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BY E-MAIL

September 22, 2016

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto, ON M4P 1E4

Dear Ms. Walli:

**Re: Milton Hydro Distribution Inc.
Notice of Motion to Review and Vary the EB-2015-0089 Decision of the OEB
(2016 Distribution Rate Application)
Board File Number EB-2016-0255**

In accordance with Procedural Order No. 1, OEB staff is providing its submission on the Milton Hydro Motion to Review and Vary.

Yours truly,

Original Signed By

Harold Thiessen
Ontario Energy Board staff
Case Manager – EB-2016-0255

Milton Hydro Distribution Inc.

**Notice of Motion to Review and Vary the
EB-2015-0089 Decision of the Ontario Energy
Board
(2016 Distribution Rate Application)**

EB-2016-0255

OEB Staff Submission

September 22, 2016

Background

In this motion, Milton Hydro Distribution Inc. (Milton Hydro) asks the Ontario Energy Board (OEB) to review and vary its July 28, 2016 Decision and Order (the Decision) in respect of Milton Hydro's application for electricity rates beginning May 1, 2016 (EB-2015-0089).

In the Decision, the OEB disallowed a number of expenses in relation to Milton Hydro's operation, maintenance and administration budget and Milton Hydro's purchase and renovation of a new headquarters and operations centre. Milton Hydro's motion relates only to one aspect of the Decision, namely the OEB's treatment of Milton Hydro's sale of a piece of land at Fifth Line and Main Street in the Town of Milton.

In particular, Milton Hydro challenges:

- (a) the OEB's decision to deem the sale price of the Fifth and Main property to be \$2.73 million instead of the \$2.4 million presented in Milton Hydro's application;
- (b) the OEB's determination that 100% of the capital gain on the Fifth and Main property should be returned to ratepayers, even though only 50% of the property had been in rate base; and
- (c) the OEB's decision to apply the capital gain on the Fifth and Main property as a reduction to rate base rather than as a one-time revenue requirement offset.

For the reasons below, OEB staff supports the first element of Milton Hydro's motion but not the latter two. In light of the new evidence filed by Milton Hydro concerning the independent appraisal of Fifth and Main, OEB staff agrees with Milton Hydro that the correct valuation is \$2.4 million. However, in OEB staff's view, Milton Hydro has not shown that the OEB's regulatory treatment of the capital gain (encompassed by the second and third elements above) was incorrect.

The Valuation of Fifth and Main

In the Decision, the OEB recounted the history of the Fifth and Main property. In brief, Milton Hydro purchased the property in 2009¹ from the Town of Milton for \$2,218,530,

¹ Although Milton Hydro said in its application and again in its motion materials that it purchased Fifth and Main in 2008, the OEB notes at p. 38 of the Decision that it was actually 2009. Nothing in Milton Hydro's motion turns on this.

with a view eventually to building its headquarters and operations centre there. The plan ran into difficulties, so Milton Hydro decided instead to purchase and renovate a building at 200 Chisholm Drive. No longer needing Fifth and Main, Milton Hydro sold it in 2015 to an affiliate, Milton Energy & Generation Solutions Inc., for the appraised value of \$2.4 million.

In the Decision, the OEB parsed the appraisal prepared by Colliers International Realty Advisors Inc. (Colliers) and noted a discrepancy between Colliers' conclusion in the "Executive Summary" section that the "rate per acre" of the 6.43 acre property was \$425,000 (the mid-point of the \$400,000 to \$450,000 range determined to be appropriate) and its ultimate opinion that the total value was \$2.4 million. The OEB found that the total value should have been \$2.73 million, which is 6.43 acres multiplied by \$425,000. At that sale price, the capital gain would have been \$505,950, not \$175,950 as presented by Milton Hydro in its application.

In its motion materials, Milton Hydro submits that the discrepancy was the result of "typographical errors" in the appraisal. Colliers meant to say that the rate per acre was \$375,000 per acre, the mid-point between \$350,000 and \$400,000. Milton Hydro has included a "corrected" appraisal from Colliers attesting that the right value was \$2.4 million all along.

In OEB staff's submission, although the inconsistencies in the original Colliers report were regrettable, there is no reason to doubt Colliers' explanation that it was the rate per acre and not the final appraisal amount that was wrong. Moreover, although a utility is responsible for ensuring that the evidence filed in support of a rate application is accurate, Milton Hydro is correct when it says that no one disputed the appraised value or pointed out the inconsistencies during the application process. Milton Hydro never had the opportunity, until now, to provide an explanation.

