] Milton Hydro response to Interrogatory 4.0-Staff-63.
[92] The OEB estimates that a land and building rate base value around $880,000 would be required to generate a revenue requirement amount of about $88,000. The Milton Hydro proposal is the equivalent of a temporary rate base reduction of this amount.

Because Milton Hydro will be operating under the OEB's Price Cap Incentive Rate Making methodology for four years after 2016, the effect of Milton Hydro's proposal would be to provide ratepayers with the benefit of this reduction for five years. Milton Hydro relies on the benefit that this proposal confers on ratepayers as additional support for its argument that the OEB should disregard the cost consequences of excess office space and the use of inside storage as an equivalent for outside storage when resolving questions related to the 200 Chisholm Drive Issue.

A feature of Milton Hydro's proposed treatment of the capital gain on the sale of the Fifth Line and Main Street site is that all of the costs of excess office space and inside versus outside storage remain in rate base with return depreciation and PILs thereon being recovered from ratepayers. The revenue offset treatment of the capital gain proposed by Milton Hydro expires at the end of five years with the result that the amount then recoverable from ratepayers would automatically increase by $87,975.

Rate base disallowances for the costs of excess office space and the capital cost differential between inside and outside storage, instead of a temporary revenue requirement offset, protect ratepayers from having to pay, at any time, for any 200 Chisholm Drive outcomes that are of no value to them.

In its consideration of buy and build options at locations other than at the Fifth Line and Main Street, Milton Hydro reflected the entire proceeds of a sale of that land as a reduction to the total capital cost of the project at a different location.[93] This approach benefits ratepayers by treating the capital gain as a rate base reduction rather than as a revenue requirement offset. This approach is particularly appropriate where a new utility asset has been acquired to replace the utility asset that has been sold.

The disposition of a utility-related land asset in rate base would normally result in a reduction in the value of rate base in an amount equal to the price realized on the disposition of the asset.

A rate base reduction of the entire capital gain of about $506,000 would produce a revenue requirement reduction in the order of $37,000 compared to the $87,975 revenue requirement reduction that Milton Hydro proposes. Milton Hydro in essence proposes that the benefit of its treatment of the capital gain be reduced to a revenue requirement offset of $17,595 if any of the costs of 200 Chisholm Drive are found not to be recoverable from ratepayers.[94]

[93] See Relocation Committee Minutes, November14, 2012, attached to Milton Hydro response to 1-SEC-14, pp. 744-761 of 910 and, in particular, p. 756.
[94] Milton Hydro Reply Argument, April 28, 2016, p. 34.

C. SUBMISSIONS OF THE PARTIES

1. Milton Hydro

Milton Hydro asks the OEB to include in its 2016 rate base the full $14,460,000 of capital cost for the 200 Chisholm Road premises and the full $467,000 of building and property related OM&A costs in the 2016 cost of service and revenue requirement. If the OEB adjusts these requested amounts, then Milton Hydro effectively requests that its $87,975 revenue requirement offset be adjusted.[95]

2. OEB Staff and Intervenors

OEB staff and Intervenors contend that the building's total size of 91,800 square feet greatly exceeds Milton Hydro's reasonable office and operations space requirements. They contend that ratepayers should not be held responsible for excess building space for office and operations uses and the extent to which Milton Hydro's capital costs of inside storage exceed the capital costs of outside storage.

Intervenors also submit that ratepayers should not be responsible for the building and property related OM&A expenses related to any capacity that is excess of Milton Hydro's reasonable office and operations space requirements and for the capacity that is used as a substitute for inside storage.[96]

Further details of the submissions of the parties are contained in the OEB Findings related to the questions that the 200 Chisholm Drive Issue raises.

D. FINDINGS

1. Outcomes of No Value to Customers

The over-arching principle embedded in the OEB's performance based outcomes approach is whether what the utility is asking the OEB to approve produces outcomes that customers value.

