



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

DECISION AND ORDER

EB-2016-0276

HYDRO ONE INC.

ORILLIA POWER DISTRIBUTION CORPORATION

Application for approval to purchase Orillia Power Distribution Corporation

BEFORE: Ken Quesnelle
Presiding Member and Vice-Chair

Christine Long
Member and Vice-Chair

Cathy Spoel
Member

April 12, 2018

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1 INTRODUCTION AND SUMMARY

This is the Decision of the Ontario Energy Board (OEB) regarding an application filed by Hydro One Inc. (Hydro One).

On September 27, 2016, Hydro One filed an application requesting the OEB's approval to acquire all of the shares of Orillia Power Distribution Corporation (Orillia Power).

As part of the proposed share acquisition, Hydro One and Orillia Power requested approval for several related proposals, including: (a) a one percent reduction in Orillia Power's residential and general service customers base distribution rates for the first five years of the proposed ten year deferred rebasing period, from the closing of the transaction; (b) transfer of Orillia Power's rate order to Hydro One; (c) transfer of Orillia Power's distribution system to Hydro One; (d) cancellation of Orillia Power's electricity distributor licence; and (e) amendment of Hydro One's electricity distributor licence. The OEB assigned the application file number EB-2016-0276.

Section 86 of the *Ontario Energy Board Act, 1998*¹(the Act) requires that the OEB review applications for a merger, acquisition of shares, divestiture or amalgamation that result in a change of ownership or control of an electricity transmitter or distributor and approve applications which are in the public interest.

In accordance with its ordinary practice, the OEB has applied the no harm test in assessing this application. The OEB denies Hydro One's application to acquire the shares of Orillia Power as the OEB is not satisfied that the no harm test has been met. Consequently, the related approval requests made as part of the share acquisition application are also denied.

¹ S.O. 1998, c.15 Schedule B

2 THE APPLICATION

Hydro One filed an application under section 86(2)(b) of the Act for approval to acquire all of the shares of Orillia Power (MAAD application).

As part of the proposed share acquisition, Hydro One and Orillia Power requested the OEB's approval for related transactions/proposals:

- Inclusion of a rate rider in Orillia Power's 2016 OEB approved rate schedule, under section 78 of the Act, to give effect to a 1% reduction in base electricity distribution rates for residential and general service customers until 2022
- Transfer of Orillia Power's rate order to Hydro One, under section 18 of the Act
- Transfer of Orillia Power's distribution system to Hydro One, under section 86(1)(a) of the Act
- Cancellation of Orillia Power's electricity distribution licence, under section 77(5) of the Act
- Amendment of Hydro One's electricity distribution licence, under section 74 of the Act
- A proposed Earnings Sharing Mechanism(ESM) which would guarantee a sharing of \$3.4 million of overearnings with Orillia Power customers
- Use of an Incremental Capital Module during the selected ten year deferred rebasing period
- Continued tracking of costs to the deferral and variance accounts currently approved by the OEB for Orillia Power and disposition of their balances at a future date
- Use of United States Generally Accepted Accounting Principles for Orillia Power financial reporting
- Application of Hydro One's Specific Service Charges to Orillia Power's customers
- A new deferral and variance regulatory account for ESM cost tracking

Process

The OEB issued a Notice of Application and Hearing on November 7, 2016, inviting intervention and comment.

The OEB approved the intervention requests of School Energy Coalition (SEC), the Vulnerable Energy Consumers Coalition (VECC), the Consumers Council of Canada (CCC), and Mr. Frank Kehoe. The OEB also determined that these intervenors are eligible to apply for an award of costs in this proceeding under the OEB's *Practice Direction on Cost Awards*.

The OEB provided for interrogatories and submissions on the application.

In the submissions filed, some intervenors raised concerns related to Hydro One's rate proposals and revenue requirements for previously acquired utilities (Norfolk, Haldimand, and Woodstock) contained in Hydro One's concurrent distribution rate application², filed on March 31, 2017. These intervenors submitted that the customers of these former utilities are expected to experience significant rate increases once the deferral period expires, and it is not therefore the case that these customers experienced "no harm". Although the distribution rates application did not include Orillia Power (because the deferral period would not end until after the term of that application), intervenors were concerned that if the current application is approved a similar fate would befall Orillia Power's customers once its deferral period ended. OEB staff observed that the proposed rates suggest large distribution rate increases for some customers of these acquired utilities once the deferred rebasing period elapses.