In light of the new information provided by Colliers, OEB staff agrees with Milton Hydro's characterization of the OEB's determination that the original \$2.4 million appraisal understated the value of the property as an "error in fact". Under Rule 42.01 of the OEB's *Rules of Practice and Procedure*, an error in fact is grounds for varying a decision. It was Milton Hydro's responsibility to ensure its evidence was accurate. Milton Hydro's failure to do so is the reason for this error. Nevertheless, OEB staff submits it would be appropriate in this case for the OEB to vary the Decision to reflect the correct \$2.4 million valuation and the corollary capital gain of \$175,950.

The Return of 100% of the Capital Gain to Ratepayers

As the OEB noted in the Decision, in Milton Hydro's previous cost of service application, the parties agreed (and the OEB accepted) that only 50% of the cost of acquiring the Fifth and Main property would be included in rate base, because only half of the value of the property would be used and useful in the 2011 test year. (Only part of the property was being used for the benefit of ratepayers, for outside storage.)

In its application for 2016 rates, Milton Hydro proposed that 50% of the capital gain be returned to ratepayers, to align with the 50% of the property that was in rate base. The OEB decided instead to apply the entire amount of the capital gain as a reduction to Milton Hydro's rate base for the new property at 200 Chisholm Drive. The key paragraph reads:

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. 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. [Emphasis added.]²

Milton Hydro argues on page 9 of its motion that "This fact [that only 50% of Fifth and Main was in rate base] was not adverted to by the Board in its analysis of the appropriate percentage of capital gain on the property to be attributed to ratepayers."

In OEB staff's submission, the OEB was well aware of that fact. It is specifically mentioned on p. 39 of the Decision, and there is nothing to suggest that the OEB did not fully appreciate that Milton Hydro's proposal to return only 50% of the capital gain to ratepayers was premised on it. The OEB dealt squarely with the merits of returning 50% versus 100% in its discussion leading up to and including the paragraph reproduced above. There was therefore no error in fact as asserted by Milton Hydro, and no reason for the OEB to vary this part of the Decision.

² Decision, p. 55 (footnotes omitted). For the reasons above, in OEB staff's view, the "entire amount of the gain" is actually \$175,950, not \$506,000, and the revenue requirement reduction would be significantly less than the \$37,000 estimated in the Decision (in its Notice of Motion, Milton Hydro puts the revenue requirement reduction associated with the \$506,000 capital gain at \$39,400).

OEB staff would add that, in assessing Milton Hydro's proposal to credit only 50% of the capital gain on the Fifth and Main property to ratepayers, the OEB was engaged in a highly discretionary exercise.³ It was required to balance the interests of Milton Hydro with the interests of the ratepayers, with a view ultimately to arriving at just and reasonable rates. While reasonable people may disagree about the precise proportion of the gain that ought to have been credited to ratepayers, it is OEB staff's submission that the OEB's finding to credit the full 100% was within the range of reasonable outcomes.

Finally, OEB staff notes that the rate impact of this issue is immaterial. If the OEB accepts the revised Colliers appraisal, this becomes a dispute over \$87,975 (that is, half of the \$175,950 capital gain). That is below the \$90,000 materiality threshold used by Milton Hydro in its application.⁴

Reimbursing Ratepayers through a Rate Base Reduction Rather than a Revenue Offset

Milton Hydro argues that as a result of the Decision, it will effectively be paying its customers \$39,400 a year (that is, the revenue requirement impact of the \$506,000 capital gain) "in perpetuity", even after the full \$506,000 has been repaid. In other words, the 200 Chisholm Drive property will be permanently impaired, long after ratepayers have been made whole for their contribution to Fifth and Main. Instead, Milton Hydro says, the capital gain should have been returned through a one-time revenue offset; that approach would have been consistent with prior OEB decisions and the OEB's *Accounting Procedures Handbook for Electricity Distributors* (the APH).

In OEB staff's submission, while there is some merit in this argument, Milton Hydro has not demonstrated that the OEB made an error.

It is evident from the Decision that the OEB turned its mind to the question of whether the capital gain should be applied as an offset or a permanent reduction to rate base. It determined that, in the circumstances of this case, a rate base reduction was preferable. It explained: "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

³ See *Toronto Hydro-Electric System Ltd. v. Ontario Energy Board*, [2009] 252 OAC 188 (Divisional Court), in particular para. 32.

⁴ EB-2015-0089, Exhibit 1, p. 96 of 108. Milton Hydro explained that it used a materiality threshold of \$90,000 even though the OEB's filing requirements supported a threshold of \$86,037 (0.5% of distribution revenue requirement).

asset that has been sold.”⁵ A related reason provided by the OEB for adopting the rate base reduction approach was that Milton Hydro’s proposed offset was “inappropriately temporary” in that the benefit to ratepayers would expire at the end of the rate period.⁶

In OEB staff’s submission, it was open to the OEB to treat Fifth and Main as an exception to the usual approach for dealing with the proceeds of the sale of unused real estate. When considering a rate application, the OEB is not bound by the APH. In any case, although the APH suggests that capital gains are part of income, it contemplates that the OEB may review a distributor’s accounting treatment of a capital gain in a rate application and adopt an alternative approach if appropriate.⁷ Nor is the OEB bound by its previous decisions: the *stare decisis* rule does not apply to administrative tribunals. For that reason, Milton Hydro’s concern about “regulatory consistency” is not in itself a reason to vary the Decision. As the OEB held in dismissing a motion by Veridian Connections Inc. to review a rate decision, although “consistency in decision making is good regulatory practice as it promotes stability, predictability and fairness”, inconsistency with past decisions is not a reviewable error:

The Board concludes that a lack of regulatory consistency cannot be an error, because if it were, then a future panel’s discretion would be bound by the prior decision. This is wholly inappropriate. While a panel should endeavour to consider other similar cases and the associated decisions, no prior decision of the Board can fetter the discretion of a later panel. Further, any enquiry into regulatory

⁵ Decision, p. 47.

⁶ Decision, p. 55. Note that under Milton Hydro’s proposal, the \$87,975 offset would have applied in each of the five years of the rate period, meaning that ratepayers would have recovered what Milton Hydro considered their share of the capital gain five times over. In this sense, Milton Hydro’s proposal was itself a departure from the usual approach. In fact Milton Hydro now proposes at p. 11 of its Notice of Motion that if the gain was \$87,975, the offset be \$17,595 in each year of the five-year period.

⁷ Under the APH, capital gains are captured by Account 4355 (Gain on Disposition of Utility and Other Property). Account 4355 is an income statement account, not a balance sheet account, which means that it is normally treated as a revenue offset rather than an adjustment to assets. (See also Appendix A to the 2006 *Electricity Rates Distribution Handbook* which classified Account 4355 as “Other Income and Deductions”, which were part of the revenue offsets to the service revenue requirement to make up the base revenue requirement.) However, the OEB may review the accounting treatment applied by the distributor and adopt a different treatment. Article 230 of the APH says that, “Unless otherwise ordered by the Board, the difference, if any, between (1) the net amount of debits and credits and (2) the consideration received for the property (less commissions and other expenses of making the sale) shall be included in Account 4355, Gain on Disposition of Property, or Account 4360, Loss on Disposition of Property” (emphasis added). And Article 410 provides that, where a distributor has recorded a gain or loss on the disposition of an asset, “The Board may require the difference between net carrying amount and the proceeds and disposal/retirement costs on disposal of property, plant and equipment or intangible assets to be considered in the determination of future rates charged to customers....” In summary, in considering whether to defer or expense gains or losses on derecognition, disposal, retirement or impairment of capital assets, a distributor needs to determine whether these gains or losses are to be recovered from future rates. In general, gains or losses should be deferred if they will be included in future rates. However, the Board reserves the right to review the accounting treatment applied and recommend different accounting treatment if deemed appropriate” (emphasis added).

consistency would result in a potentially complex analysis. For example, the Board would need to consider and potentially determine which decision, from amongst a set of decisions, is the “correct” decision which in turn forms the standard against which others are measured for consistency.⁸

In summary, OEB staff submits that the OEB’s decision to treat the Fifth and Main proceeds differently than such proceeds are normally treated was not an error. It was within the OEB’s discretion, as part of its balancing of interests in setting just and reasonable rates, to apply the Fifth and Main capital gain as a reduction to rate base rather than as an offset to revenue requirement.

In making this submission, OEB staff does not want to be understood as questioning or undermining the usual treatment. One of the benefits of the usual treatment is that it provides a utility with greater flexibility to change its plans: if a permanent reduction to rate base were the norm, a utility might be reluctant to replace sub-optimal real property with real property that would be better aligned with its needs and the needs of its ratepayers.

All of which is respectfully submitted.

⁸ EB-2012-0201, Decision and Order on Motion to Review, June 14, 2012, pp. 8 and 9.