The OEB finds that there are two outcomes of Milton Hydro's acquisition of the land and the renovation of the building at 200 Chisholm Drive that have no value to its customer. First, office space has been created that exceeds Milton Hydro's reasonable requirements over the planning horizon. Second, the incremental "premium" costs of

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95 *Ibid.*
96 See SEC Argument, April 19, 2016, p. 3.

more expensive indoor space for use as an equivalent to outside storage is similarly of no value to ratepayers.

2. Cheaper Total Project Capital Costs Do Not Displace the OEB's Consideration of the Cost Consequences of Valueless Outcomes

The OEB does not accept Milton Hydro's argument that the cost consequences of the outcomes that have no value for customers should be disregarded because total project capital costs for the 200 Chisholm Drive premises of $158 per square foot of building space are materially lower than the total project capital costs per square foot of building space incurred by other electricity distributors in the acquisition of land and the construction of their own office and operations facilities.[97]

Milton Hydro's argument is effectively a proposal that the OEB accept the creation of a new bundled total project capital cost per square foot of building space benchmark for use when considering utility proposals to own and construct their own office and operations facilities. The submission is that higher benchmark costs incurred by other utilities can be relied upon by an applicant utility to justify the cost consequences of outcomes that have no value to customers. The OEB rejects this proposal for several reasons.

First, the total project capital costs per square foot of building space benchmark that Milton Hydro proposes is an unreliable basis for comparing costs of the land acquisition and building projects of one utility to another. Bundling land, site development and building costs to calculate a cost per square foot of building space leads to results that are not comparable. For example, the land costs for 200 Chisholm Drive are for seven acres. The land costs for Waterloo North are for 24 acres.[98] The size of the land component in the benchmark proposed by Milton Hydro can significantly influence the utility-specific total project cost per square foot of building space calculation. Moreover, land costs per acre can significantly vary on the basis of location and market conditions prevailing at the time of purchase.

Similarly, the denominator in the calculation being the total square footage of the building constructed or purchased and renovated can materially distort the calculation. The square footage of the buildings in the sample of comparators that Milton Hydro relies on includes office and operations space only. However, the square footage that Milton Hydro uses in the calculation of its total project cost benchmark includes about 41,000 square feet of space that is excess to its reasonable office and operations requirements and was not renovated to provide office or operations services. Using

[97] Milton Hydro Reply Argument, April 28, 2016, p. 33.
[98] Exhibit K1.3, p. 7.

square footage that is supplemental to office and operations space in the calculation materially understates Milton Hydro's cost per square foot of renovated office and operations space.[99] The OEB finds that the total capital cost per square foot of building benchmark that Milton Hydro proposes is inappropriate.

For the same reasons, the OEB finds that the bundled benchmarking approach that OEB staff propose in their submission for the purpose of valuing the excess office space in 200 Chisholm Drive is inappropriate.

Third, simply said, ratepayers should only be expected to pay for things that are of demonstrable value to them. A utility's assessment of its needs has to start there. Mapping of expenditures to valuable outcomes should be at the core of a utility's planning process. This process should be clearly defined and articulated for that purpose. There should be no expectation that those expenditures that cannot be linked to a valuable outcome can be included in a revenue requirement.

For all of these reasons the OEB does not accept Milton Hydro's proposed "benchmark" approach.

3. Amount of Excess Office Space and Operations Space

Intervenors and OEB staff took different approaches to support their submissions on the amount of office and operations space in the 200 Chisholm Drive building that exceeds Milton Hydro's reasonable requirements over the planning horizon.

Using the area of the space that Milton Hydro had at Lawson Road for office and operations use as the point of departure, along with the size of offices, common areas, meeting rooms and board rooms at that location, SEC urges the OEB to find that 12,800 square feet of the 32,800 square feet of office space that Milton Hydro has created at 200 Chisholm Drive exceeds its reasonable requirements. SEC appears to accept that the 23,000 square feet of operations space at the new location is reasonable.[100]

OEB staff approached the excess space issue by considering the combined amount of office and operations space that is reasonably required to meet Milton Hydro's requirements. Using square foot per FTE metrics derived from the buildings of other electricity distributors being an average of 778 square feet per FTE and Milton Hydro's FTE count as of 2016 of 61.5, OEB staff submitted that Milton Hydro's reasonable office and operations space requirements should be found to be a total of about 47,800

[99] See Section 6.3.C subsection 4(b) where $220 per square foot is derived from numbers that Milton Hydro has provided.
[100] SEC Argument, April 8, 2016, p. 34

square feet.[101] This is about 8,000 square feet less than the 55,800 square feet of office and operations space that has been created at 200 Chisholm Drive.

