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

BY EMAIL

December 20, 2019

Ms. Christine E. Long
Registrar and Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4
BoardSec@oeb.ca

Dear Ms. Long:

Re: Peterborough Distribution Inc., Peterborough Utility Services Inc., Hydro One Networks Inc., and 1937680 Ontario Inc.
Application for approval to amalgamate Peterborough Distribution Inc. and Peterborough Utilities Services Inc. and sell the amalgamated electricity distribution system to Hydro One Networks Inc.
Ontario Energy Board File Number: EB-2018-0242

Hydro One Networks Inc. and Orillia Power Distribution Inc.
Application for approval to purchase all issued and outstanding shares of Orillia Power Distribution Corporation
Ontario Energy Board File Numbers: EB-2018-0270

OEB Staff Submission

In accordance with Procedural Orders No. 7 and 9, please find attached the OEB staff submission for the above proceedings. This document has been sent to all registered parties to this proceeding.

Hydro One Networks Inc., Orillia Power Distribution Inc., and Peterborough Distribution Inc. are reminded that their reply submission is due by January 17, 2020.

Yours truly,

Original Signed By

Andrew Bishop
Project Advisor, Generation & Transmission
Encl.

OEB Staff Submission

Application for approval to amalgamate Peterborough Distribution Inc. and Peterborough Utilities Services Inc. and sell the amalgamated electricity distribution system to Hydro One Networks Inc.

Peterborough Distribution Inc., Peterborough Utility Services Inc., Hydro One Networks Inc., and 1937680 Ontario Inc.

EB-2018-0242

Application for approval to purchase all issued and outstanding shares of Orillia Power Distribution Corporation

Hydro One Networks Inc. and Orillia Power Distribution Inc.

EB-2018-0270

December 20, 2019

1 INTRODUCTION

1.1 Overview of the Application

Hydro One Networks Inc. (Hydro One) and Orillia Power Distribution Inc. (Orillia Power) filed an application[1] with the Ontario Energy Board (OEB) on September 26, 2018 requesting, among other things, approval to purchase all of the shares of Orillia Power (Orillia Application). On October 12, 2018, Peterborough Distribution Inc. (PDI), Peterborough Utilities Services Inc. (PUSI), Hydro One, and 1937680 Ontario Inc. filed an application[2] with the OEB (Peterborough Application). A revised version of the Peterborough Application was filed on November 1, 2018. The Peterborough Application requested, among other things, approval to amalgamate PDI and PUSI[3], sell the amalgamated corporation to 1937680 Ontario Inc.[4], and then dispose of it to Hydro One.

The Orillia Application and Peterborough Application (collectively, the Applications) filed by Hydro One, Orillia Power and PDI (collectively, the Applicants) also requested various OEB approvals in addition to the requests made pursuant to section 86 of the *Ontario Energy Board Act, 1998* (OEB Act).

1.2 Process to Date for the Applications

A Notice of Hearing for the Orillia Application was issued on November 23, 2018 and the following parties requested and were granted intervenor status:

- Consumers Council of Canada (CCC)
- Energy Probe Research Foundation (Energy Probe)
- Power Workers' Union (PWU)
- School Energy Coalition (SEC)
- Vulnerable Energy Consumers Coalition (VECC)
- Mr. Frank Kehoe
- Mr. Maurice McMillan
- Ms. Dael Morris

[1] EB-2018-0270
[2] EB-2018-0242
[3] PDI and PUSI are wholly owned subsidiaries of the City of Peterborough Holdings Inc. (CoPHI). CoPHI is a holding company that is wholly owned by the Corporation of the City of Peterborough.
[4] A Hydro One Inc. subsidiary.

Each of CCC, Energy Probe, SEC, VECC, Mr. Kehoe, Mr. McMillan and Ms. Morris applied for and were granted eligibility for cost awards.

On October 16, 2018, SEC filed a Notice of Motion for an order dismissing[5] the Orillia Application on the grounds that it sought “the exact same relief and requires a redetermination of the same issues that have already been determined by the Board and is, a matter of law, *res judicata*, vexatious, and an abuse of power.”[6] Following submissions on SEC’s motion, the OEB issued its Decision on Motion and Procedural Order No. 3 for the Orillia Application on March 12, 2019, in which it denied the motion and established a schedule for written interrogatories.

The OEB issued a Notice of Hearing for the Peterborough Application on December 5, 2018. The following parties requested and were granted intervenor status:

- CCC
- Energy Probe
- Ms. Alison Davidson
- International Brotherhood of Electrical Workers, Local 636 (IBEW)
- PWU
- Save PDI Coalition
- SEC
- VECC

Each of Ms. Davidson, CCC, Energy Probe, Save PDI Coalition, SEC, and VECC applied for and were granted eligibility for cost awards for the Peterborough Application.

Following the Applicants’ responses to interrogatories on the Peterborough Application, and prior to the filing of interrogatories for the Orillia Application, Hydro One filed a letter on the record of the Applications on March 19, 2019. Hydro One stated that given the nature of some of the conclusions reached by the OEB in its Decision and Order on the Hydro One 2018-2022 distribution rates application[7], it would be filing supplemental evidence for the Applications. Hydro One filed the supplemental evidence on April 26, 2019.

On May 9, 2019, the OEB issued procedural orders for the Applications. The procedural order for the Peterborough Application made provision for interrogatories and interrogatory responses on the supplemental evidence filed by Hydro One while the procedural order for the Orillia Application made provision for interrogatories and

[5] Hydro One had previously applied to the OEB for approval to purchase Orillia Power (EB-2016-0276), but was denied as the OEB was not satisfied that the “no harm” test had been met.
[6] SEC Notice of Motion, p. 5
[7] EB-2017-0049

interrogatory responses on the pre-filed evidence and supplemental evidence filed by Hydro One. Following review of the Applicants' responses to interrogatories, the OEB determined that a technical conference was required.

The technical conference was held on October 3 and 4, 2019. Upon completion of the technical conference, the OEB issued a letter on October 28, 2019 requesting submissions from parties as to whether to proceed directly to written submissions or if an oral hearing was required for the Applications.

Following submissions from parties, the OEB determined that an oral hearing was necessary for the Applications. On November 28, 2019, the OEB issued procedural orders for both the Orillia Application and Peterborough Application which clarified the scope of the oral hearing as well as established the dates for an Argument-in-Chief and submissions. The oral hearing for the Applications was held on December 2 and 3, 2019.

The Argument-in-Chiefs for the Orillia Application and Peterborough Application were filed with the OEB on December 13, 2019.

2 RELEVANT REGULATORY PRINCIPLES

2.1 The "No Harm" Test

The OEB applies the "no harm" test when assessing applications for approval of utility consolidations. The "no harm" test was first established by the OEB in 2005 through its decision in an adjudicative proceeding,[8] and has been used to guide OEB decision making on mergers, acquisitions, amalgamations and divestitures (MAADs) applications since then.

The *Handbook to Electricity Distributor and Transmitter Consolidations* (MAADs Handbook), issued by the OEB on January 19, 2016, confirmed that the OEB will continue its practice of applying the "no harm" test when adjudicating utility consolidation requests. 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. The OEB Act states:[9]

> **Board objectives, electricity**
>
> 1(1) The Board, in carrying out its responsibilities under this or any other Act in relation to electricity, shall be guided by the following objectives:[10]
>
> 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, including having regard to the consumer's economic circumstances.
>
> 4. To facilitate the implementation of a smart grid in Ontario.

[8] RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257

[9] OEB Act, Section 1

[10] Note that on a date to be named by proclamation of the Lieutenant Governor, paragraph 1 of subsection 1 (1) will be repealed and replaced with "To inform consumers and protect their interests with respect to prices and the adequacy, reliability and quality of electricity service", and paragraph 1.1 will be repealed.

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 connections of renewable energy generation facilities.

If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.[11]

2.2 OEB Policy on Rate-Making Associated with Consolidations

The OEB introduced policies that provide consolidating distributors with an opportunity to offset merger-related transaction costs with any achieved savings through deferral of the rebasing of the consolidated entity.

The OEB's policies related to the deferral of rate rebasing are set out in the *Report of the Board – Rate-making Associated with Distributor Consolidation*[12], issued July 23, 2007 (the 2007 Report) and a further report[13] issued under the same name on March 26, 2015 (the 2015 Report). The 2007 Report permitted a deferred rebasing period of five years. The 2015 Report extended the permitted deferred rebasing period, allowing consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

Consolidating distributors are required to select a definitive timeframe for the deferred rebasing period. The OEB's expectation is that, when consolidating distributors select a deferred rebasing period, they have committed to a plan based on the circumstances of the consolidation and that, if an amendment to the selected deferred rebasing period is requested, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interests of customers.

The OEB requires consolidating entities that propose to defer rebasing beyond five years to implement an earnings sharing mechanism (ESM) for the period beyond five years to protect customers and ensure that they share in any increased benefits from consolidation during the deferred rebasing period.

[11] MAADs Handbook, pp. 3-4
[12] https://www.oeb.ca/documents/cases/EB-2007-0028/report_ratemaking_20070723.pdf
[13] https://www.oeb.ca/oeb/_Documents/EB-2014-0138/Board_Report_MAADs_Ratemaking_20150326.pdf

3 SUMMARY OF OEB STAFF SUBMISSIONS REGARDING THE APPLICATIONS

The MAADs Handbook provides guidance to applicants and stakeholders on how the OEB reviews consolidation transactions proposed under section 86 of the OEB Act. As noted above in Section 2.1, the MAADs Handbook confirms that the OEB applies the "no harm" test in its assessment of consolidation applications. In determining whether the proposed transaction has a positive or neutral effect on the attainment of the OEB's statutory objectives, the OEB has primarily focused its review on the impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the consolidating utilities. With respect to consideration of the impact on price, the OEB has historically focused its review on the cost structures that would result following a consolidation transaction[14]. In recent cases[15], the OEB has included in this analysis a consideration of the costs that acquired customers will have to pay following an acquisition (i.e., rates).

OEB staff submits that, based on the forecasts provided by the Applicants, it is clear that the proposed transactions have the potential to benefit existing (legacy) and acquired customers and are consistent with OEB and other public policy that encourages consolidation transactions.[16] However, OEB staff has a number of concerns about the reasonableness of the forecasts, and submits that without specific conditions[17] in place, there is a realistic chance that customers may be harmed by the transaction. OEB staff submits that the OEB should approve the Applications with the conditions proposed by OEB staff to prevent possible harm for customers. If the conditions are not feasible or cannot be agreed to by Hydro One, and Hydro One has no viable alternatives that meet the spirit of OEB staff's conditions, then OEB staff submits that both the Orillia Application and Peterborough Application should be denied.

Hydro One's consolidation proposals have the potential to benefit customers, but there is also the potential for harm if Hydro One's performance and cost projections do not materialize as outlined in the Applications. Without conditions, there will be little recourse for affected ratepayers as it will not be possible to unwind the transaction if it is

[14] MAADs Handbook, p. 6
[15] For example, see Decision and Order on the original Hydro One/Orillia 2016 MAADs application (EB-2016-0276).
[16] For example: MAADs Handbook and the provincial government's announced extension to the availability of time-limited relief on taxes pertaining to transfers of electricity assets https://www.fin.gov.on.ca/en/tax/ea/transferselecassets.html
[17] OEB staff notes that MAADs transactions are often subject to a number of standard conditions, for example that leave to consolidate expires within 18 months of the decision and that the OEB is to be notified of the completion of the transaction. The conditions proposed by OEB staff would be in addition to the standard conditions.

determined later that there was, in fact, harm. OEB staff submits that the onus to demonstrate no harm lies with the Applicants, and that conditions are appropriate to ensure that the forecasts can be held to.

OEB staff has considered conditions that might prevent harm to both Hydro One's legacy and acquired customers. Conditions considered by OEB staff include establishing limits on how much Hydro One may charge acquired customers, limiting the consequences of potential Hydro One forecast errors on legacy customers, as well as implementing new reporting requirements and performance guarantees for Hydro One. These conditions can help ensure the potential benefits of the proposed consolidations, while protecting customers in the event Hydro One's performance and cost projections do not materialize as outlined in the Applications.

OEB staff's submissions are made within the context of the current consolidation policy and considering the recent findings made by the OEB related to the Orillia Power transaction. OEB staff has focussed its submissions on how to address the risks associated with the transactions. The sections that follow discuss the potential risks and why, in OEB staff's view, conditions are necessary to protect customers.

4 OEB STAFF SUBMISSIONS REGARDING THE "NO HARM" TEST

In its review of the Applications, OEB staff considered the requirements described in the MAADs Handbook and other applicable OEB policies as described herein.

4.1 Impact on Price, Economic Efficiency and Cost Effectiveness

The MAADs Handbook allows for an acquiring or merging utility to elect, as part of the consolidation application, to defer rebasing for up to a maximum of ten years.[18] This deferral period is to allow the acquiring or merging utility an opportunity to recover transaction costs, which are not normally allowed to be recovered directly from customers, through operational and capital efficiencies resulting from the transaction over a reasonable period of time.

Hydro One submits that the proposed consolidations with PDI and Orillia Power will achieve cost savings and "provide benefits to all ratepayers in the long term".[19] In addition, Hydro One submits that the customers of PDI, Orillia Power and Hydro One will be held harmless.[20]

Submission

OEB staff submits that any approval of the proposed consolidations should be accompanied by conditions to protect acquired customers from potentially higher asset replacement costs and rates that may be higher than the status quo, and to protect existing customers from having to "subsidize" acquired customers.

Hydro One's rate classification proposal

As shown in Table 1, Hydro One's current base distribution charges are higher than PDI and Orillia Power's. Hydro One's revenue requirement per customer is also higher, as shown in Table 2. OEB staff submits that PDI and Orillia Power customers would therefore be harmed if they were to pay Hydro One's existing distribution rates: their rates would increase. OEB staff notes that PDI has not rebased since 2010[21] and Orillia Power has not rebased since 2013[22], and that if they were to rebase today, their rates would be somewhat higher than they currently are. However, given the fact that neither PDI nor Orillia Power are currently significantly under-earning, and that there is such a significant difference between PDI and Orillia Power's rates measured against Hydro

[18] MAADs Handbook, p. 12
[19] EB-2018-0242/Exhibit A/Tab 2/Schedule 1; EB-2018-0270/Exhibit A/Tab 2/Schedule 1
[20] EB-2018-0242/Exhibit A/Tab 1/Schedule 1, p. 9; EB-2018-0270/Exhibit A/Tab 2/Schedule 1, p.8
[21] EB-2009-0273
[22] EB-2012-0160

One's rates, OEB staff submits that Hydro One's current rates are still higher than either PDI or Orillia Power's rates would be after rebasing.

Table 1: Hydro One, PDI and Orillia Power Base Monthly Distribution Charges, 2019

Utility	Residential	GS<50	GS>50
Orillia Power[23]	$ 30.94	$ 79.10	$ 721.15
PDI[24]	$ 23.37	$ 50.96	$ 925.31
Hydro One[25]	$ 34.26	$ 81.60	$ 2,559.27

Table 2: Hydro One, PDI and Orillia Power Revenue Requirement per Customer, 2019

Utility	Residential	GS<50	GS>50
Orillia Power[26]	$ 357	$ 1,155	$ 14,430
PDI[27]	$ 300	$ 749	$ 9,567
Hydro One[28]	$ 424	$ 1,276	$ 16,413

Hydro One submits that PDI and Orillia Power customers will pay less than they would otherwise pay without the consolidations if they are put into acquired rate classes created by Hydro One for them or which may exist at the time of rebasing.[29] Hydro One notes that the MAADs Handbook allows distributors to place acquired customers into an existing rate class or into a new rate class.[30] OEB staff agrees that new rate classes can be created, but notes that the MAADs Handbook also establishes the expectation that, whatever the rate option, rates will reflect the cost to serve the acquired customers[31].

It is not clear to OEB staff whether Hydro One's acquired rate class proposals for PDI and Orillia Power reflect true long-term cost causality or whether they are simply a way of avoiding the higher rates that would apply if PDI and Orillia Power customers were incorporated into Hydro One's existing rate classes.

[23] EB-2018-0270/Exhibit I/Tab 1/Schedule 11, OEB 11
[24] EB-2018-0242/Exhibit I/Tab 2/Schedule 43, SEC 43
[25] *Ibid.*
[26] EB-2018-0270/Exhibit I/Tab 1/Schedule 12, OEB 12
[27] EB-2018-0242/Exhibit I/Tab 2/Schedule 44, SEC 44. Note: PDI figures are labelled in the reference as "Revenue Collected"
[28] EB-2018-0270/Exhibit I/Tab 1/Schedule 12, OEB 12
[29] EB-2018-0270/Exhibit I/Tab 1/Schedule 8, OEB 8; EB-2018-0242/Exhibit I/Tab 1/Schedule 47, OEB 47
[30] EB-2018-0242/EB-2018-0270 Technical Conference Transcript, Vol. 1, p. 118
[31] MAADs Handbook, p. 18

The appropriateness of Hydro One's proposed allocation of direct costs

Hydro One proposes to directly allocate some costs to acquired utilities through the use of "adjustment factors".[32] Hydro One submits that this is generally preferred to assigning average rate class costs to PDI and Orillia Power acquired customers.[33]

Hydro One submits that it will speak to the reasonableness of the adjustment factors used at the next rebasing, and that it expects the adjustment factors will evolve over time as more is learned about the acquired utilities.[34]

OEB staff accepts that where costs associated with specific rate classes are known, direct allocation is appropriate. OEB staff further submits that, as a general concept, Hydro One's proposal to use adjustment factors as a proxy for direct allocation is reasonable. As noted above, however, the specific adjustment factors will need to be assessed during Hydro One's first rates application following the deferred rebasing period, including consideration of the fact that, unlike PDI and Orillia Power, legacy Hydro One customers will not get the benefit of their own adjustment factors to effectively allocate direct costs.[35]

The appropriateness of Hydro One's proposed allocation of shared costs

Hydro One proposes to allocate shared costs among acquired and legacy rate classes using the OEB cost allocation model (CAM)[36]. Shared costs will be allocated in proportion to OM&A and fixed assets.[37] Hydro One will ensure that shared costs are allocated so that PDI and Orillia Power rates remain between the "goal posts" of the status quo and residual cost to serve.[38]

OEB staff submits that Hydro One's proposed allocation of shared costs does not appear to lead to appropriate results. Hydro One states that if the CAM results in a cost-to-serve that is higher than the status quo scenario, it will adjust revenue to cost ratios.[39] This is problematic in the case of PDI since some of the proposed revenue to cost ratios are already at the minimum levels allowable by the OEB as shown in Table 3 below (i.e., there is no room for further reductions).[40]

[32] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.1, p. 23
[33] EB-2018-0270/Exhibit I/Tab 1/Schedule 8, OEB 8; EB-2018-0242/Exhibit I/Tab 1/Schedule 47, OEB 47
[34] EB-2018-0270/Exhibit I/Tab 1/Schedule 9, OEB 9; EB-2018-0270/Exhibit I/Tab 2/Schedule 26, SEC 26; EB-2018-0242/Exhibit I/Tab 4/Schedule 24, VECC 24
[35] EB-2018-0242/EB-2018-0270 Technical Conference Transcript, Vol. 1, p. 83-87
[36] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.1, p. 137
[37] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.2, p. 73
[38] EB-2018-0242/Exhibit A/Tab 4/Schedule 1/p.7; EB-2018-0270/Exhibit A/Tab 4/Schedule 1/p. 8
[39] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol. 2, p. 75
[40] EB-2018-0242/Exhibit I/Tab 1/Schedule 49, OEB 49

Table 3: PDI - Proposed Revenue to Cost Ratios

Rate Class	R/C Ratio from CAM	Proposed R/C Ratio from Rate Design	Board Approved R/C Ratio Range
Residential	0.74	0.85	0.85 to 1.15
GS < 50kW	0.67	0.80	0.80 to 1.20
GS 50-4,999 kW	0.69	0.80	0.80 to 1.20
Large Use*	1.00	1.00	0.80 to 1.20

** Large Use Customers are proposed to be moved to Hydro One's Sub-Transmission Rate Class*

Table 4: Orillia Power - Proposed Revenue to Cost Ratios

Rate Class	R/C Ratio from CAM	Proposed R/C Ratio from Rate Design	Board Approved R/C Ratio Range
Residential	0.94	0.94	0.85 to 1.15
GS < 50kW	0.88	0.88	0.80 to 1.20
GS 50-4,999 kW	0.97	0.97	0.80 to 1.20

Hydro One appeared to suggest during the oral hearing that it may, as needed, further reduce the revenue to cost ratios, even outside the OEB-approved range, in an effort to remain between the “goal posts”. If Hydro One undertook to further reduce the ratios, additional costs would flow to legacy customers.

OEB staff notes that having the proposed revenue to cost ratios for acquired customers at the minimum levels allowable by the OEB in fact may already reflect a “subsidization” by legacy customers.

It is also not evident to OEB staff how such “goal seeking” is consistent with principles of cost causation and equity to all customers. OEB staff notes that the OEB previously told Hydro One that allocations should reflect cost causation and be equitable to all customers.[41]

OEB staff submits that Hydro One should not be allowed to reduce the revenue to cost ratios for either Orillia Power or PDI outside of the OEB-approved ranges.

[41] EB-2017-0049, Decision and Order, March 7, 2019, p. 162

The risk associated with Hydro One's projected consolidation savings

Hydro One submits that the proposed consolidations will reduce the total cost of serving acquired and legacy customers: the combined revenue requirements of all three service territories in 2030 will be between 0.4% and 0.6% lower with consolidation than without consolidation (Tables 5 and 6).[42]

Table 5: Orillia Power and Hydro One Revenue Requirement, 2019 and 2030: With and Without Consolidation

Utility	2019	2030 Without Consolidation	2030 With Consolidation
Orillia Power[43]	$ 8,859,135	$ 14,448,364	$ 9,586,153
Hydro One[44]	$ 1,497,859,890	$ 1,909,692,763	$ 1,906,966,036
Total	**$ 1,506,719,025**	**$ 1,924,141,127**	**$ 1,916,552,189**

Table 6: PDI and Hydro One Revenue Requirement, 2019 and 2030: With and Without Consolidation

Utility	2019	2030 Without Consolidation	2030 With Consolidation
PDI[45]	$ 17,168,906	$ 26,324,000	$ 20,550,232
Hydro One[46]	$ 1,497,859,890	$ 1,909,692,763	$ 1,904,762,530
Total	**$ 1,515,028,796**	**$ 1,936,016,763**	**$ 1,925,312,762**

While OEB staff accepts that some savings can be achieved, OEB staff submits that Hydro One may be overestimating likely savings. In particular, OEB staff submits that Hydro One's projected status quo baseline projections for PDI and Orillia Power may be too high, and Hydro One's projected incremental costs to serve may be too low. The net result is a narrowing of the so-called "goal posts" outside of which the customers of acquired utilities would pay higher rates than otherwise would be the case.[47]

For example, the rate of growth in the status quo revenue requirement projections for Orillia Power and PDI between 2019 and 2030 well exceeds the rate of growth, including rate rebasings, experienced by other utilities in recent years (Table 7). The compound annual growth rate experienced by other utilities, as cited by Hydro One in

[42] 0.4% lower in the case of Orillia Power and Hydro One, 0.6% lower in the case of PDI and Hydro One.
[43] EB-2018-0270 Exhibit I/Tab 1/Schedule 12, OEB 12
[44] *Ibid.*
[45] EB-2018-0242 Exhibit I/Tab 2/Schedule 44, SEC 44
[46] *Ibid.*
[47] The narrower the space between the goal posts, the greater the risk to Orillia Power, PDI and legacy customers.

their evidence[48], used a simple average of utility rate increases and did not take into account the number of years between rate rebasing. When the annual growth rate was calculated by OEB staff to reflect the years between rebasing, the growth rate was found to be lower, as shown in Table 7. In addition, the rates of growth in the Orillia Power and PDI status quo projections were developed using some cost of capital parameters that exceed the parameters currently approved by the OEB.[49] As illustrated in Section 6, Condition 1, Orillia Power and PDI revenue requirements by 2030 would each be lower than currently projected if their growth followed the more moderate pace of the comparator utilities cited in Hydro One's evidence and the OEB's current cost of capital parameters.[50]

Table 7: Compound Annual Growth Rate of Projected Status Quo Revenue Requirement

Utility	Compound Annual Growth Rate (CAGR)
Orillia Power: 2019 to 2030	4.5%
PDI: 2019 to 2030	4.0%
Orillia Power: 2010 to 2030[51]	3.2%
PDI: 2013 to 2030[52]	3.2%
Average of Cohort cited in Hydro One's evidence, as calculated by OEB staff[53]	2.9%

OEB staff also remains unclear as to whether Hydro One has appropriately accounted for acquired utility asset replacement needs (which are substantial) over the coming decade. Any additional costs to replace the acquired utilities' assets beyond what is forecast by Hydro One would serve to narrow the "goal posts". Although Hydro One refers to a potential "additional capital envelope" to fund requirements over and above those explicitly identified[54], it is not clear to OEB staff whether this capital envelope has been reflected in Hydro One's projected incremental cost of serving Orillia Power and PDI, or whether it is an additional amount included in Hydro One's status quo budget.

[48] EB-2018-0242 Attachment 19; EB-2018-0270 Attachment 19
[49] For example, the Long Term Debt Rate assumed in PDI and Orillia Power Status Quo projections is 4.21%: this is higher than the OEB-approved 3.21%. Further, the ROE assumed in PDI and Orillia Power Status Quo projections is 9%: this is higher than the currently OEB-approved 8.52%.
[50] EB-2018-0242 Attachment 19; EB-2018-0270 Attachment 19
[51] Compound annual growth rate calculated based on 2010 revenue requirement (EB-2009-0273) of $7.6 million and 2030 revenue requirement of $14.5 million
[52] Compound annual growth rate calculated based on 2010 revenue requirement (EB-2012-0160) of $15.4 million and 2030 revenue requirement of $26.3 million
[53] *Ibid.*, OEB Staff calculations
[54] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.1, p. 114

Moreover, OEB staff is concerned that Hydro One's overall per-unit costs to serve acquired utilities will be higher over the long-term. Despite requests made by parties for Hydro One to compare its long-term costs to Orillia Power's and PDI's, or to support its suggestions of economies of scale, Hydro One has not done so.[55] Although Hydro One cites economies of scale as a means of lowering the costs of purchasing new equipment, without providing an indication of total project costs (i.e., including labour and overheads), it has not been demonstrated that Hydro One can do the same job as PDI or Orillia Power for the same or lower costs[56]. In fact, OEB staff notes that Hydro One explained during the oral hearing that the sum of the capital envelope that PDI expects to spend over the 10-year deferral period without the consolidation is $18.4 million, and the sum of the capital envelope that Hydro One has built into their forecast under the consolidation scenario is nearly the same at $18.1 million[57]. However, the difference is that PDI plans to replace/refurbish[58] nine stations during the course of the ten year deferred rebasing period, while Hydro One indicated that it has identified six stations to replace/refurbish for this dollar amount. It therefore would appear that Hydro One cannot carry out work at the same cost as PDI.

This is further illustrated by the discussion of specific service charges during the oral hearing[59]. Hydro One has stated that its specific service charges are based on labour and materials, and it can be seen that specific service charges not capped[60] by the OEB are generally higher as compared to Orillia Power and PDI. For instance, Hydro One charges $88.29 for easement letters whereas Orillia Power and PDI only charge $15. For special meter readings, Hydro One charges $90 while PDI and Orillia Power each only charge $30.

OEB staff submits that there is a risk that consolidation synergies achieved in the near-term may be exceeded in the longer-term by Hydro One's potentially higher per-unit costs.[61]

[55] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.2, p. 164
[56] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.2, pp. 91-92
[57] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.2, p. 88
[58] During the second day of the technical conference, it was stated that some stations may not be replaced, instead, they would be refurbished. However, the cost of replacement and refurbishment was noted to be relatively close. See EB-2018-0242/EB-2018-0270 Technical Conference Transcript, Vol. 2, pp. 2-3.
[59] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol.2, pp. 92-97
[60] For example: 1. OEB issued New Customer Service Rules March, 2019; 2. EB-2017-0049 Decision and Order pp. 147 - 150
[61] EB-2018-0242/EB-2018-0270 Exhibit JT2.5, Attachment 1

Conclusion

In summary, Hydro One proposes new rate classes for Orillia Power and PDI customers. OEB staff submits that it is not clear whether Hydro One's rate class proposals for PDI and Orillia Power reflect true long-term cost causality or whether they are simply a way of avoiding higher rates that would apply if PDI and Orillia Power customers were incorporated into Hydro One's existing rate classes.

OEB staff further submits that Hydro One's expected savings from consolidating with Orillia Power and PDI are likely overestimated, and that Hydro One's potentially higher per-unit costs might eventually outweigh synergies achieved during the deferred rebasing period.

OEB staff therefore suggests that conditions be put in place to protect acquired customers from potentially higher asset replacement costs and rates that may be higher than the status quo, and to protect existing customers from having to "subsidize" acquired customers. OEB staff conditions are discussed in Section 6.

4.2 Impact on Service Quality and Reliability

The MAADs Handbook requires utilities to indicate the impact that the proposed transaction will have on customers with respect to reliability and quality of electricity service. The MAADs Handbook also provides 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.[62]

OEB staff reviewed the Applicants' 2018 Electricity Utility Scorecards to examine each utility's performance with regard to three[63] service quality metrics. The results of this review indicate that the Applicants all exceed industry targets for the three service quality metrics. However, when each of the service quality scores for the Applicants are averaged for the time period of 2014 to 2018, Orillia Power is observed to be the best performer in all three metrics and PDI second best.

Hydro One states that it will endeavour to maintain or improve, where possible, the reliability and quality of electricity service for customers. This is exemplified by Hydro One stating that it has engaged and acquired technology that will assist in fault location and power restoration via automated switching on Hydro One operated lines and that it pursues a vigorous maintenance schedule for all of its assets.[64] In addition, the Hydro

[62] MAADs Handbook, p. 7
[63] The three service quality performance metrics include: (1) new residential/small business services connected on time; (2) scheduled appointments met on time; and, (3) telephone calls answered on time.
[64] EB-2018-0242/Exhibit I/Tab 5/Schedule 5, IBEW 5

One call centre is open additional hours when compared to those of Orillia Power and PDI.

The System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI) values reported for Hydro One reflect reliability statistics of customers in the vicinity of the City of Peterborough (Table 8) and customers in the vicinity of the City of Orillia (Table 9). The statistics illustrate that Hydro One customers experience a higher interruption duration compared to PDI and Orillia Power customers. However, customers of PDI and Orillia Power experience more interruptions than Hydro One customers.

Table 8: Historical SAIDI and SAIFI Comparison of Hydro One and PDI[65]

	2014		2015		2016		2017	
	Hydro One	PDI	Hydro One	PDI	Hydro One	PDI	Hydro One	PDI
SAIDI	5.35	0.90	5.78	3.59	2.09	2.01	3.72	2.22
SAIFI	2.01	0.83	1.49	2.81	0.89	2.34	1.18	2.53

Table 9: Historical SAIDI and SAIFI Comparison of Hydro One and Orillia Power[66]

	2013		2014		2015		2016		2017		2018	
	Hydro One	Orillia Power	Hydro One	Orillia Power	Hydro One	Orillia Power	Hydro One	Orillia Power	Hydro One	Orillia Power	Hydro One	Orillia Power
SAIDI	3.06	1.13	0.76	2.15	4.08	1.06	2.77	0.52	5.73	3.63	2.07	1.43
SAIFI	1.37	1.03	0.39	1.28	1.33	2.44	0.84	1.10	1.59	0.92	0.81	1.50

Differences in the Applicants' capital plans, and the subsequent potential impacts on reliability, were addressed during the course of the proceeding. This was highlighted by PDI planning to replace/refurbish[67] nine stations during the course of the ten year deferred rebasing period, while Hydro One indicated that it had identified six stations to replace/refurbish.

Submission

Based on the evidence provided, OEB staff submits that acquired customers have the potential to experience harm with regards to service quality and reliability, if

[65] EB-2018-0242/Exhibit A/Tab 2/Schedule 1/p. 9 – November 29, 2019 update
[66] EB-2018-0270/Exhibit A/Tab 2/Schedule 1/p. 9 – November 29, 2019 update
[67] During the second day of the technical conference, it was stated that some stations may not be replaced, instead, they would be refurbished. However, the cost of replacement and refurbishment was noted to be relatively close. See EB-2018-0242/EB-2018-0270 Technical Conference Transcript, Vol. 2, pp. 2-3.

consolidated with Hydro One without conditions in place. This is exemplified by differences in capital plans regarding the refurbishment/replacement of distribution assets in the PDI service territory. The capital plan proposed by Hydro One would refurbish some, but not all of the stations identified by PDI (i.e., Hydro One appears to have only budgeted to refurbish six of the nine stations that PDI intends to refurbish). This could be attributed to Hydro One's solution being more cost-efficient than that proposed by PDI for station replacement/refurbishment or, it could reflect an underestimation from Hydro One with respect to the condition of the acquired assets. OEB staff does note that the differences in capital plans was addressed in both the technical conference and the oral hearing. However, OEB staff submits that the certainty regarding the number of stations proposed to be refurbished/replaced is unclear and the resulting impacts on the reliability of electricity service of acquired customers remains unclear.[68]

The effect of Hydro One's historical reliability performance on acquired customers is uncertain. Hydro One customers have experienced higher durations of service interruptions when compared to customers of PDI and Orillia Power. However, PDI and Orillia Power customers experience more service interruptions than Hydro One customers. Further, it is unclear if there would be improvements or deterioration in SAIDI and SAIFI levels of legacy customers following consolidation.

OEB staff also notes that there are benefits that will be experienced by acquired customers. Hydro One's call centre is open on Saturdays and has extended weekday operating hours. Further, Hydro One is able to provide email and text outage notifications to customers – all service quality elements that PDI and Orillia Power customer do not currently experience. Hydro One also offers service guarantees to customers. In the instance that Hydro One fails to meet commitments, such as a missed scheduled appointment, residential customer accounts are proactively credited $75.[69]

Overall, OEB staff submits that adequate conditions are required to prevent harm to customers with respect to service quality and reliability from the proposed consolidations. OEB staff conditions are discussion in Section 6.

4.3 Impact on Financial Viability

The OEB sets out in the MAADs Handbook that the impact of a proposed transaction on the acquiring utility's financial viability for an acquisition, or on the financial viability of

[68] EB-2018-0242/EB-2018-0270 Oral Hearing Transcript, Vol. 1, pp. 114-117
[69] EB-2018-0242/Exhibit A/Tab 2/Schedule 1/pp. 18-19; and EB-2018-0270/Exhibit A/Tab 2/Schedule 1/pp. 19-20

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 historical (book) value of the assets involved

- The financing of incremental costs (transaction and transition costs) to implement the consolidation transaction

Hydro One proposes to pay $41.3 million for the acquisition of Orillia Power. This comprises a cash payment of approximately $26.4 million for the shares and the assumption of short and long-term debt of approximately $14.9 million.[70] Hydro One stated that the premium paid will not be included in its revenue requirement and will not be funded by ratepayers. Further, the premium paid over the asset's book value will not have a material impact on the financial viability of Hydro One Inc. as the transaction price will account for less than 1% of Hydro One Distribution's net fixed assets.

Similarly, the Peterborough Application states that the purchase price to be paid for the net assets is $105 million. The premium to be paid over the asset's book value will not have a material impact on the financial viability of Hydro One Inc. as the amount accounts for less than 2% of Hydro One Distribution's net fixed assets. In addition, the price paid will not be included in Hydro One's revenue requirement and, therefore, not be funded by ratepayers.[71]

With regards to transaction and integration costs, the Orillia Application states that Hydro One's incremental transaction costs are estimated to be approximately $3 million[72], while those identified in the Peterborough Application will be approximately $0.2 million[73]. Both of the Applications attributed such costs to legal and tax costs relating to completion of the transactions, and costs associated with the necessary regulatory approvals.

Hydro One approximates $6 million and $9 million in integration costs associated with incremental up-front costs to transfer Orillia Power and PDI customers, respectively, into Hydro One's customer and outage management systems. The incremental costs will be financed through productivity gains associated with the consolidation and will not be recovered through rates. If productivity gains are not realized as forecasted over the

[70] EB-2018-0270/Exhibit A/Tab 2/Schedule 1/p. 20
[71] EB-2018-0242/Exhibit A/Tab 2/Schedule 1/pp. 19-20
[72] EB-2018-0270/Exhibit A/Tab 2/Schedule 1/p. 20
[73] EB-2018-0242/Exhibit A/Tab 2/Schedule 1/p. 19

rebasing deferral period, the remaining balance of the transaction and integration costs will be borne by Hydro One shareholders.[74]

Submission

Based on the evidence provided, OEB staff submits that the proposed financing of the consolidations, and the premiums paid, will not have an adverse impact on Hydro One Inc.'s financial viability. As a result, OEB staff submits that the Orillia Application and Peterborough Application both meet the "no harm" test with regards to financial viability.

[74] EB-2018-0270/Exhibit I/Tab 1/Schedule 14, OEB 14 and EB-2018-0242/Exhibit I/Tab 1/Schedule 37, OEB 37

5 OEB STAFF SUBMISSIONS REGARDING OTHER MATTERS

The Applications include requests for approval of a number of other matters, as discussed below.

Deferred Rebasing Period and 1% Reduction to OEB-Approved Rate Schedules for PDI and Orillia Power

The Applicants are choosing to defer the rebasing of rates for ten years from the date of the closing of the proposed consolidations. In years six to ten of the deferred rebasing period, Hydro One proposes to set the rates of Orillia Power and PDI customers using the Price Cap Index adjustment mechanism. During years one to five of the deferred rebasing period, Hydro One is seeking to include a rate rider in the current[75] OEB-approved rate schedules of PDI and Orillia Power to give effect to a 1% reduction relative to the Base Distribution Delivery Rates[76] (exclusive of rate riders). A unique element is that Hydro One proposes the residential variable rate rider be rounded to five decimal places – an exception to the OEB's rule of four decimal places. All other rate riders for PDI and Orillia Power customers will continue to be rounded to four decimal places.

Submission

OEB staff submits that the deferred rebasing period chosen by the Applicants is consistent with the OEB's policies.

OEB staff does not object to rate riders that would give effect to a 1% reduction relative to the Base Distribution Delivery Rates (exclusive of other rate riders). The OEB previously approved the implementation of a 1% reduction to each of the acquired utilities' rates in the cases of Haldimand, Norfolk and Woodstock. However, OEB staff questions Hydro One's proposed method of implementation. Specifically, Hydro One proposes a volumetric rate rider to five decimal places for the residential class whereas both PDI and Orillia Power have transitioned to fully-fixed distribution charges. Therefore, to effect the proposed 1% reduction, OEB staff submits that a fixed, not volumetric rate rider equivalent to the targeted 1% reduction could be established for the residential class and suggests that Hydro One comment on this alternative in its reply submission.

[75] For PDI, the current rates as of the closing date of the proposed transaction based upon the revenue requirement approved in EB-2017-0266 while for Orillia Power the current rates as of the closing date of the proposed transaction based upon the revenue requirement in EB-2015-0024.
[76] Within PDI service territory, the rebate would be provided to customers across the residential, general service, and large user rates classes. With Orillia Power service territory, the rebate would be provided to customers within the residential and general service classes.

Specific Service Charges

The Applications propose that PDI and Orillia Power's tariffs would remain as approved by the OEB in their respective rate orders, with the exception of the Specific Service Charges. The Specific Service Charges would be those of Hydro One.

Submission

OEB staff supports the proposal to alter the Specific Service Charges of PDI and Orillia Power to align with those of Hydro One following consolidation. OEB staff notes that revenue differences arising between Hydro One's and the acquired utilities' service charges do not appear to be significant.

Incremental Capital Module (ICM)

Hydro One requests access to an ICM, if the need arises, to service unforeseen needs within the PDI and Orillia Power service territories during the deferred rebasing period. In the Applications, Hydro One stated that it "…currently has no plan to apply for ICM relief during the deferred rebasing period, however if circumstances prevail where Hydro One does require an ICM, the details pertaining to the ICM will be provided in that future application."[77]

Submission

OEB staff does not object to Hydro One having access to an ICM. However, OEB staff notes that (with the OEB's permission) neither PDI nor Orillia Power have filed consolidated Distribution System Plans (DSP) since the onset of the requirement to do so. OEB staff submits that Hydro One should be required to provide DSPs in its next cost-based application (due in 2022 for 2023 rates) for the PDI and Orillia Power service territories. In the event that Hydro One wishes to seek an ICM in advance of 2023 rates, then it should file the associated DSP as part of the ICM application.

The capital plans within the DSPs should include information on the current condition of distribution system assets as well as the planned capital investments that Hydro One plans to make. For the first DSPs to be filed by Hydro One for each of the service areas, the planned capital investments that the PDI and Orillia Power utilities currently have in place for the next five years (i.e. as part of the status quo forecast and therefore would have been undertaken during the deferred rebasing period if the Applications were not approved) must be included, and any significant changes relative to what Hydro One is proposing must be explained in detail. This will provide a baseline upon which Hydro

[77] EB-2018-0242/Exhibit A/Tab 2/Schedule 1/p. 22; EB-2018-0270/Exhibit A/Tab 2/Schedule 1/p. 22

One's justification for the need and prudence of an ICM can be evaluated by the OEB in the future.

Proposed ESM

Hydro One proposes the implementation of an ESM in the Applications. In the case of PDI, the ESM will guarantee a cumulative $1.8 million amount of overearnings[78] while for Orillia Power, the ESM will guarantee a cumulative $2.6 million amount of overearnings[79] to be provided to acquired customers. Hydro One also requests that if the OEB approves the proposed consolidations, the OEB establish a new deferral account to record the costs of the ESM refund amount for future disposition. Principal amounts recorded in the account would be added annually and the interest would be calculated in a manner consistent with the OEB's Prescribed Interest Rates.[80]

Submission

OEB staff supports Hydro One's request to establish a deferral account to track costs associated with the ESM. OEB staff accepts Hydro One's proposal to guarantee an ESM for acquired customers, but is of the view that this should be a minimum amount. To the extent that the savings exceed the guaranteed amount, Hydro One should be required to share the savings on a 50/50 basis with all customers.

OEB staff submits that Hydro One should provide a draft accounting order as a condition of the OEB's approval of the Applications or should file the accounting order as a subsequent application.

Accounting Matters

In the Peterborough Application, Hydro One and 1937680 Ontario Inc. seek approval to use US Generally Accepted Accounting Principles (US GAAP) for PDI financial reporting. In the Orillia Application, approval is sought for Hydro One to also utilize US GAAP for Orillia Power financial reporting.

Submission

OEB staff submits that the requests to use US GAAP should be granted. OEB staff notes that in the MAADs applications for Haldimand, Norfolk and Woodstock, the OEB granted similar requests.[81] Further, OEB staff notes that in case the transition to US GAAP results in any material revenue requirement impact that could potentially be

[78] EB-2018-0242 Exhibit A/Tab 3/Schedule 1/p. 2
[79] EB-2018-0270 Exhibit A/Tab 3/Schedule 1/p. 2
[80] EB-2018-0242 Exhibit A/Tab 1/Schedule 1/p. 8; EB-2018-0270 Exhibit A/Tab 1/Schedule 1/p. 7
[81] EB-2013-0196, EB-2014-0244 and EB-2014-0213

refunded to ratepayers, the OEB should establish a deferral account to capture any material transition impact that is favourable to acquired customers. OEB staff notes that the establishment of such a deferral account does not guarantee the disposition of the account as it will be subject to a prudence review in a subsequent rate application. If the OEB approves the establishment of this deferral account, Hydro One could file a draft accounting order at the same time as it will file its draft accounting order for the ESM.

Amendment and Cancellation of Electricity Distribution Licences

In order to effect the proposed consolidations, the Applicants request approval of electricity distribution licence amendments and cancellations.

Submission

OEB staff supports the electricity distribution licence amendments and cancellations that the Applicants have proposed in order to effect the consolidations.

6 OEB STAFF PROPOSED CONDITIONS

Previous sections of this submission introduced the concept of implementing specific conditions to help ensure the potential benefits of the proposed consolidations, while protecting customers in case Hydro One's performance and cost projections do not materialize. Essentially, these conditions will shift the risks associated with the proposed consolidations from customers (both legacy and acquired) to Hydro One. In OEB staff's view, conditions are necessary given the uncertainties in Hydro One's ability to satisfy the "no harm" test following the end of the deferred rebasing period.

OEB staff has developed a number of conditions that, in OEB staff's opinion, should be conditions of the OEB's approval. However, OEB staff appreciates that the implementation of these conditions will require significant regulatory oversight and may pose implementation challenges. These challenges do not outweigh the need for conditions, given the risk of potential harm for both acquired and legacy customers, and the fact that once the transaction has been completed, it is not possible to unwind the transaction if there is, in fact, harm. Accordingly, if the conditions are deemed not feasible or cannot be agreed to by Hydro One, and Hydro One has no viable alternatives that meet the spirit of OEB staff's conditions, OEB staff submits that both the Orillia Application and Peterborough Application should be denied.

Condition 1: Not-to-Exceed Cost Limit

Condition 1 provides that any costs to serve the current PDI and Orillia Power service territories that exceed the status quo forecast are not recoverable through rates. OEB staff outlines additional reporting measures in Conditions 2 through 4. OEB staff considered carefully whether additional reporting is required. Given the context of these applications, and the OEB's findings in previous decisions, it is OEB staff's view that the additional reporting requirements will allow Hydro One to track the information necessary to propose a reasonable rebasing plan for the acquired class following the deferred rebasing period.

OEB staff outlines two options for the post deferral period that link the going forward rates with OEB staff's revised status quo forecast as will be discussed further below.

This condition holds Hydro One to account on the foundational aspects of its proposals and protects acquired customers from the primary risks outlined in this submission.

The OEB established a similar requirement through its Decision and Order on Hydro One's 2018-2022 distribution rates application[82]. In that decision, the OEB identified the purpose of this requirement:

> The determination that Hydro One is to absorb revenue shortfalls associated with its cost to operate the [acquired utilities] eliminates the negative impact that Hydro One's rate proposal would have had on its customers.[83]

During the oral hearing, OEB staff questioned Hydro One on its willingness to accept such a condition; Hydro One expressed reluctance. Instead, Hydro One stated that, if as a result of the consolidation, the rates of acquired customers were to increase by an amount greater than their forecast status quo, their revenue to cost ratios would be adjusted so that existing customers would pay a greater share of the costs.

For the reasons described in Section 4.1, OEB staff submits that the status quo forecasts proposed by Hydro One are too high. As a result, such forecasts should be downwardly-revised before they serve as the starting point for the limit above which costs cannot be recovered. The status quo forecast should be revised to reflect a compound annual growth rate of no more than 2.9% from the time of the utilities' last rebasing. The 2.9% represents the average compound annual growth rate of utilities who rebased in 2017 and 2018, as calculated by OEB staff.[84] PDI and Orillia Power last rebased in 2010 and 2013, respectively. Applying this annual growth rate from the last rebasing year would change PDI's 2030 revenue requirement from $26.32 million to $25.03 million and Orillia Power's 2030 revenue requirement from $14.45 million to $13.54 million. Any costs to serve the acquired customers above these revised status quo forecasts should not be recoverable by Hydro One through future rates.

The OEB could consider two options for the post deferral period:

(1) Hydro One could be expected to file a rebasing plan that allows the OEB to assess the proposed impacts on the acquired class versus the revised status quo forecast, so that the OEB can determine the costs to serve the acquired rate classes and whether any costs above the revised status quo forecast[85] will be recoverable by Hydro One through rates; or

(2) The OEB could cap the rates that Hydro One can charge to acquired customers going forward. For example, an approach could be taken whereby the average of all electricity distributor rate increases from the previous five year period is applied to the

[82] EB-2017-0049
[83] EB-2017-0049 Decision and Order, March 7, 2019, p. 164.
[84] The calculation is shown on page 7 OEB staff's compendium for the oral hearing.
[85] As noted in EB-2018-0242/Exhibit I/Tab 2/Schedule 44, SEC 44; and in EB-2018-0270/Exhibit I/Tab 1/ Schedule 12, OEB 12 – Year 11 of the status quo forecast is 2030

revised status quo forecast, in order to determine the maximum rates that can be charged to the acquired customers. Any costs to serve the acquired customers above this limit would not be recoverable by Hydro One through future rates.

Condition 2: Capital Budgets Accountability for the Deferred Rebasing Period

Condition 2 provides that if Hydro One's actual capital expenditures for the acquired utilities exceed the capital budgets it forecast in the Applications for the deferred rebasing period, these additional costs would not be recoverable by Hydro One through future rates. The purpose of this condition is two-fold:

1. To address OEB staff's uncertainty with respect to Hydro One's capital planning for the Orillia Power and PDI service territories as discussed in Section 4.2.
2. To reduce the risk to customers associated with a potentially imprecise projection of capital spending requirements within the acquired service territories.

This condition is not to say that Hydro One should avoid making any required capital investments. Rather, if it is determined that Hydro One underestimated the capital required to maintain the reliability of PDI or Orillia Power within prescribed standards, the capital work must be done, however, the cost for this work would not be recoverable by Hydro One through future rates. For clarity, Hydro One's capital costs in excess of its forecasts for PDI and Orillia Power should not be made good from the capital budget for its legacy service areas. Doing so would harm legacy customers by diverting funds and not address OEB staff's identified risks around Hydro One's approach to capital planning in the acquired service territories.

To ensure transparency, all capital spending undertaken by Hydro One within the acquired service territories during the deferred rebasing period would be separately tracked and reported to the OEB as part of Hydro One's cost-based rate applications following the consolidations (e.g. 2023 and 2028 rates). As part of this reporting, Hydro One would be required to indicate the source of funding for any amounts spent on capital in excess of the capital budgets proposed by Hydro One in the Applications.

It should be noted that in the event that the OEB approves an ICM, Hydro One would be eligible to recover these costs.

Condition 3: Preserving Reliability and Service Quality

Condition 3 is that during the deferred rebasing period, Hydro One must separately track reliability and service quality performance metrics of acquired and legacy customers and be prepared to demonstrate that neither deteriorated as a result of the consolidations. Specifically, Hydro One should report on measures within the Service

Quality, Customer Satisfaction, and System Reliability performance categories included in the OEB's scorecard. If levels of reliability and service quality (e.g., SAIDI, SAIFI, telephone call abandonment rate) are shown to have declined, Hydro One must provide an explanation for the change. If it is shown in that the decline is attributable to the consolidation, Hydro One must make the investments necessary to return performance to, at a minimum, pre-consolidation levels. Hydro One must explain how the identified investments are anticipated to return performance to pre-consolidation levels. To the extent the costs of these investments exceed the capital budgets proposed for PDI or Orillia Power in the Applications, in accordance with Condition 2, these costs would not be recoverable through future Hydro One rates.

To fulfill this requirement, Hydro One must separately report the measures within the Service Quality, Customer Satisfaction, and System Reliability performance categories included in the OEB's scorecard for former PDI and former Orillia Power from the overall Hydro One service territory reporting at the same time as it reports on its capital costs discussed earlier (i.e. as part of its future cost based rate applications during the deferred rebasing period). For clarity, this reporting requirement is not intended to replace Hydro One's consolidated annual scorecard. Rather, Hydro One would be required to file supplemental reports that provide PDI- and Orillia Power-specific metrics. These reports should provide a clear comparison of pre- and post-consolidation performance. Hydro One should propose a structure for these reports for the OEB's consideration.

Condition 4: Tracking of Costs During Rebasing Deferral Period

Through previous Hydro One MAADs decisions, the OEB established the cost information it expects acquiring utilities to track during the rebasing deferral period. These same decisions also indicated how the OEB may use that cost information during its consideration of post-deferred rebasing period rate applications. For the PDI and Orillia Power transactions, OEB staff is proposing this Condition 4 as the framework that will ensure Hydro One tracks the appropriate information in a manner that will be useful to the OEB in assessing the risks outlined in this submission.

In its decisions on Hydro One's Haldimand, Norfolk, and Woodstock consolidation applications, the OEB identified that it expected Hydro One to track costs for the acquired utilities, separately.[86] This is exemplified in the Decision and Order for the Woodstock consolidation in which the OEB directed Hydro One to report "[a]ll costs (including overhead corporate costs) associated with serving the Woodstock service

[86] EB-2013-0196/EB-2013-0187/EB-2013-0198, Decision and Order, July 3, 2014, p. 25; EB-2014-0213, Decision and Order, September 11, 2015, p. 22; EB-2014-0244, Decision and Order, March 12, 2015, p. 3

area, recorded and reported both on an annual and cumulative basis from the time of the closing of the share purchase transaction."[87]

Through its Decision and Order on Hydro One's 2018-2022 distribution rates application[88], the OEB stated that Hydro One had failed to appropriately track the costs to serve acquired customers in the Haldimand, Norfolk and Woodstock service territories, as directed. The OEB stated that such tracking was required as it would be used "…to inform the rate-setting process at the completion of the respective deferral periods." [89]

OEB staff understands that Hydro One was expected to accurately track all costs, including overhead corporate costs, which OEB staff views as equivalent to shared costs. Such tracking would demonstrate to the OEB that the acquisition-related efficiencies forecast by Hydro One had been obtained and that, in-turn, these efficiencies had resulted in, amongst other things, rates no higher than they would have otherwise been (i.e., that the "no harm" test, from a cost-to-customer perspective, had been met).

Hydro One has stated it will not track the costs previously requested related to serving the PDI and Orillia Power service territories during the deferred rebasing period. Specifically, Hydro One has indicated that it will not track shared costs, which are presently uncertain and which have the potential to represent a significant portion of the total cost to serve acquired customers. OEB staff is of the view that if the shared costs for acquired customers are not tracked, Hydro One will not be in a position to conclusively demonstrate the extent to which projected cost efficiencies have been realized, the impact of these efficiencies, or that the proposed rates for acquired customers are appropriate.

Hydro One should be required to track all costs (capital and OM&A) to serve acquired customers, including shared costs. If Hydro One is unable to track shared costs, then it should propose an alternative methodology for understanding the shared costs for acquired customers during the deferred rebasing period. The methodology should allow the OEB, at the end of the deferred rebasing period, to assess whether the shared costs proposed to be allocated to the acquired customers seem reasonable. Any costs not deemed appropriate would not be recoverable by Hydro One through future rates.

Additionally, Hydro One should be required to provide the OEB with cost reports, the first of which should be submitted within six months of the close of the transactions, and then after at each cost-based application (e.g. for 2023 rates and then again for 2028

[87] EB-2014-0213, Decision and Order, September 11, 2015, p. 22
[88] EB-2017-0049
[89] EB-2017-0049, Decision and Order p. 159.

rates). Hydro One should propose a structure for this reporting with its first report to the OEB.

The purpose of these reports will be to ensure that Hydro One is reliably tracking costs, in a manner that will allow the OEB to rely on when considering Hydro One's first rate rebasing proposal (to be in effect for some time around 2030 rates).

Condition 5: Rules for the Assignment of Shared Costs

Hydro One states that it will propose inputs in order to allocate shared costs to acquired customers as part of its first cost of service application following the deferred rebasing period. Hydro One states that when shared costs are applied, the bills of acquired customers will remain lower than the status quo scenario. OEB staff's concern is that in order to achieve this goal, Hydro One may attempt to adjust the revenue to cost ratios such that legacy customers subsidize the acquired customers to such a level that there is no longer a benefit for legacy customers from the consolidation. In order to ensure that legacy customers are not worse off as a result of the transactions, Condition 5 is that Hydro One must demonstrate how much of the shared costs have been allocated to the acquired customers in the first rate rebasing application following the deferred rebasing period. The allocation of shared costs will be subject to OEB review and approval at that time. If it is determined that it is not possible to appropriately allocate shared costs to acquired customers and still maintain rates below the limit established in Condition 1, any incremental amount of shared costs beyond the established limit that should have been allocated to acquired customers, but were not, would not be recoverable by Hydro One through future rates. OEB staff further submits that Hydro One should not be allowed to reduce the revenue to cost ratios for either Orillia Power or PDI outside of the OEB-approved ranges. This condition will ensure that there is no harm for legacy customers associated with the transaction.

Other Conditions

As further described in Section 5, OEB staff submitted that the OEB's approval should also include the following conditions:

1. Hydro One should be required to provide a draft accounting order related to its proposed ESM deferral account
2. A deferral account should be established to capture any material impact resulting from the proposed transition to US GAAP that is favourable to acquired customers and Hydro One should be required to provide a draft accounting order.
3. Hydro One should be required to provide DSPs in its next cost-based application (due in 2022 for 2023 rates) for the PDI and Orillia Power service territories. The

DSPs should include information on currently planned investments in the status quo forecasts developed by PDI and Orillia Power. In the event that Hydro One wishes to seek an ICM in advance of 2023 rates, then it should file the associated DSP as part of the ICM application.

7 CONCLUSION

OEB staff submits that the proposed transactions have the potential to benefit legacy and acquired customers, and are consistent with public policy that strives to reduce the number of local distribution utilities in Ontario. As described above, however, OEB staff is concerned that without certain specific conditions, there is a realistic chance that customers (whether acquired, legacy, or both) may be harmed by the transactions. As such, OEB staff submits that the OEB should approve the Applications with the conditions proposed by OEB staff to prevent possible harm. The conditions should help to ensure the potential benefits of the proposed consolidations, while protecting customers in case Hydro One's performance and cost projections do not materialize as outlined in the Applications. Essentially what OEB staff is proposing is simply that Hydro One be held to its forecasts (including some forecasts as adjusted by OEB staff) and its commitment that consumers will not be harmed.

If the conditions are not feasible or cannot be agreed to by Hydro One, and Hydro One has no viable alternatives that meet the spirit of OEB staff's conditions, OEB staff submits that both the Orillia Application and Peterborough Application should be denied.

All of which is respectfully submitted.