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BY EMAIL and RESS

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Our File: EB20190022

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Christine Long, Registrar & Board Secretary

Dear Ms. Long:

Re: EB-2019-0022 – BPI/Energy+ 2020 ICM – SEC Submission

We are counsel to the School Energy Coalition ("SEC"). Pursuant to Procedural Order No. 2, these are SEC's submissions on the applications by Brantford Power Inc. ("BPI") and Energy+ Inc. ("Energy+") for approval for Incremental Capital Modules ("ICM") related to each of their portions of a proposed new shared facility located on Savannah Oak Dr. in Brantford (the "Savannah Oak Facility").

As a preliminary matter, SEC submits that it does not appear Energy+ is eligible for an ICM, since for regulatory purposes its cost is not properly a capital expense. Energy+ is seeking to include capitalized calculation of future lease payments under its lease with BPI for use of the Savannah Oak Facility as an ICM. While it appears Energy+ may capitalize a portion of the lease under accounting rules that does not mean that it should be allowed to do so for regulatory purposes.

SEC concludes that the evidence demonstrates that the proposed new shared Savannah Oak Facility meets the need, materiality, and prudence criteria for an ICM for BPI.[1]

If the Board disagrees with SEC's position on eligibility for Energy+, then in the alternative, while the project meets the need criteria for Energy+, there still remain concerns regarding its prudence.

Additionally, SEC has some concerns regarding certain adjustments to the proposed requests so that both utilities' customers are treated fairly and are not overpaying.

Background

BPI and Energy+ have brought forward individual applications for ICMs for their portion of a Savannah Oak Facility. This new Savannah Oak Facility will be owned by BPI and serve as its new administration

[1] The test for an ICM is outlined in *the Report of the Board – New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, EB-2014-0219, September 18, 2014, p.17

and operations centre. Energy+ will lease a portion of the facility and use its portion of the facility primarily as an operations centre to serve its customers in its Brant County service territory.[2]

Based on the most recent cost estimate filed as an update to B-Staff-20, the total cost of the facility is $26.8M, to be allocated between BPI, Energy+, an affiliate of BPI, and a fourth tenant, who has not been identified yet.[3]

Savannah Oak Facility		
Tenant	**Square Feet**	**Cost**
BPI	71,539	$14,378,438
Energy+	29,558	$8,352,524
BPI Affiliate	5,235	$634,407
4th Tenant	28,415	$3,443,157
Facility Total	***134,747***	***$26,808,526***
Source: B-Staff-20 (Update)		

BPI is seeking approval for an ICM of $15,028,188, which includes its allocation of the building costs and $649,750 in furniture, fixtures and equipment.[4] Energy+ is seeking approval for an ICM of $3,557,067, which represents the portion of its share of the Savannah Oak Facility where it has exclusive use.[5] The rationale for only including this portion in its ICM is that, under accounting rules regarding capital leases, Energy+ is only allowed to capitalize space that is in exclusive use and not costs for shared space.[6]

<u>Energy+ Eligibility</u>

SEC submits that Energy+ is not eligible for an ICM, as it should not be allowed for regulatory purposes to capitalize any portion of the lease. SEC understands that under IFRS 16, for general accounting purposes, an entity must capitalize a lease, or portions of one, where it has exclusive use.[7] IFRS 16 is intended to ensure that there is a full balance sheet disclosure of future obligations under certain types of leases.[8] Capitalization of spending for regulatory purposes is conceptually different. For regulatory purposes, capitalization represents recognition of a cash investment on which the regulated entity will incur costs of capital and PILs.

Under Energy+' proposed approach, it will earn a return on this net present value of future payments as it would with any other capital investment. The ICM, in fact, is structured to mimic exactly that. The problem is that this is not an actual capital investment. No capital investment is actually being incurred, there is nothing to finance, and there is no reason that Energy+ should be compensated for cost of capital. It has no cost of capital.

Further, Energy+ does not own the property and has no claim to it after the expiry of the lease. If at some point in the future BPI proposes to sell the property, the proceeds of sale of the building, and gains on the land, do not flow to Energy+ for the benefit of its ratepayers, as would normally be the

[2] Brantford Power Inc., 2020 IRM Application, p.24
[3] B-Staff-20 (Updated)
[4] *Ibid*
[5] See Energy+ Updated IRM Model filed on December 1, 2019.
[6] Energy+ Inc., 2020 IRM Application, p.45-46
[7] *Ibid*; E-Staff-15; E-Staff-60
[8] https://www.ifrs.org/-/media/project/leases/ifrs/published-documents/ifrs16-effects-analysis.pdf

case. Nothing in the memorandum of understanding with BPI states that Energy+ has a claim on those gains during or after the lease has expired.[9]

SEC also notes that the accounting treatment may result in an over collecting from customers by way of a difference in tax treatments. One would expect that the lease payments are deductible in computing the Energy+ taxable income. If for regulatory purposes it is treated as a capital asset that would include PILs, thus over collecting from customers.

The broader implication of allowing leases to be capitalized is that it provides a new avenue for utilities to seek ICM treatment from increased spending during IRM. Any time a utility moves to a new facility that it may lease, they would be eligible for ICM treatment for most, if not all, of the new facility. This was not the intent of the Board's various ICM policies, which are intended to fund actual capital investments that the utility will own.

SEC submits the entire lease should be treated as an OM&A expense for regulatory purposes and is therefore not recoverable through an ICM.

If the Board disagrees, SEC in the alternative provides submissions on how Energy+ meets the Board's ICM criteria.

ICM Criteria - BPI

Need. BPI currently operates from three separate facilities across Brantford through leases with the City of Brantford, part of a shared services agreement.[10] BPI has been advised that the City of Brantford will not renew the shared services agreement and BPI is required to vacate all facilities by the end of 2022. SEC submits that on this basis BPI has met the need requirement for a solution to its administration and operations requirements. As noted below, the choice of a new facility, as opposed to other options, has been the subject of an extensive due diligence process.

Materiality. SEC agrees that the BPI ICM request related to the Savannah Oak Facility meets both the materiality tests, as BPI has surpassed the threshold value set by the Board's ICM, and the BPI portion meets the project materiality threshold.

Prudence. A review of the evidence demonstrates that the Savannah Oak Facility is a prudent choice to meet the needs of BPI.

SEC notes that BPI has done a significant amount of due diligence to determine the most cost-effective option. Over a number of years, it has done a comprehensive review of the choices available to it, and has been willing to change approaches as opportunities arose to save money. BPI (and Energy+) at first planned to construct a greenfield facility to share on Garden Ave.[11] BPI had already purchased the land and gone out to tender on construction of the new building. That tender was unsuccessful due to the cap BPI placed on the bid price.[12]

At the same time, Savannah Oak Facility property went on the market. BPI had previously considered the property. Due to the cost of constructing the Garden Ave. facility, BPI determined that the

[9] Energy+ Inc., 2020 IRM Application, App. F, Exhibit II, Memorandum of Understanding
[10] Brantford Power Inc., 2020 IRM Application, IRM Attachment A, p.13-14
[11] *Ibid*, p.21
[12] *Ibid*, p.22

Savannah Oak Facility property, which included an existing building that would only need renovating, was the most cost-effective solution for both itself and Energy+.[13]

SEC also commends BPI for right-sizing the facility by making unneeded space available to be rented to its affiliate and a fourth tenant, and that upfront the allocated space is not included in the amounts to be recovered from ratepayers. Allocating the risk to BPI to rent out the additional space is the appropriate approach.

The benchmarking analysis provided in the BPI Application compared the proposed costs to other new facilities approved by the Board in recent applications, updated for the revised Class C estimate and design, on a cost per square foot basis.[14] The information of other facilities compares from BPI's evidence.[15] BPI's forecast cost per square foot is $200.99 per square foot compared to the average of the comparator facilities on an inflation adjusted basis of $274.

	Savannah Oak Facility			Comparator Facilities						
	BPI (ICM Proposed)	Energy+ (ICM Proposed)	Energy+ (Full Cost)	Milton Hydro	Waterloo North	InnPower	PUC Hydro	Energy+ (Southworks)	Enersource	Powerstream
Year of Occupancy	2020	2020	2020	2015	2011	2015	2011	2022	2012	2008
Function	Admin & Ops	Ops	Ops	Admin & Ops	Admin & Ops	Admin & Ops	Admin & Ops	Admin	Admin & Ops	Admin & Ops
Type	Purchase/ Refubish	Lease	Lease	Purchase/ Refubish	Custom Build	Custom Build	Custom Build	Purchase/ Refubish	Purchase/ Refubish	New Build
Capital Cost (App by OEB)	$14,378,438	$3,557,067	$8,352,524	$ 12,557,798	$25,882,961.00	$10,896,704	$22,916,497	$6,567,000	$18,000,000	$27,700,000
Capital Cost (App by OEB) inflation adj	$14,378,438	$3,557,067	$8,352,524	$ 13,688,635	$30,211,282.00	$11,877,959	$25,811,280	$6,567,000	$20,598,117	$33,178,279
Square Footage	71,539	15,679	29,558	91,828	105,000	36,172	110,382	21,892	79,000	92,000
Capital Cost/Square Foot	*$200.99*	*$226.87*	*$282.58*	*$136.75*	*$246.50*	*$301.25*	*$207.61*	*$299.97*	*$227.85*	*$301.09*
Cost (inflation adj)/Square Foot	*$200.99*	*$226.87*	*$282.58*	*$149.07*	*$287.73*	*$328.37*	*$233.84*	*$299.97*	*$260.74*	*$360.63*
Source: BPI Application, p.25; B-Staff-20 (Updated)										

ICM Criteria – Energy+

SEC submits that the Energy+ lease is not eligible for ICM treatment, as it is not in fact a capital investment by Energy+. In the alternative, if the Board wishes to consider ICM treatment, we have the following submissions on Energy+'s satisfaction of the ICM criteria.

Need. The evidence in this application, and as discussed as part of the 2019 Cost of Service application (EB-2018-0028), is that the current Dundas Street facility is no longer suitable due to primarily its condition, and the lack of efficient utilization of the space that occurred after the acquisition of Brant Power by Cambridge North Dumfries Hydro.[16] As the company was integrated as Energy+, administrative staff were consolidated which left significant unused space in the Dundas Street Facility.[17] At the same time, there was a lack of operations space. Based on a third-party assessment, it was determined that due to a variety of factors, it was not feasible to refurbish or rebuild the Dundas Street facility.[18] As it appears the main driver is the condition of the property, SEC agrees the need criterion has been met. SEC is not convinced that the question of efficient utilization, especially one that occurs as a result of a MAADs transaction, requires customers to pay additional costs for new facilities.

[13] *Ibid*, p.23
[14] *Ibid,* p.25; B-Staff-20 (Updated). SEC notes that some of the comparators used in this table may not be completely appropriate, as specific circumstances (for example in Milton and InnPower) mean the comparisons are not entirely apples to apples.
[15] Brantford Power Inc., 2020 IRM Application, IRM Attachment A, p.25
[16] *Ibid*, p.45-46, 48
[17] *Ibid*, p.52
[18] *Ibid*

Materiality. SEC is unable to make any submissions on whether any capital spending on this project appropriately exceeds the ICM threshold. Depending on the proportion of the capitalized value of the lease that is considered to be prudent (see below), the project may meet or exceed the project materiality criterion.

Prudence. It does not appear that Energy+ considered all their options. While SEC does not dispute the evidence that the Dundas Street Facility is no longer appropriate, the options analysis undertaken by Energy+ is insufficient. Energy+ appeared to consider only two real categories of options: Refurbish or rebuild the Dundas Street Facility, or partner with BPI.[19] While it does mention that it considered acquiring or leasing its own facility, it appears to have only done a cursory review by relying on previous third-party work that BPI had done in 2015 and 2016.[20] SEC is not clear what the relevance of the BPI site review would be for Energy+, considering the different needs of the utilities (administrative/operations vs. just operations) and that BPI looked exclusively in its own service territory of Brantford.

Energy+ costs per square foot are higher than those of BPI due to the agreed upon allocation methodology which directly allocated certain construction (as opposed to the land and building purchase price) costs directly to each of the four tenants based on whose space they benefit.[21]

Based on the costs that Energy+ is proposing to include as part of the ICM, its total costs are $226.87 per square foot. A more accurate view of Energy+'s proposed costs is to look at the full costs that are to be allocated to it. While it may not be seeking to include these entire costs as part of its ICM, due to the limitation of how much it is allowed to capitalize due to accounting rules on leases, ultimately at rebasing, customers will be asked to pay for the entire amount of the lease, whether as part of OM&A, capital, or both. On that basis, the Energy+ cost per square foot is higher at $282.58, compared to the inflation adjusted average for the comparators of $274.

SEC notes that there is no other operations only facility as part of the benchmark sample. One would expect that an operations only facility, on per square foot basis, would be of a lower cost than an administration or joint administration and operations facility.

Without a relevant comparison to other operations only facilities, SEC is left with a simple question of whether spending $8.35M, regardless of the specific regulatory and accounting treatment, is it a prudent expense for an operations centre that is currently staffed by 13 operations employees?[22]

When one adds in the Southworks facility that was approved as an ACM, Energy+ customers appear to be paying more and more for facilities. The overall cost per square foot is likely to be well above the inflation-adjusted average of the combined administration/operations comparators.

In many ways the Energy+ approach to this Savannah Oak facility mirrors SEC's criticisms of its proposed Southworks facility.[23] In that case, similar to here, there was evidence a new facility was needed, but there was no evidence that the specific option it had chosen was the best option available to it. SEC submits that without evidence supporting a full, comprehensive due diligence process, the

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[19] Energy+ Inc., 2020 IRM Application, p.45-46
[20] *Ibid*
[21] Brantford Power Inc., 2020 IRM Application, IRM Attachment A, p.38
[22] Energy+ Inc., 2020 IRM Application, p.45-46
[23] *Decision and Order* (Energy+ - 2018-0028), June 13, 2019, p.10

Board cannot assess the reasonableness of the proposed facility, and thus Energy+ has not discharged its burden at this point.

The Board is left with the option of disallowance of some amount of the request. SEC submits that what it should do, similar to its previous submissions regarding the Southworks facility, is to disallow a portion of the expenditure, but allow Energy+ to seek recovery of an additional amount, above the disallowance, on a going forward basis only at the time of rebasing, if it can satisfy the concerns that have been raised. This would reflect a fair compromise between recognizing that a new facility is needed, and it may be the proposal it has brought forward, but that Energy+ has simply not met its onus to demonstrate prudence.

If the lease is, as SEC submits, to be treated as a series of OM&A payments, as its terms set out, and is not a capital investment, then the issue of prudence is moot. When Energy+ comes in for its next rebasing, it will have to demonstrate that its lease payments are prudent on an annual basis, and it will have much more information for the Board to assess that during rebasing.

In-Service Date

The ICM model assumes that the forecast project will be in-service on January 1st 2020 and the rate rider is calculated on that basis.

SEC submits this approach may not be appropriate in this case, where the evidence is that the expected move-in date for both BPI and Energy+ is expected to be October 2020.[24] Assuming that this date ends up being accurate, which with respect to large construction projects is not a given, at least 75% of the 2020 year, customers will be paying for a facility that would not be in-service. Considering the overall amount of the ICM and the rate impacts, this is not appropriate. SEC proposes the Board implement any approved ICM rate rider effective October 2020. The amount would be calculated on an annual basis, but would only begin to be charged to customers when it becomes used and useful. This approach would ensure customers only pay for the new facility when it is providing them with benefits.

Lease Savings

BPI. As BPI transitions from its currently leased premises that are included within its Board approved OM&A budget, to the Savannah Oak Facility which it will now recover through the ICM, ratepayers will be overpaying until rebasing unless the existing lease amounts are removed from rates.

The evidence is that the 2020 savings in lease payments will be $144,197 for the partial year and $595,946 on a full year basis in 2021.[25] SEC submits these lease savings should be credited back to ratepayers by a direct adjustment to the ICM rate riders. If not, then ratepayers will be overcompensating BPI.

At this point it is not clear, based on the evidence, what offsetting OM&A costs will be incurred as a result of the new building. BPI's evidence is that there are going to be no net savings in 2020 or 2021,[26] i.e. it will be in a "steady-state" situation by 2022, the year it is scheduled to rebase.[27] SEC finds this unlikely, at least in 2021, when it will have the benefit of the entire savings from the three separate

[24] SEC-BPI-13; SEC-Energy-17
[25] B-Staff-15(a)
[26] B-Staff-15(e)
[27] *Ibid*

leases. Moreover, SEC would expect that BPI would ensure there would be net savings as soon as possible.

SEC submits the Board should reduce the ICM rate riders by the amount of the avoided lease payments included in base rates. BPI claims that there are some incremental OM&A costs it will incur due to the new facility that is not related to the lease payments. The Board has previously confirmed that incremental OM&A costs related to the ICM project are not recoverable from customers.[28] The issue here is that because of accounting treatment, it will be recovering the same type of costs, twice from customers.

Energy+. SEC is unsure if Energy+ is in a similar situation. The evidence is that while it sold the Dundas Street Facility in 2018, it entered into a short-term lease for a portion of the facility to occupy until its new shared facility with BPI was ready.[29] SEC requests in its reply argument, that Energy+ confirm if lease revenue was or was not included in its approved OM&A for 2020, and if so what the amount was. If an amount was included, then for the same reasons as discussed above for BPI, any approved ICM rate rider should be reduced to account for these amounts to ensure customers are not paying twice for property to service Brant County.

Energy+ Gain on Sale

Energy+ proposed to return to customers the gain on the sale of the Dundas Street Facility through a deferral account to be refunded by way of a rate rider. This is appropriate, as the Savannah Oak Facility is intended to act as a replacement operations centre for the Brant County service territory.

SEC's concern is related to the calculation of the gain on sale. Energy+ has adjusted the amount of the gain by deducting $479,581 from the proceeds for what it calls "Fair value increase paid by former [Cambridge and North Dumfries Hydro Inc. (CND)] on Acquisition".[30] SEC understands this amount to reflect the fair value increase over the book value that was paid by Cambridge and North Dumfries Hydro Inc. for the Dundas Street Facility as part of the acquisition of Brant Country Power.[31].

SEC submits that an adjustment to the gain on the sale is an indirect method for Energy+ to recover part of the premium it paid for Brant Country Power. The Board has been clear that the premium paid as part of any MAAD transaction is not recoverable from ratepayers.

As part of its application for approval of the transaction, Cambridge and North Dumfries Hydro Inc. explicitly told the Board that "the premium paid will not be included in its distribution revenue requirement and thus will not be funded by ratepayers."[32] This is consistent with both the MAADs policy in place at the time of the transaction[33], and now.[34]

SEC submits the Board should reject this proposed adjustment and approve the disposition to ratepayers at a total of $882,388 for the proceeds of the gain on the sale of the Dundas Street Property.

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[28] *Decision and Rate Order* (EB-2018-0328 - Halton Hills Hydro Inc ICM), April 4 2019, p.9
[29] Energy+ Inc., 2020 IRM Application, p.50
[30] Energy+ Inc., 2020 IRM Application, p.61
[31] E-Staff-46
[32] *Decision and Order* (EB-2014-0217/0223), October 30 2014, p.4
[33] *Rate-making Associated with Distributor Consolidation*, July 23, 2007; Decision and Order (EB-2014-0217/0223), October 30 2014, p.4
[34] *Handbook to Electricity Distributor and Transmitter Consolidations*, January 19 2016, p.8

Shepherd Rubenstein

Yours very truly,
Shepherd Rubenstein P.C.

Original signed by

Mark Rubenstein

cc: Wayne McNally, SEC (by email)
Applicants and intervenors (by email)