In reply, Milton Hydro submitted that if the estimated FTE count of 69 projected for 2020 is used, then the OEB staff approach produces an office and operations area of about 53,682 square feet.[102] This is about 2,118 square feet less than the 55,800 square feet of office and operations space in the new premises.

The OEB finds that there is a total 6,800 square feet of office space at Chisholm Drive that exceeds Milton Hydro's reasonable requirements over the planning horizon. There are two components of this excess.

First, there is the 5,160 square feet of office space on the mezzanine which was left as raw and vacant space and closed in to comply with fire regulations. This space is obviously in excess of Milton Hydro's office space requirements.

Second, the OEB's finding that there is another 1,640 square feet of office space stems from the fact that throughout the entire planning process, which has spanned more than four years, Milton Hydro has quantified is office space requirements at 26,000 square feet. In these circumstances, the OEB finds that there was no reasonable basis for creating 27,640 square feet of renovated office space (an increase of 1,640 square feet above the 26,000 square foot requirements calculation) and holding another 5,160 square feet of raw space for future office use.

The OEB finds that Milton Hydro's creation of 23,000 square feet of operations space at 200 Chisholm Drive is reasonable. There is no excess operations space.

4. Capital Cost Consequences of Excess Office Space

(a) Un-renovated Area of 5,160 Square Feet

The OEB finds that the capital cost consequences of the 5,160 square feet of excess office space that was not renovated should be determined essentially as proposed by Milton Hydro in Undertaking response J2.2 along with the separately filed spreadsheet, subject to the following adjustments.

First, the rate base amount of $332,663 for the un-renovated space should be increased to $343,308 to align that amount with 5,160 square feet of space rather than the 5,000 square feet used in the Undertaking response. Second, for the reasons outlined in subsection 8, this rate base value (which includes the full cost of the land at 200 Chisholm Drive) should be reduced by the proportion of the capital gain of about

[101] OEB staff Argument, April 8, 2016, p. 20.
[102] Milton Hydro Reply Argument, April 28, 2016, p. 33.

$506,000 related to the sale of the property at the Fifth Line and Main Street. The reduction amount is 5.6% of $506,000 or $28,336 and the net rate base value for the excess un-renovated office space area is $314,972. Third, the amortization rate used in the calculation should be compatible with the weighted amortization rate in the Application materials related to the building purchase and renovation costs. The PILs should be calculated in the same manner shown in the spreadsheet filed with the response to Undertaking J2.2.

(b) Renovated Area of 1,640 Square Feet

The OEB finds that the rate base value of the 1,640 square feet of excess office space that has been renovated is about $360,800. This amount has been calculated by multiplying the 1,640 square feet of excess renovated office space by $220 per square foot which is the approximate cost of the 27,640 square feet of office space that was created. There is no land value in this amount.

The $220 amount stems from the information presented by Milton Hydro in Exhibit K1.3.[103] Total office renovation costs are $5,062,000. The 27,640 square feet of renovated office space comprises about 30% of the total 91,800 square foot building. The cost of the building was $3,390,000 of which 30% or $1,021,000 is allocable to the renovated office space. The total costs for the renovated office space are about $6,079,000 or about $219.93 per square foot or about $220.

(c) Total Rate Base Value of Excess Office Space

The OEB finds that the total rate base value of excess office space is about $675,722, being the sum of the rate base values of the un-renovated and renovated office space of $314,972 and $360,800, respectively.

5. Capital Cost Consequences of the Use of Inside Storage as an Outside Storage Equivalent

In response to Undertaking J1.3 (amended), Milton Hydro calculated the capital cost “premium” differential between inside and outside storage to be $20.93 per square foot. For the 36,000 square feet of inside storage being used as the equivalent of outside storage, this equates to a rate base value of $753,480. The OEB finds that this capital cost differential amount is of no value to Milton Hydro’s customers.