In its reply argument, Hydro One submitted that there is a reasonable expectation, based on underlying cost structures, that the costs to serve acquired Orillia Power customers following the consolidation will be no higher than they otherwise would have been.

Having reviewed the evidence and the submissions of parties, the OEB issued Procedural Order No. 6, on July 27, 2017, in which it determined that the hearing of the MAAD application would be adjourned until the OEB rendered its decision on Hydro One's rate application. The OEB found that Hydro One should defend its cost allocation

² EB-2017-0049

proposal in the distribution rate application prior to the OEB determining if the Orillia Power acquisition is likely to cause harm to any of its current customers.

Hydro One and Orillia Power each filed a Notice of Motion requesting a review and variance of Procedural Order No. 6. In a decision³ (Motions Decision), issued on January 4, 2018, the OEB granted the motions and referred the matter back to the OEB panel on the MAAD application for re-consideration.

In Procedural Order No. 7 issued on February 5, 2018, the OEB determined that it would re-open the record of the MAAD application. The OEB ordered Hydro One to file further material, in the form of evidence or submissions on its expectations of the overall cost structures following the deferred rebasing period and the impact on Orillia Power customers.

Submissions were filed by Hydro One and Orillia Power on February 15, 2018.

³ EB-2017-0320

3 REGULATORY PRINCIPLES

3.1 The No Harm Test

The OEB applies the no harm test in its assessment of consolidation applications⁴, as described in The *Handbook to Electricity Distributor and Transmitter Consolidations* (Handbook) issued by the OEB on January 19, 2016.

The OEB considers whether the no harm test is satisfied based on an assessment of the cumulative effect of the transaction on the attainment of its statutory objectives. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

The statutory objectives to be considered are those set out in section 1 of the Act:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
 - 1.1 To promote the education of consumers.
- 2 To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.
- 3 To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario.
- 4 To facilitate the implementation of a smart grid in Ontario.
- 5 To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities.

While the OEB has broad statutory objectives, in applying the no harm test, the OEB has focused on the objectives that are of most direct relevance to the impact of the proposed transaction; namely, price, reliability and quality of electricity service to

⁴ The OEB adopted the no harm test in a combined proceeding (RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257) as the relevant test for determining applications for leave to acquire shares or amalgamate under section 86 of the Act and it has been subsequently applied in applications for consolidation.

customers, and the cost effectiveness, economic efficiency and financial viability of the consolidating utilities.

The OEB considers this an appropriate approach, given the OEB's performance-based regulatory framework, the Renewed Regulatory Framework for Electricity Distributors (RRFE)⁵, which was set up to ensure that regulated distribution companies operate efficiently, cost effectively and deliver outcomes that provide value for money for customers. One of these outcomes is operational effectiveness, which requires continuous improvement in productivity and cost performance by distributors and that utilities deliver on system reliability and quality objectives.

Ongoing performance improvement and performance monitoring are underlying principles of the RRFE. The OEB has established performance standards to be met by distributors, ongoing reporting to the OEB by distributors, and ongoing monitoring of distributor achievement against these standards by the OEB. These metrics are used by the OEB to assess a distributor's services, such as frequency of power outages, financial performance and costs per customer.

The OEB assesses applications for consolidation within the context of the RRFE. The OEB is informed by the metrics that are used to evaluate a distributor's performance in assessing a proposed consolidation transaction. All of these measures are in place to ensure that distributors meet expectations regardless of their corporate structure or ownership.

⁵ Report of the Board: Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach

3.2 OEB Policy on Rate-Making Associated with Consolidation

To encourage consolidations in the electricity sector, the OEB has put in place policies on rate-making that provide consolidating distributors with an opportunity to offset transaction costs with savings achieved as a result of the consolidation.

The OEB's 2015 Report⁶ permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction. The extent of the deferred rebasing period is at the option of the distributor and no supporting evidence is required to justify the selection of the deferred rebasing period. Consolidating entities, must, however, select a definitive timeframe for the deferred rebasing period.

The 2015 Report sets out the rate-setting mechanisms during the deferred rebasing period, requiring consolidating entities that propose to defer rebasing beyond five years to implement an ESM for the period beyond five years to protect customers and ensure that they share in increased benefits from consolidation.

The Handbook clarifies that rate-setting following a consolidation will not be addressed in an application for approval of a consolidation transaction unless there is a rate proposal that is an integral aspect of the consolidation, e.g. a temporary rate reduction. Rate-setting for a consolidated entity will be addressed in a separate rate application, in accordance with the rate setting policies established by the OEB.

⁶ EB-2014-0138 Report of the Board on Rate-making Associated with Distributor Consolidation, March 26, 2015

4 DECISION ON THE ISSUES

4.1 Application of the No Harm Test

Price, Cost Effectiveness and Economic Efficiency

Hydro One submitted that Orillia Power's customers will benefit from the proposed transaction through a: (i) reduction of 1% in the base distribution delivery rates for Orillia Power's residential and general service customers in years 1 to 5; (ii) rate increase of less than inflation in years 6 to 10 (inflation less a productivity stretch factor); and (iii) \$3.4 million being paid to Orillia Power customers, a result of the guaranteed ESM.⁷

Hydro One provided a forecast ten year cost structure analysis, that compared overall expected savings based on Orillia Power, remaining as a stand-alone distribution utility (status quo) to having Orillia Power integrated with Hydro One's existing operations.

Hydro One projected that the consolidation would result in overall ongoing operating, maintenance and administration (OM&A) cost savings of approximately \$3.9 million per year and reductions in capital expenditures of approximately \$0.6 million per year. Cost savings are anticipated from elimination of redundant administrative and processing functions in the following areas: financial, regulatory, legal, executive and governance, human resources, and information technology; as well as economies of scale from a larger customer base such that costs for processing systems like billing, customer care, human resources and financial are spread over a larger group of customers.⁸

Hydro One asserted that geographic contiguity (Hydro One's existing service area being situated immediately adjacent to Orillia Power's service area) allows for economies of scale to be realized at the field or operational level through more efficient scheduling of operational and maintenance work and dispatching of crews over a larger service area. Hydro One also asserted that more efficient utilization of work equipment (e.g. trucks and other tools), leads to lower capital replacement needs over time and more rational and efficient planning and development of the distribution system.⁹

In the submissions filed, parties questioned Hydro One's submissions.

⁷ Application, Exh A/T1/S1, p.4

⁸ Application, Exh A/T1/S1, pages 2, 11-13

⁹ Application, Exh A/T1/S1, p.10

SEC argued that approval for the proposed transaction should be denied, stating that the no harm test will not be met in this case. SEC submitted that Hydro One has shown no credible evidence that it will be able to generate any savings by acquiring Orillia Power and that there will be cost increases for Orillia's customers after the deferral period.¹⁰ SEC argued that there were no cost savings for the customers of Norfolk, Haldimand and Woodstock, noting the rates proposed for customers of these previously acquired utilities rise significantly after the end of the deferral period as shown in Hydro One's distribution rate application. SEC submitted that the rates of Orillia's customers are likely to rise in a similar manner.

CCC submitted that Hydro One has provided no evidence in this proceeding to support the argument that the transaction meets the no harm test. CCC referenced Hydro One's distribution rate application, stating that Hydro One has proposed a new rate class for Norfolk, Haldimand and Woodstock that has the rates of the customers in those areas rising significantly. CCC submitted that Hydro One has provided no guarantee that when the deferral period ends, the rates for Orillia Power's customers will reflect the costs to serve these customers. CCC submitted that unless Hydro One can convince the OEB that the benefits of this transaction (a 1% rate reduction, a rate freeze and up-front ESM savings) to Orillia Power's customers outweigh the expected rate increases at the end of the deferral period, the transaction should not be approved.¹¹

VECC submitted that it accepts that the application meets the no harm test with respect to price although the benefits to Orillia Power customers are not as significant as claimed. VECC argued that the no harm test with respect to price can only be satisfied if the rates eventually charged to former Orillia Power customers are reflective of Hydro One's cost to serve them and submitted that the OEB should set out this expectation as it has done with other consolidation applications filed by Hydro One.¹²

OEB staff submitted that the evidence provided by Hydro One supports the claim that the proposed transaction can reasonably be expected to result in overall cost savings and operational efficiencies but that these operational and cost efficiencies may not necessarily translate to lower distribution rates for customers of the acquired entity after the deferred rebasing period has ended. OEB staff observed that the rates proposed for previously acquired utilities in Hydro One's distribution rate application suggest large

¹⁰ SEC Submissions, p. 4,6

¹¹ CCC Submissions, p.3

¹² VECC Submissions

distribution rate increases for some customers of these acquired utilities once the deferred rebasing period elapses.¹³

Hydro One responded to VECC's submissions stating that it is Hydro One's intention to apply rates to Orillia Power's customers that reflect the cost of serving those customers at that time.

In response to SEC's assertions, Hydro One stated that it has provided evidence that the proposed transaction results in the lowering of cost structures to operate the existing Orillia Power service territory. In its reply submissions, Hydro One provided a cost structure analysis for the period 2015-2022 reflecting that the cost structures of Norfolk, Haldimand and Woodstock are lower than they would have been absent the consolidation transactions. Hydro One argued that the evidence provided in its distribution rate application shows that costs have declined consistent with the projections made in the consolidation application for each of the three previously acquired distributors. Hydro One submitted that there is a reasonable expectation, based on underlying cost structures, that the costs to serve acquired Orillia Power customers following the consolidation will be no higher than they otherwise would have been.¹⁴

Orillia Power argued that the evidence filed in this case supports a finding that efficiencies will be gained and lower costs will be realised as a result of the proposed acquisition and that any reference to Hydro One's rate application is irrelevant to the issues before the OEB in this application. Orillia Power submitted that this acquisition is an illustration of the types of ratepayer benefits envisioned by the Ontario Distribution Sector Review Panel in its report on the benefits of distributor company consolidations.

In Procedural Order No. 7, the OEB ordered Hydro One to file further material, in the form of evidence or submissions on its expectations of the overall cost structures following the deferred rebasing period and the impact on Orillia Power customers.

No new evidence was filed. Submissions were filed by Hydro One and Orillia Power. Hydro One submitted that, based on the projected Hydro One cost savings forecast for the 10 year period following the transaction, Hydro One can definitively state that the overall cost structures to serve the Orillia area will be lower following the deferred rebasing period in comparison to the status quo. Hydro One submitted that at the time of rebasing, Hydro One will adhere to the cost allocation and rate design principles, in

¹³ OEB Staff Submissions, p.7

¹⁴ Hydro One Final Argument, May 5, 2017 pages 2-5

place at such time in the future, ensuring that the costs allocated to Orillia Power customers fairly and accurately reflect the new lower cost structure to serve all customers.¹⁵ Orillia Power supported the submissions of Hydro One.

OEB Findings

In reviewing a proposed transaction, the OEB examines the long term effect of the consolidation on customers.

The Handbook clarified the OEB's expectations with respect to price:

“A simple comparison of current rates between consolidating distributors does not reveal the potential for lower cost service delivery. These entities may have dissimilar service territories, each with a different customer mix resulting in differing rate class structure characteristics. For these reasons, the OEB will assess the underlying cost structures of the consolidating utilities. As distribution rates are based on a distributor's current and projected costs, it is important for the OEB to consider the impact of a transaction on the cost structure of consolidating entities both now and in the future, particularly if there appear to be significant differences in the size or demographics of consolidating distributors. A key expectation of the RRFE is continuous improvement in productivity and cost performance by distributors. The OEB's review of underlying cost structures supports the OEB's role in regulating price for the protection of consumers.

Consistent with recent decisions,¹⁶ the OEB will not consider temporary rate decreases proposed by applicants, and other such temporary provisions, to be demonstrative of “no harm” as they are not supported by, or reflective of the underlying cost structures of the entities involved and may not be sustainable or beneficial in the long term. In reviewing a transaction the OEB must consider the long term effect of the consolidation on customers and the financial sustainability of the sector.

To demonstrate “no harm”, applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve

¹⁵ Hydro One Cost Structure Submissions, February 15, 2018, pages 2,6

¹⁶ EB-2013-0196/EB-2013-0187/EB-2013-0198
EB-2014-0244

acquired customers following a consolidation will be no higher than they otherwise would have been. While the rate implications to all customers will be considered, for an acquisition, the primary consideration will be the expected impact on customers of the acquired utility”.¹⁷

One of the key considerations in the no harm test is protecting customers with respect to the prices they pay for electricity service. Although the Handbook states that “rate setting” following a consolidation will not be considered as part of a section 86 application, that does not mean the OEB will not consider the costs that acquired customers will have to pay following an acquisition (both in the short term and the long term). Indeed the Handbook is clear that the underlying cost structures and the rate implications of those cost structures will be a key consideration.

As stated in the Handbook and confirmed in decisions made on previous Hydro One acquisitions¹⁸, the OEB does not consider temporary rate decreases to be on their own demonstrative of no harm as they are not supported by, or reflective of the underlying cost structures of the entities involved and may not be sustainable or beneficial in the long term.

The OEB’s primary concern is that there is a reasonable expectation that underlying cost structures for the acquired utility are no higher than they would have been had the consolidation not occurred. Although the OEB accepts that the acquisition will lead to some savings on account of eliminating redundancies, that does not necessarily mean that Hydro One’s overall cost structure to serve Orillia’s customers will be no higher than Orillia’s underlying cost structure would have been absent the proposed acquisition.

The experience of the three acquired utilities in Hydro One’s current distribution rates case is informative. In the MAADs proceedings in which Hydro One acquired these utilities, Hydro One pointed to savings that would be realized through the acquisition. Although these savings may well have occurred, they do not appear to have resulted in overall cost structures (and therefore rates) for customers of the acquired utilities that are no higher than they would have been, once the deferral period ended and their rates were adjusted to account for Hydro One’s overall costs to serve them. Material filed in the Hydro One current distribution rates case shows that some rate classes are

¹⁷ Handbook, pages 6-7

¹⁸ EB-2013-0196/EB-2013-0187/EB-2013-0198
EB-2014-0244
EB-2014-0213

expected to experience significant and material increases.¹⁹ While the OEB has not approved these requested rates, this panel takes notice of the proposed rate increases which Hydro One states are reflective of the costs to service the acquired customers, and are inclusive of the “savings” that Hydro One states were realized.

The OEB recognizes that Orillia was not part of Hydro One’s distribution rates filing, and that it is not certain that its customers’ experiences would be the same. Because of this uncertainty, the OEB provided Hydro One the opportunity to file further evidence on what it expects the overall cost structure to be following the deferral period and to explain the impact on Orillia’s customers. Hydro One did not file further evidence. Hydro One’s submissions simply restated its expectation that based on the projected Hydro One cost savings forecast for the 10 year period following the transaction, the overall cost structures to serve the Orillia area will be lower following the deferred rebasing period in comparison to the status quo. The OEB is of the view that it would have been reasonable to see a forecast of costs to service Orillia customers beyond the ten year period and an explanation of the general methodology of how costs would be allocated to Orillia ratepayers after the deferral period. Hydro One takes the position that this information is not known. The OEB recognizes that any forecast of cost structures and cost allocation 10 years out would include various assumptions and could not be expected to be 100% accurate. However, the OEB has highlighted its concern and its need to better understand the implications of how Orillia customers will be impacted by the consolidation beyond the ten year period. In the absence of information to address that OEB concern, the OEB cannot reach the conclusion that there will be no harm.

As discussed above, the OEB is not satisfied that a list of forecast cost savings from the acquisition automatically results in overall cost structures for the customers of the acquired utility that are no higher than they would be without the consolidation. Hydro One has failed to make the case that the OEB can be assured that the underlying cost structures would be no greater than they would have been absent the acquisition.

The OEB is therefore not satisfied that the no harm test has been met, and on this basis the application is denied.

¹⁹ Hydro One Final Argument, Attachment 1

Reliability and Quality of Electricity Service

Hydro One submitted that it will endeavour to maintain or improve reliability and quality of electricity service for all of its customers.

Hydro One provided a comparison of reliability statistics from 2013-2015 claiming that Hydro One customers in the vicinity of the City of Orillia experienced a level of service in terms of duration and frequency of interruptions comparable to the level experienced by Orillia Power customers. Hydro One submitted that it anticipates that reliability will improve with the combination of pre-existing Hydro One and former Orillia Power resources optimized for the broader Orillia area.²⁰

Hydro One also provided a comparison of Hydro One's and Orillia Power's performance on various dimensions of service quality.²¹

Hydro One's interrogatory responses indicated that of the fifteen Orillia Power direct staff positions, nine positions will be absorbed by Hydro One while six positions will be eliminated. Hydro One submitted that the associated work will be picked up by other (more centralized) units in Hydro One.²²

Hydro One indicated that it intends to construct a new operations centre within the City of Orillia to consolidate operations between Hydro One's pre-existing Orillia operating centre and Orillia Power's operating centre. Hydro One submitted that Orillia Power's current facility is undersized with no expansion potential and is not ideally located to serve the expanded service area. The current Hydro One operations centre is considered too small and inflexible to meet the operating needs of the company.

Hydro One stated that the need for a new operations centre would still exist if this transaction was not contemplated. Hydro One argued that consolidation of the operation centres will not impact service quality or reliability and will be more operationally and cost efficient.²³

VECC submitted that Hydro One's evidence does not clearly demonstrate that the no harm will be satisfied. VECC submitted that the SAIDI and SAIFI statistics are inconclusive as to whether Hydro One's reliability performance is better or worse.

²⁰ Application, Exh A/T2/S1/p.7

²¹ Application, Exh I/T3/S17 c)

²² OEB Staff IR 8 and VECC IR 12

²³ OEB Staff IR 5 e)

VECC expressed concerns with Hydro One's anticipated reductions in direct staff positions and how it would impact reliability. VECC submitted that there is no evidence that, based on Hydro One's spending plans, reliability for former Orillia Power customers will improve in the future or even that current levels of reliability will be maintained for former Orillia Power customers.

VECC submitted that the comparison of the service quality metrics demonstrates that Orillia Power's current performance exceeds Hydro One's in almost every category suggesting that service quality for Orillia Power's customers could decline as a result of the application.²⁴

CCC asserted that Hydro One has filed no compelling evidence that Orillia Power's reliability will be maintained or improved as a result of the transaction. CCC submitted that Orillia Power's service quality metrics are generally better than Hydro One²⁵ indicating that Orillia Power's customers will have a lower quality of service under Hydro One ownership.

OEB staff submitted that, based on the evidence provided, Hydro One can reasonably be expected to maintain the service quality and reliability standards currently provided by Orillia Power.

OEB staff submitted that with respect to Hydro One's proposed construction of a new operations centre, the OEB should, in making its decision, specifically note that it is not approving the construction of this operation centre as part of this proceeding as the OEB will review whether this is a prudent expenditure in a future rate application. OEB staff also submitted that the OEB examine the cost/benefit of the new operations centre and whether other options were explored in the future rate application.

In reply submissions, Hydro One submitted that the differences in the SAIDI and SAIFI results can likely be attributed to differences in geography and asset characteristics. For instance, Hydro One's local service territory is still more rural relative to the Orillia Power's service territory, and approximately 30% of Orillia Power's service territory is served by an underground distribution system. Hydro One reasserted that despite these differences, its reliability results were relatively similar to Orillia Power for both SAIDI and SAIFI.

²⁴ VECC Submissions

²⁵ Application, Exh I/T3/S17

Hydro One argued that Orillia Power customers' reliability levels are protected through the OEB's codes and licence requirements. With respect to the service quality metrics comparison, Hydro One submitted that its results are relatively similar to those of Orillia Power for the majority of the measures and that for the two measures for which Hydro One's results are below Orillia Power's (telephone accessibility and telephone call abandon rates), Hydro One's results are still compliant with the OEB-prescribed standards.

Hydro One reaffirmed that it will maintain Orillia Power's existing reliability and quality of service levels as it will have to continue to have regional operations in the Orillia area, consisting of both existing Orillia Power staff and Hydro One staff.

OEB Findings

The Handbook sets out that in considering the impact of a proposed transaction on the quality and reliability of electricity service, and whether the no harm test has been met, the OEB will be informed by the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard. The Handbook also sets out that utilities are expected to deliver continuous improvement for both reliability and service quality performance to benefit customers following a consolidation and will be monitored for the consolidated entity under the same established requirements.²⁶

The OEB is satisfied based on the evidence before it, that it can be reasonably expected that Orillia Power's quality and reliability of service would be maintained following a consolidation. The fact that the consolidated entity is required to report on reliability and quality of service metrics in its annual filings confirms to the OEB that any reduction in service quality would become apparent and would be addressed therefore reducing any risk of harm.

Financial Viability

Hydro One has agreed to purchase the shares of Orillia Power at a price of \$41.3 million, consisting of a cash payment of approximately \$26.4 million and the assumption

²⁶ Handbook, p. 7

of short and long term debt of approximately \$14.9 million. The 2015 net book value of Orillia Power's assets is \$22.5 million.

Hydro One submitted that the premium paid will not be recovered through rates and will not impact any future revenue requirement. Hydro One also stated that the proposed transaction will not have a material impact on Hydro One's financial position as the price is less than 1% of Hydro One's net fixed assets.

Hydro One submitted that it expects to incur incremental transaction costs of approximately \$3 million for legal, advisory and tax costs for the completion of the transaction and costs associated with the necessary regulatory approvals. In addition, Hydro One expects to incur \$5 to \$6 million in integration costs, which includes up-front costs to transfer the customers into Hydro One's customer and outage management systems. Hydro One confirmed that all of these costs will be financed through productivity gains associated with the transaction and will not be recovered through rates

OEB staff submitted that the applicants' evidence demonstrates that no adverse impact on the applicants' financial viability is anticipated.

OEB Findings

The Handbook sets out that the impact of a proposed transaction on the acquiring utility's financial viability for an acquisition, or on the financial viability of the consolidated entity in the case of a merger will be assessed.

The OEB's primary considerations in this regard are:

- The effect of the purchase price, including any premium paid above the historic (book) value of the assets involved
- The financing of incremental costs (transaction and integration costs) to implement the consolidation transaction

The OEB does not find that there will be an adverse impact on Hydro One's financial viability as a result of its proposals for financing the proposed acquisition transaction.

4.2 Other Approval Requests

As part of the proposed share acquisition, Hydro One and Orillia Power requested the OEB's approval for related transactions/proposals:

- Inclusion of a rate rider in Orillia Power's 2016 OEB approved rate schedule, under section 78 of the Act, to give effect to a 1% reduction in base electricity distribution rates for residential and general service customers until 2022
- Transfer of Orillia Power's rate order to Hydro One, under section 18 of the Act
- Transfer of Orillia Power's distribution system to Hydro One, under section 86(1)(a) of the Act
- Cancellation of Orillia Power's electricity distribution licence, under section 77(5) of the Act
- Amendment of Hydro One's electricity distribution licence, under section 74 of the Act
- Proposed ESM which guarantees a sharing of \$3.4 million of overearnings with Orillia Power customers
- Use of an Incremental Capital Module during the selected ten year deferred rebasing period
- Continued tracking of costs to the deferral and variance accounts currently approved by the OEB for Orillia Power and disposition of their balances at a future date
- Use of United States Generally Accepted Accounting Principles for Orillia Power financial reporting
- Application of Hydro One's Specific Service Charges to Orillia Power's customers
- A new regulatory account for ESM cost tracking

OEB Findings

As the OEB is denying Hydro One's application for the proposed share acquisition transaction, the requests set out above, which are applicable only in the event that the proposed transaction were to be approved are also denied.

5 CONCLUSION

The OEB denies Hydro One's application to acquire the shares of Orillia Power as the OEB is not satisfied that the no harm test has been met. Consequently, the additional related approval requests made as part of the application are also denied.

The OEB finds that the applicants bear the onus of satisfying the OEB that there will be no harm.

In reviewing a proposed consolidation transaction, the OEB examines both the short term and the long term effect of the consolidation on customers.

The OEB has determined that it is reasonable to expect that the underlying cost structures to serve acquired customers following a proposed consolidation will be no higher than they otherwise would have been.

It is the OEB's expectation that future rates paid by the acquired customers will be based on the same cost structures used to project the future cost savings in support of this application.

Hydro One has not demonstrated that it is reasonable to expect that the underlying cost structures to serve the customers of Orillia Power will be no higher than they otherwise would have been, nor that they will underpin future rates paid by these customers.

6 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. The application filed by Hydro One Inc. to acquire all of the issued and outstanding shares of Orillia Power Distribution Corporation is denied. All related approval requests made as part of the application are also denied.
2. The applicants shall pay the OEB's costs of and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

DATED at Toronto April 12, 2018

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary