January 4, 2020

Christine Long
Registrar and Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Long:

Re: EB-2018-0242/0270 – Hydro One Networks Inc. – Orillia Power Distribution Corporation – Peterborough Distribution Inc. – Applications for Acquisition by Hydro One Networks Inc.

We are representing the Consumers Council of Canada in the above-referenced proceedings. Please find, attached, our Final Argument. We have filed a single Final Argument that addresses the Applications for both Peterborough Distribution Inc. and Orillia Power Distribution Corporation.

Yours truly,

Julie E. Girvan

Julie E. Girvan

CC: All Parties

<u>FINAL ARGUMENT OF THE CONSUMERS COUNCIL OF CANADA</u>

RE: EB 2018-0242 AND EB-2018-0270

PETERBOROUGH DISTRIBUTION INC./HYDRO ONE NETWORKS INC.

ORILLIA POWER DISTRIBUTION CORPORATION/HYDRO ONE NETWORKS INC.

APPLICATIONS FOR ACQUISITIONS BY HYDRO ONE NETWORKS INC.

I. INTRODUCTION:

On September 26, 2018, Hydro One Networks Inc. ("HON") and Orillia Power Distribution Corporation ("OPDC") filed an application with the Ontario Energy Board ("OEB") for approval of the relief necessary to effect HON's purchase of OPDC. On October 12, 2018, HON and Peterborough Distribution Inc. ("PDI") filed an application with the OEB for approval of the relief necessary to effect the purchase of the electricity distribution system assets of PDI.

Although for the initial discovery processes these Applications were separate the OEB combined them for both a Technical Conference and Oral Hearing. The Technical Conference was held on October 3 and 4, 2019, and the Oral Hearing was held on December 2 and 3, 2019. These are the submissions of the Consumers Council of Canada ("Council") regarding the two Applications. The Council will first set out the background to the Applications, provide an overview of the proposals, and then provide the Council's submissions on the Applications.

II. BACKGROUND:

The "No Harm" Test

The OEB uses the "no harm" test in assessing whether to approve utility mergers acquisitions, amalgamations and divestiture ("MADD") applications. The *Handbook to Electricity Distributor and Transmitter Consolidations* issued on January 19, 2016 ("MADDs Handbook") sets out guidance as to how the OEB intends to apply the "no harm" test. In that Handbook the OEB states:

> The "no harm" test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB's statutory objectives, as set out in section 1 of the OEB Act. The OEB will consider 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[1].

The statutory objectives that are directly relevant to the OEB's consideration of MADDs Applications are:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service;

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[2].

With respect to price the OEB stated in the MADDs Handbook that:

> …to demonstrate "no harm", applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve 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[3].

With respect to reliability the OEB stated:

> Under the OEB's regulatory framework, utilities are expected to deliver continuous improvement for both reliability and service quality performance to benefit customers. This continuous improvement is expected to continue after a consolidation and will continue to be monitored for the consolidated entity under the same established requirements.[4]

With respect to promoting economic efficiency and cost effectiveness, the OEB's primary considerations are:

1. The effect of the purchase price, including any premium paid above the historic (book) value of the assets involved; and

2. The financing of incremental costs (transition and integration costs) to implement the consolidation transaction.[5]

---

[1] *Handbook to Electricity Distributor and Transmitter Consolidations*, dated January
[2] Ibid, p. 6
[3] Ibid, p. 7
[4] Ibid
[5] Ibid, p. 8

The OEB has made it clear that its concerns with respect to the purchase price will be strictly focused on the effect of that price on the underlying cost structures and financial viability of the acquiring utility or in the case of a merger the consolidated entity. The OEB has also allowed for deferred rebasing in order to enable the utilities to offset the transaction costs with efficiency gains. [6]

If an Applicant can meet the "no harm" test the OEB will approve the Application.

History of the OPDC Applications:

This is not the first time that OPDC and HON have sought approval for the transaction that is the subject of this current Application. The chronology is as follows:

- The initial Application regarding the exact same transaction was filed by HON and OPDC on October 11, 2016;

- Parties (OEB Staff, Intervenors and the Applicants) filed final submissions regarding the Application in April and May of 2017, following a written discovery process;

- Having reviewed the submissions, the OEB determined, in its Procedural Order No. 6, dated July 27, 2017, that the hearing of the Application would be adjourned until the OEB rendered its Decision on HON's distribution Application for the period 2018-2022 (EB-2017-0049);

- The OEB determined that evidence in the distribution rate proceeding was relevant to its consideration of the initial Application. The cost allocation proposals in that proceeding resulted in significant rate increases for acquired utility customers (customers in the Norfolk, Haldimand and Woodstock service territories);

- The OEB concluded that its determinations on the HON distribution rate proceeding would be determinative of how customers impacted by acquisitions are to be treated in the future[7];

- HON and OPDC each filed a Notice of Motion requesting for a review and variance of that Decision. In its Motions Decision the OEB granted the motions and referred the matter back to the original panel for reconsideration[8]. The original panel determined that it would re-open the record of the initial Application and require HON to file evidence on its

[6] Ibid, pp. 8-9
[7] EB-2016-0276, Procedural Order No. 6, dated July 27, 2017
[8] EB-2017-0320 Decision, dated January 4, 2018

expectations of the overall cost structures following the deferred rebasing period and the effect on OPDC customers[9];

- HON and OPDC did not file the requested evidence. Instead they filed submissions stating that based on the projected HON cost savings forecast for the 10 year period following the transaction, HON 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. HON submitted that at the time of rebasing it will adhere to the cost allocation and rate design principles, in place at such time in the future, ensuring that the costs allocated to Orillia customers fairly and accurately reflect the new lower cost structure to serve all customers;[10]

- The OEB concluded, in its Decision dated April 12, 2018, that HON 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 further concluded that it was not satisfied the "no harm" test had been met and denied the Application.[11]

- HON and OPDC filed Motions to review and vary the MADDs Decision on May 2, 2018. The OEB denied the Motions on the basis that they did not pass the OEB's threshold test set out in its Rules of Practice and Procedure[12].

The OPDC and HON Applications before the OEB today relate to the exact same transaction that was before the OEB in the EB-2016-0276 proceeding. Those Applications were denied by the OEB. The fundamental difference between the OPDC Applications that were filed in 2016 and the OPDC Applications before the OEB today appears to be HON's decision to propose a cost allocation approach after the deferred rebasing period specific to the acquired customers – and its intent to continue that approach in perpetuity. That approach will be different than the cost allocation approach HON uses for all of its legacy customers. From the Council's perspective it should be rejected by the OEB on the basis that it is unfair to legacy customers of HON and not consistent with generally accepted cost allocation principles. HON should not be permitted to "tinker" with its cost allocation in order to convince the OEB that its "no harm" test has been met and that on that basis a MADDs Application should be approved.

III. OVERVIEW:

The OPDC Applications:

---

[9] EB-2016-0276, Procedural Order No. 7, dated February 5, 2018
[10] HON Submissions, dated February 15, 2018, pp. 2,6
[11] EB-2016-0276, Decision and Order dated April 12, 2018, p. 13
[12] EB-2017-0171, Decision and Order, dated August 23, 2018

The following summarizes the key components of the OPDC Applications (by OPDC and HON) and the request for relief:

- HON is seeking approval to acquire all of the issued and outstanding shares of OPDC;

- OPDC is seeking to dispose of all of its distribution assets to HON;

- OPDC is seeking approval pursuant to section 78 of the Ontario Energy Board Act to include a rate rider to its OEB approved rate schedules to allow for a 1% reduction relative to the base delivery rates applicable at the time of the closing and applicable for the first 5 years of the 10-year deferred rebasing year. Beyond the first 5 years the OPDC rates will be set on the basis of a Price Cap IRM;

- HON is seeking to update all of OPDC's Specific Service Charges to align with those of HON;

- HON is seeking approval to establish a new deferral account to record an Earnings Sharing mechanism amount of $2.6 million to be refunded to OPDC customers at some point in the future;

- HON is seeking a deferred rebasing period of 10 years;

- HON is seeking approval to use an Incremental Capital Module ("ICM") if required during the deferred rebasing period.[13]

HON's evidence is that as of Year 11 Orillia customers will benefit from ongoing cost structures as a result of operational synergies – both capital and OM&A. HON argues that its legacy customers will benefit from lower ongoing cost structures by having its shared costs allocated over a larger customer base. It is HON's position that the acquisition of OPDC is forecast to generate $6.5 million in savings in Year 11, with HON's legacy customers seeing a $1.7 million reduction in the costs to b collected from them and OPDC customers seeing a $4. 8 million in the costs that would otherwise be collected from them if the transaction is not approved.[14] Based on this evidence HON submitted that the Application satisfies the "no-harm" test[15].

[13] Ex A/T1/S1
[14] HON – Argument in Chief, OPDC, dated December 13, 2019, p. 3
[15] Ibid

With respect to reliability HON claims that given its evidence, it is "clear" that the transfer of OPDC to HON is expected to maintain or improve the reliability and quality of electricity service.[16]

Regarding economic efficiency, HON argues that this transaction will promote economic efficiency and cost effectiveness in the electricity industry[17].

The PDI Applications:

The following summarizes the key components of the PDI Applications (by PDI and HON) and the request for relief:

- PDI is applying to amalgamate with Peterborough Utility Services Inc. ('PUSI");

- A rather complicated series of transactions would have the distribution system (after the amalgamation) being sold to a numbered company, 1937680, with the distribution system ultimately disposed of to HON;

- PDI is seeking approval pursuant to section 78 of the Ontario Energy Board Act, to include a rate rider to its OEB-approved rate schedules to give effect to 1% reduction relative to the base delivery rates applicable at the time of closing and applicable for the first 5 years of the 10 year deferred rebasing period. Beyond the first 5 years PDI's rate would be set on the basis of Price Cap IRM;

- HON is seeking to update all of PDI's Specific Service Charges to align with those of HON;

- HON is seeking approval to establish a new deferral account to record an Earnings Sharing mechanism amount of $1.7 million to be refunded to PDI customers at some point in the future HON;

- HON is seeking a deferred rebasing period of 10 years;

- HON is seeking approval to use an ICM, if required, during the deferred rebasing period.[18]

HON's evidence is that PDI customers will benefit from lower ongoing cost structures as a result of operational synergies – OM&A and Capital. HON' s legacy customers will benefit from lower ongoing cost structures by having its shared costs

[16] Ibid, p. 5
[17] Ibid, p. 6
[18] Ex. A/T1/S1

allocated across a broader customer base. The acquisition of PDI is forecast to generate a total of $9.3 million in savings in Year 11, with HON's legacy customers seeing a $3.6 million reduction in the costs to be collected from them and PDI customers seeing a $5.7 million in the costs that would otherwise be collected from them if the transaction is not approved.[19] Based on this evidence HON submitted that the Application satisfies the "no-harm" test[20].

With respect to reliability HON claims that with the consolidation of and integration of the two territories there is an opportunity to improve the reliability for PDI customers through new tools and technologies that HON currently utilizes. HON argues that in the long term PDI customers are expected to benefit from the operational efficiencies to be created from the consolidation. They also claim that HON will provide a level of customer service that extends beyond service levels provided by smaller utilities such as extended call centre service hours, key account managers and automated outage notifications.[21]

HON also claims that the transaction will promote economic efficiency and cost effectiveness leading to lower ongoing cost structures, pointing specifically to OM&A and Capital savings.

IV. SUBMISSIONS:

Cost Structures:

The Council is not convinced, by the evidence presented in this proceeding by HON, OPDC, and PDI that either of these transactions satisfy the OEB's "no harm" test. HON has a long track record of acquiring utilities. In 1999 and 2000 HON acquired 89 utilities and through a lengthy harmonization process the rates of those utilities were rolled into the rates of HON. The rate increases for the customers of the acquired utilities over time have been significant. The cost savings that were promised did not materialize, as HON remains the highest cost utility in the Province.

For the first 10 years of the proposed deferred rebasing period HON has promised a 1% rate reduction to base rates for both OPDC and PDI and it is also proposing what it calls an ESM for the customers guaranteeing $1.8 million for PDI customers and $2.6 million for OPDC customers. The Council accepts that under this scenario, during the deferred rebasing period, OPDC and PDI customers will be better off relative to scenario whereby the acquisitions never happened.

The OEB, however, in previous decisions and the MADDs Handbook has confirmed it expectations regarding price and the "no harm" test:

---

19 HON – Argument in Chief, PDI, dated December 13, 2019, p. 3
20 Ibid
21 Ibid, p. 14

> Consistent with recent decisions, the OEB will not consider temporary rate decreases proposed by the 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…
>
> To demonstrate "no harm", applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve 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.[22]

In its Decision regarding the initial OPDC Application the OEB reiterated this point and denied the Application on the basis that a list of forecast savings from the acquisition does not automatically result in lower cost structures.[23]

So, have the Applicants presented evidence on this case to demonstrate that the underlying cost structures will be less relative to a scenario where the transactions did not take place? No – they have not. The Council has a number of issues with the analysis presented by HON and is of the view the following points are critical to the OEB's assessment of the these Applications:

1. The current rates and bill impacts for PDI and OPDC in comparison to HON's current rates and bill impacts are lower. Although PDI has not rebased since 2013, its ROE in 2018 was comparable to HON's[24] demonstrating that its current cost structure is less than HON's. The same is true for OPDC, which has not rebased since 2010. Its ROE was comparable to HON's in 2018[25] demonstrating that its current cost structure is less than HON's;

2. HON has attempted to justify the PDI Application on the basis of a comparison of the 2018 OM&A cost/customer. Using HON's analysis the value for HON was $176 whereas the value for PDI was $245. The Council has reviewed the Final Argument of the Vulnerable Energy Consumers' Coalition ("VECC") on this point and agrees that HON's analysis is flawed. If the OM&A cost/customer is presented on a truly comparable basis (as set out by VECC) PDI's costs are lower. With respect to OPDC, based on the VECC analysis, the differential between OPDC's OM&A cost/customer and that of HON is not as substantial as presented by HON;

[22] MADDs Handbook, p. 7
[23] EB-2016-0276 Decision and Order, p. 13
[24] Ex. JT2.3
[25] Tr. Vol. 2, p. 54

3. HON presented an analysis for each utility that compares the projected savings for each utility under a Status Quo forecast and HON's forecast. For PDI the projected savings are $7.8 million for OM&A and $1.3 million in Capital.[26] For OPDC the projected savings are $4.7 for OM&A and $.2 million in Capital.[27] The Council questions whether these savings could be achieved in light of the fact HON's has never demonstrated that its acquisitions result in lower costs for the acquired customers. In addition, the analyses provided by HON to demonstrate savings have overstated the revenue requirements for OPDC and PDI at the end of the deferred rebasing period. These are simply forecasts and do not ensure the customers of the acquired utilities will see the savings projected by HON;

4. HON has presented an analysis for each utility setting out the Revenue Requirement in Years 10 and 11 with and without consolidation[28].
The Council submits that the projection of the status quo revenue requirement for both PDI and OPDC are overstated. This is clearly illustrated if one compares the compound annual growth rate for these utilities relative to the average revenue growth rate of other utilities. HON's argument that this is because these two utilities have not rebased in years is not credible. From the Council's perspective the projections should not be accepted as demonstrative of the differentials, as the compound annual growth rate for a utility's revenue requirement over a ten-year period is unreasonable. Despite the fact OPDC and PDI have not had their rates rebased the differential between what HON is proposing and the status quo forecasts are not reasonable;

5. HON's central argument regarding "no-harm" with respect to both Applications relies on the "goal post" concept that was discussed at length during the oral hearing process. HON is committing for the Year 11 rebasing application that the total costs, including shared costs, to be collected from the acquired customers (in the Orillia and Peterborough rate zones) would (i) remain between the residual costs to serve scenario plus low voltage charges and (ii) the Year 11 revenue requirement under the status quo scenario plus Year 11 low voltage charges. At the low end of the "goal posts" all savings from the transaction would accrue to PDI and OPDC customers, while they would pay for their residual costs to serve so that HON's legacy customers are held harmless. At the high end of the "goal posts" the revenues to be collected from acquired customers in rates would be at the status quo cost to serve, meaning all savings from the transaction would accrue to HON's legacy customers.[29] It is HON's position that this proposal will result in (i) an allocation of costs to the acquired customers (both Orillia

[26] Ex. A/T2/S1/p. 2
[27] Ex. A/T2/S1/p. 2
[28] HON–AIC–OPDC, p. 8 and HON-AIC-PDI, p. 7
[29] HON- AIC-OPDC, pp. 11-12 and HON-AIC-PDI, pp. 11-12

and Peterborough customers) that reflects the cost to serve them (ii) rates that collect costs from the acquired customers that are less than they would have paid if the transaction never occurred; and (iii) HON legacy customers being unharmed or slightly better off.[30] In order to accomplish this HON will be employing a different approach to cost allocation for the customers in these two rate zones. The Council does not accept that this is a reasonable approach and it is ultimately unfair to the legacy customers. What is also potentially unfair to legacy customers is the fact that PDI customers and OPDC customers will not pay any of HON's shared costs until rebasing even though they will have the benefit of those services. Those costs are fully funded by the legacy customers;

6. HON is proposing to establish new rate classes for the customers currently in PDI and OPDC's Residential, GS<50 and GS>50 rate classes. The cost allocation will be revised to ensure that an appropriate allocation of the fixed assets used to serve them. This is, in effect, using a direct allocation approach. With respect to shared costs HON will apply the same allocation principles and allocators it uses in the OEB's cost allocation model so that the legacy and acquired customers are allocated these costs in a consistent manner. From the Council's perspective HON is applying a different approach to these new classes (direct allocation), not because of some principled cost allocation approach, but in order to make the case that these Applications, and ultimately the acquisition of these distribution utilities, meet the "no-harm" test. HON has attempted to justify the two different approaches on the basis that it has better information on the costs to serve PDI and OPDC customers than it does for its legacy customers;[31]

7. HON's cost allocation approach (direct allocation) for these two customer groups is inappropriate, unfair and not consistent with OEB accepted cost allocation principles. The Council also notes that this approach was advanced by HON its last distribution rates proceeding regarding the customers of the former Norfolk Hydro, Woodstock Hydro and Haldimand Hydro. It was ultimately rejected by the OEB in its Decision, as it was inconsistent with the OEB's past Decisions regarding the acquired utilities;[32]

8. None of the evidence presented in this proceeding demonstrates that the underlying cost structures for OPDC and PDI customers will be less than if the transaction did not take place. On that basis the "no-harm" test has not been met. HON has proposed an alternative cost allocation approach that reduces the overall costs allocated to these new customers, but that approach is inconsistent with OEB practice and unfair to the legacy customers. Unless HON can demonstrate that the newly acquired customers

---

[30] Ibid
[31] Tr. Vol. 1, p. 85-86
[32] Eb-2017-0049 Decision and Order, p. 159

and the legacy customers are no worse off, the transactions cannot be approved. From the Council's perspective HON has failed to demonstrate this;

9. The Council is also concerned that HON is making promises to ensure these customers are no worse off, and in fact better off, that it cannot keep. 10 years is a long time and if the OEB approves these transactions it will be difficult to assess in Year 11 whether HON has met its commitments to ensure "no harm". Unless the OEB is convinced that the evidence before it today will result in "no harm", it should not approve the transactions. HON is proposing cost allocation and rate design proposals for Year 11, which in the future may not be acceptable to future panels of the OEB. One of those proposals is to adjust revenue to cost ratios outside of the OEB-approved ranges, for example. In addition, the overall regulatory framework may change, making the proposals set out by HON today inappropriate or no longer applicable. Accordingly, to set conditions today, that must be met in 11 years may be problematic;

10. Furthermore, the Council is concerned that with each and every HON acquisition "like" customers will be placed into separate rate classes simply on the basis that it may be the only way to demonstrate "no harm". This could result in a considerable amount of inequity with respect to HON's customer base going forward;

11. Overall, the Council continues to question how acquisitions of lower cost utilities, by a high cost utility like HON, can be justified without compromising well established cost allocation and rate design principles.

Customer Service:

With respect to customer service the Council has reviewed the Table that compares scorecard metrics for HON, PDI and OPDC that was presented to the witnesses at the Technical Conference by SEC[33]. The metrics for answering phone calls and first contact resolution are worse for HON than for OPDC and PDI. Although HON has promised enhanced customer service through its longer call centre hours and outage notification, it appears that PDI and OPDC customers may experience reduced customer service with respect to phone calls and first contact resolution. This will likely be a function of a larger utility unable to provide good local service. This is could likely be exacerbated with the elimination of local employees. For these reasons the Council submits that HON cannot conclude that customer service for the OPDC and PDI customers will be enhanced through these acquisitions.

The OEB MADDs Policies:

---

[33] Ex. KT2.2

In light of the evidence in this proceeding, the OEB's Decision in the HON Distribution rates proceeding (EB-2017-0049) regarding HON's other acquisitions, and recent ICM proceedings the Council encourages the OEB to undertake a full review of it MADDs policies as soon as possible. The Council is supportive of distributor consolidation as long as it results in overall benefits for customers largely through reduced rates and enhanced customer service. A fresh look at the OEB's policies and the development of clear policies that will ultimately benefit customers in the long run is, from the Council's perspective, warranted at this time.

V. COSTS

The Council requests that it be awarded 100% of its reasonably incurred costs for participating in these proceedings.

All of which is respectfully submitted