[103] Exhibit K1.3, pp. 5 and 14.

6. OM&A Costs Related to Excess Office Space

Intervenors submit that portions of the OM&A costs related to the land and building at 200 Chisholm Drive that can be linked to the excess office space and the use of inside storage as an equivalent to outside storage should not be recoverable from ratepayers.[104]

In the response to Undertaking J2.2 and in its Reply Argument,[105] Milton Hydro effectively acknowledges that the OM&A costs for property taxes, gas and electricity should be included in the revenue requirement related to the 5,160 square feet of un-renovated office space. The OEB agrees and finds that these OM&A costs for excess office space should not be recoverable from ratepayers.

Having regard to the updated information provided by Milton Hydro in response to Undertaking J1.3, the OEB finds that gas and electricity expenses for the entire building total about $160,400. Property taxes for 2016 are about $120,000.[106] The total for these items of expense is $280,400. The 5,160 square feet of excess and un-renovated office space comprises about 5.6% of the total building. The OEB finds that areas within the building classified as office space should attract a full proportionate allocation of property taxes, gas and electricity costs being the result that would ensue if the office space was leased to a third party. Accordingly, the OM&A costs for property taxes, gas and electricity attributable to this un-renovated office space are about $15,700.

Since there is a total of 6,800 square feet of excess office space in the building, the appropriate disallowance for OM&A costs related to excess office space is about $20,700.[107]

The OEB rounds this number down and finds that $20,000 of OM&A costs related to excess storage should not be recoverable from ratepayers.

7. OM&A Costs related to the Use of Inside Storage as an Equivalent to Outside Storage

VECC submitted that a portion of OM&A costs linked to the use of 36,000 square feet of inside storage as outside storage should not be recoverable from ratepayers.[108] VECC was supported by the other Intervenors.

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[104] See VECC Argument, April 25, 2016, p. 9.
[105] Milton Hydro Reply Argument, April 28, 2016, p. 34.
[106] See Exhibit K2.2, p. 2.
[107] 6,800 sq. ft. divided by 5,160 sq. ft. x $15,700 = $20,689.
[108] VECC Argument, April 15, 2016, p. 9.

The OEB recognizes that the part of the building that is used as the equivalent of outside storage may not consume as much gas and electricity as is consumed in the areas classified as office space. The storage space comprises 39% of the total building. At best, the only amounts that might be considered for disallowance are the amounts for gas and electricity costs reasonably attributable to the 36,000 square feet of storage space. Property taxes related to this space are properly recoverable from ratepayers. A 39% proportion of total gas and electricity costs of $160,400 is $62,556. Taking into account the probability that gas and electricity consumption in this part of the building is less than in the areas classified as office space, the OEB finds that $30,000 of OM&A costs related to the use of the building as an equivalent to outside storage should not be recoverable from ratepayers.

8. Regulatory Treatment for the Capital Gain on the Sale of the Fifth Line and Main Street Property

The OEB finds that the questions of the value of the Fifth Line and Main Street property at the time of its sale and the appropriate regulatory treatment of the capital gain realized on that sale are questions that fall within the ambit of the unresolved 200 Chisholm Drive Issue. These questions are items that relate to a determination of the net capital costs to be allowed in rate base for the land at 200 Chisholm Drive. In the Settlement Proposal,[109] the parties agreed that items of cost linked to the Chisholm Drive Issue would be subject to adjustment.

With respect to the first question, the OEB finds that, for rate-making purposes, the appraisal evidence supports a sale value of $2.73 million for the 6.43 acre parcel rather than the $2.4 million amount presented by Milton Hydro. This sale value is derived by multiplying the $425,000 per acre mid-point of the value range, as determined by the appraiser, by the land area of 6.43 acres. The OEB finds that the capital gain realized on the sale is $505,950 and not the $175,950 calculated by Milton Hydro.

With respect to second question pertaining to the appropriate regulatory treatment of that capital gain, the OEB finds that the Fifth Line and Main Street property was purchased in 2009 for eventual use as the site for Milton Hydro’s office and operations centre. The property at 200 Chisholm Drive is essentially a substitute for and replaces the Fifth Line and Main Street property.

Milton Hydro proposes that 50% of its calculation of the amount of the capital gain be credited to ratepayers as a revenue requirement offset. The proposal is premised on OEB approval for recovery in rates of all costs related to the 200 Chisholm Drive premises. Under Milton Hydro’s proposal, the revenue requirement offset benefit to

[109] Settlement Proposal, February 9, 2016, p. 9.

ratepayers is temporary. The benefit expires at the end of 2020. At that time, Milton Hydro's rates would automatically increase by the amount of the offset. Moreover, throughout 2016-2020 and beyond, ratepayers would be paying return, depreciation and taxes related to excess office space costs and the capital cost differential between inside and outside storage, which the OEB has found to be of no value to Milton Hydro's customers.

While Milton Hydro's proposal does provide ratepayers with a significant benefit, that benefit is inappropriately temporary. OEB approval of the benefit would inappropriately require ratepayers, from 2016 onwards, to pay rates that include costs that have been found to be of no value to them. The OEB does not accept the revenue requirement offset benefit that Milton Hydro proposes. The OEB finds that the $87,975 revenue requirement reduction is to be reversed and eliminated.

In this case, where Milton Hydro's purchase of the 200 Chisholm Drive property effectively replaces the Fifth Line and Main Street property, the OEB finds that the appropriate regulatory treatment for the capital gain is to record the entire amount of the gain of almost $506,000 as a credit or reduction to the rate base value of the land at 200 Chisholm Drive. This regulatory treatment is most appropriate where one parcel of property acquired for future use is replaced with another. The appropriateness of this approach is reinforced by the fact that this is the way Milton Hydro treated the capital gain on an assumed sale of the Fifth Line and Main Street property in its internal presentations of own and build options that involved land other than that at Fifth Line and Main Street.[110] Treating the entire capital gain as a rate base deduction rather than a revenue offset should produce a revenue requirement reduction of about $37,000.

The net effect of the foregoing adjustments is to reduce the revenue requirement reduction related to the capital gain to an amount more than the amount of $17,595 suggested by Milton Hydro in its Reply Argument but less than the $87,950 revenue offset that it proposed.[111] The OEB finds that it would be manifestly unfair to Milton Hydro to allow ratepayers to benefit from the combined effect of almost $1.935 million of rate base disallowances related to 200 Chisholm Drive and the $87,975 revenue requirement offset proposed by the utility.

The OEB's principled approach to the Chisholm Drive Issue achieves an outcome that permanently precludes the recovery from ratepayers of costs incurred that have been found to be of no value to customers. The benefit to ratepayers of these OEB's findings will prevail from 2016 to 2020 and beyond.

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[110] Relocation Committee Meeting Slides, November 14, 2012, attached to Milton Hydro response to 1-SEC-14 – see table at p. 756 of 910.
[111] Milton Hydro Reply Argument, April 28, 2016, p. 34.

This regulatory treatment of the $506,000 capital gain operates to reduce the Milton Hydro's proposed rate base value for the un-renovated office space component of the 6,800 square feet of excess office space by a total of $28,336 as described in subsection 4 above.

9. Accumulated Depreciation

The foregoing disallowed rate base values are gross value amounts. They do not reflect any depreciation thereon recorded by Milton Hydro in 2014 and 2015. The building at 200 Chisholm Drive was purchased in the last half of 2014. Renovations were made between the possession date and the end of 2015.

The depreciation rate that Milton Hydro used in its Undertaking response J2.2 was 2% per annum. The OEB has used that rate to derive its estimate of the accumulated depreciation at December 31, 2015 related to the depreciable components of the total of the 200 Chisholm Drive rate base disallowances in the amount of about $1.935 million. The depreciable components of the rate base disallowances total about $1,405,426, being $291,146 for the un-renovated mezzanine space, $360,800 for the renovated office space and $753,480 for the inside storage space premium.

After taking into account the half-year rule for 2014, the OEB estimates accumulated depreciation related to these disallowed building assets acquired in September 2014 to be 1% of the building value attributable to the 6,800 square feet of office space being a value of $479,905 for 2014 depreciation and accumulated depreciation at December 31, 2014 of $4,799. For 2015, the OEB estimates depreciation to be 2% of $1,405,426, being an amount of $28,108 for total accumulated depreciation at December 31, 2015 of $32,907 or about $33,000.

The adjustment for accumulated depreciation will increase Milton Hydro's opening 2016 rate base by about $33,000.

10. Summary of Disallowances and Adjustments Related to 200 Chisholm Drive

By way of summary, the disallowances and other adjustments related to the 200 Chisholm Drive Issue are as follows:

(i) For the capital gain realized on the sale of the property at the Fifth Line and Main Street – a rate base reduction of about $506,000;

(ii) For 6,800 square feet of excess office space – a rate base reduction of $675,722;

(iii) For the capital cost differential between inside and outside storage – a rate base reduction of $753,480;

(iv) The reversal and elimination of the revenue requirement offset of $87,975;

(v) For OM&A cost reductions related to excess office space and the use of building space as the equivalent of outside storage – a total amount of $50,000 included in the $550,000 OM&A expenses disallowance found in Section 6.2 of this Decision and Order; and

(vi) For the reversal of accumulated depreciation amounts at December 31, 2015 related to the depreciable components of disallowed rate base items – a total amount of $33,000. Rate base for 2016 will increase by this amount.

7 FORGONE REVENUE RECOVERY

In its original application, Milton Hydro requested a May 1, 2016 implementation of its new distribution rates. At that time, Milton Hydro also requested that, in the event the OEB were unable to issue a decision on the application by May 1, 2016, the OEB declare Milton Hydro's current rates interim from May 1, 2016 until the issuance of a final rate order.

On April 29, 2016, the OEB issued an interim rate order declaring Milton Hydro's current approved distribution rates interim as of May 1, 2016 and until such time as the OEB issues a final rate order.

The OEB has determined that the effective date for rates in this Decision is May 1, 2016, with an expected implementation date of September 1, 2016. Therefore, Milton Hydro is directed to calculate, as part of its draft Rate Order, the forgone revenues/credits to customers for this period and to propose an appropriate method for either recovering from or crediting these amounts to ratepayers over the remainder of the 2016-2017 rate year.

8 IMPLEMENTATION AND ORDER

The OEB directs Milton Hydro to file a Draft Rate Order reflecting the OEB's findings in this Decision, complete with detailed supporting material, including:

- all relevant calculations showing the determination of the revenue requirement for 2016
- a schedule (or schedules) clearly showing the allocation of the revenue requirements from this Decision to the customer classes for 2016
- a schedule (or schedules) clearly showing the calculation of the forgone revenue/credit rate rider regarding the May 1, 2016 to September 1, 2016 period
- a schedule of final rates and all approved rate riders, including bill impacts for all rate classes, and a calculation showing reconciliation of the total revenues by class to the revenue requirements
- any other documentation that would assist Intervenors, OEB staff and the OEB in their consideration of the proposed Draft Rate Order.

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Milton Hydro shall file with the OEB, and forward to all intervenors, a Draft Rate Order that includes all items listed above, including revised models in Microsoft Excel format as appropriate and a proposed Tariff of Rates and Charges reflecting the OEB's findings no later than **August 9, 2016**.

2. OEB staff and intervenors shall file any comments on the Draft Rate Order with the OEB with Milton Hydro no later than **August 15, 2016**.

3. Milton Hydro shall file with the OEB, and forward to intervenors, responses to any comments on its Draft Rate Order no later than **August 19, 2016**.

All filings to the OEB must quote the file number, **EB-2015-0089**, be made through the OEB's web portal at https://www.pes.ontarioenergyboard.ca/eservice/, and consist of two paper copies and one electronic copy in searchable / unrestricted PDF format. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at http://www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available, parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file seven paper copies.

DATED at Toronto July 28, 2016

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary