EVIDENCE OF PAULA ZARNETT

ON BEHALF OF
ESSEX POWERLINES CORPORATION,
BLUEWATER POWER DISTRIBUTION CORPORATION,
AND NIAGARA-ON-THE-LAKE HYDRO

In the Matter of
Application by Hydro One Inc. EB-2013-0196
Application by Norfolk Power Inc. EB-2013-0187
Application by Hvdro One Networks Inc. EB-2013-0198

Before the Ontario Energy Board
February 26, 2013

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EXECUTIVE SUMMARY

Introduction and Scope

If the Board approves the applications in the proceeding, HONI will acquire NPDI and partially integrate it with the operation of HONI. NPDI customers will receive the benefit of a 1% reduction relative to 2012 base electricity rates, which reduced rates, if approved, will remain frozen in effect for five years. As with all similar applications, the Board must be satisfied that no harm results to customers in terms of the factors identified in the Board's objectives.

EBN has intervened, and requested BDR to:

- Review evidence as to cost structures to determine whether they are likely to increase or decrease as a result of the intended transaction;
- To comment on non-financial impacts, such as quality of service; and
- To consider and comment on whether the purchase price is set at a level that would create a financial burden on the acquiring utility; and
- To develop and present a possible scenario for estimation of the impacts of harmonization of rates, once the proposed rate freeze period expires.

To carry out the assignment, BDR has reviewed the evidence filed in this proceeding and other information in the public domain, evaluated that evidence and drawn conclusions based on its experience in the electricity sector and in the capital markets sector. In reviewing the information, BDR considered whether it was internally consistent, and also whether it was consistent with other information available to BDR about business in the electricity sector in Ontario.

Conclusions

Operating and Capital Expenditure Costs

With regard to operations and capital, it is BDR's conclusion that the Applicants have not demonstrated any changes likely to produce reductions in operations direct staffing, vehicles, or facility costs that flow from the transaction.

Furthermore, the 2012 Statistical Yearbook shows that average OM&A per customer for HONI was $439.77 per customer as compared with $333.43 per customer for NPDI. In HONI's response to EBN Interrogatory 13, they claim that the appropriate comparative figure is lower because only costs allocated to urban and medium density customers should be considered, and go further to say that on average, there will be lower costs than HONI's average to serve NPDI's southern Ontario distribution territory. No analysis has been provided to support this statement, and it is noted that HONI has not provided information as to which of its density classes are appropriate to NPDI customers. There is thus no evidence that HONI can achieve a lower operating cost per customer than NPDI has achieved, and it is noted that NPDI's cost levels appear from the analysis of the PEG report, to be relatively efficient when its business conditions are taken into account.

With regard to capital, the Applicants have forecast lower capital expenditures, without explaining or supporting that the capital expenditure reductions reflect the achievement of system improvements and sustainment as a direct result of the transaction. The Applicants have not provided any asset condition assessment or other evidence that the capital expenditure program planned by NPDI management could be reduced without adverse impacts on the ability to provide reliable service to consumers. In the absence of such support, it is of concern that the reductions are intended to improve cash flow to the shareholder, while potentially causing harm to customers in terms of reliability and/or higher costs in the future. This is occurring at a time when the Board is encouraging LDCs to manage their assets better, and to reinvest prudently in the expansion, modernization and sustainment of their distribution systems.

BDR therefore concludes that the Applicants have not shown that any significant reductions in costs related to field operations and capital work can be attributed to the transaction, and that potential harm may occur as a result of the planned capital program reductions.

With regard to administrative and processing functions, HONI has filed plans indicating that it intends to eliminate 30 positions in NPDI, and fulfill the functions using HONI staff, without increasing HONI staff levels relative to levels planned without consideration of the transaction. No information has been provided to show that the costs are truly fixed, so that the addition of customers and distribution system will drive no incremental levels of activity and cost. BDR then reviewed each utility administrative cost function, and determined that under the scenario of separate rates, accounts, etc., many of the activities carried out today in NPDI would continue to need to be carried out. BDR concluded that resources would continue to be necessary to carry out those functions, and that these would be incremental to HONI's status-quo complement, unless that complement is not at the most efficient level (for the status quo). If incremental costs are incurred within HONI to serve NPDI, and not allocated to NPDI, this represents a harm to legacy HONI customers. ***BDR has drawn the conclusion that the Applicants' savings estimate is overstated, and that the benefits that are achievable would not be achieved immediately.***

Financing costs represent the final element of the relevant cost structures. HONI has claimed, but not demonstrated through evidence, that it can provide cost reductions to customers through lower interest rates. As a stand-alone municipally-owned LDC, NPDI can assess cost-effective financing through Infrastructure Ontario. Infrastructure Ontario funding is not available to HONI.

Based on information found in the public domain, it appears that financing rates through Infrastructure Ontario are below the rates that HONI has recently obtained, for loans of similar term. Therefore, by removing accessibility to a less costly source of debt, the transaction increases the cost structure of NPDI and creates a harm to the customers.

Furthermore, even if HONI can provide funding at a reduced cost, it has not made any commitment that it will assume and re-finance NPDI's debt in order to do so.

BDR concludes that the Applicants have not supported their claim that lower costs of debt are a certain benefit of the transaction, both because NPDI can and has already obtained cost effective debt capital from Infrastructure Ontario, and because there has been no commitment that Hydro One will refinance the higher-cost debt assumed in the transaction.

Even if Hydro One's costs of capital could be shown to be significantly lower today (for which there is no evidence), there is no evidence that this will continue into the future, when its cost of capital may be impacted both by increasing demands for borrowing to fund infrastructure and by the effects of having borrowed to fund the premiums of acquisition which may or may not be repaid to the shareholder through cost efficiencies.

Non-financial impacts on customers, such as quality of service

With regard to Service Quality, BDR has concluded that information from public sources provides a basis for concern that NPDI customers may experience a decline in levels of service with HONI. This information has not been countered by evidence from the Applicants. Based on the Service Quality Indicators (SQIs) reported by HONI in the 2012 Statistical Yearbook, the overall standard of service by HONI for reliability and emergency response is lower than the standard of service of NPDI. There is no evidence that HONI plans to maintain the historic local service levels in its service to NPDI customers. If HONI allows the level of service to deteriorate to the levels that it maintains for its legacy customers, the NPDI customers will be harmed by the transaction.

Creation of a financial burden on the acquiring utility

The premium that Hydro One proposes to pay for NPDI is significantly higher than the levels at which LDCs were able to achieve transactions historically. As indicated, there is cause to be concerned that the additional premium will not be recovered for the shareholder through savings gained before the rates are rebased. Hydro One is proposing to extend its credit for acquisitions at the same time that significant funds are needed for investment in the distribution and transmission systems. The Applicants have not provided any information to show that the excess premiums involved in this transaction, aggregated with the premiums from other transactions in the works or planned, will not affect the capacity of Hydro One to borrow, or increase its cost to do so.

Furthermore, if Hydro One establishes the level of premium paid for NPDI as the standard for acquisitions of Ontario LDCs, some municipal LDCs may decide to compete for acquisitions at these prices. These smaller entities will more quickly reach levels at which their ability to borrow is impacted negatively. As most LDCs have need of higher levels of distribution system investment now, consumers will clearly be harmed if the investments need to be postponed, or incur a higher cost of capital in order to proceed.

Impact of Rates on Harmonization

Using the 2019 rates proposed by HONI in its 2015 Custom IR application, we attempted to quantify the customer impacts of rate harmonization after five years of a freeze of NPDI rates at 2012 base less 1%. The comparison was made separately for each density classification in the residential class, and for the and UGe GSe class of HONI compared with NPDI's GS<50 kW class.

On this basis, an NPDI residential customer would experience a 10% decrease in distribution charges if transitioning to HONI's UR rate; however the customer would receive an increase of 42% if assigned to R1, and a 238% increase if assigned to R2. A general service customer transitioning from NPDI's rate to HONI's UGe or GSe rate would receive an increase of or 162% and 218% respectively on this basis. These changes do not include the higher commodity charges each NPDI customer will face due to HONI's higher line losses.

1 Introduction and Purpose of the Report

This evidence is being filed with the Ontario Energy Board ("OEB" or "Board") on behalf of Essex Powerlines Corporation, Bluewater Power Distribution Corporation, and Niagara-on-the-Lake Hydro (together "EBN") in the matter of applications filed by Hydro One Networks Inc. ("HONI") and Norfolk Power Distribution Inc. ("NPDI"), both licensed electricity distributors, and Hydro One Inc. ("Hydro One"), HONI's parent company (together the "Applicants"), on April 26, 2013 and subsequently amended.

The applications, as clarified by the Applicants in January, 2014 and set out by the Board at page 2 of its Decision and Order and Procedural Order No. 8 dated January 24, 2014, are as follows:

> "1. an application by Hydro One for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. under section 86(2)(b) of the Act;
>
> 2. an application by NPDI seeking to include a rate rider in the 2013 Ontario Energy Board approved rate schedule of NPDI to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act;
>
> 3. an application by NPDI for leave to transfer its distribution system to HONI under section 86(1)(a) of the Act; and
>
> 4. an application by NPDI for leave to transfer/assign its electricity distribution licence and rate order to HONI under section 18 of the Act."

EBN has intervened in these applications, stating as its concern that the "no harm" test has not been satisfied, and, along with other parties, submitted interrogatories intended to compel disclosure from the Applicants of additional information regarding impact of the transaction on consumer rates and impact of the purchase price on consumers, and on the efficiency and cost-competitiveness of the industry as a whole.

The Board, in its January 24, 2014 Decision and Order and Procedural Order No. 8, at pages 4, 5 and 6, defined its interest in the information to be provided as follows:

> "Therefore, in applying the "no harm" test, it is appropriate for the Board to assess the cost structures which will be introduced as a result of the transfer of NPDI's distribution system and associated licence to HONI in comparison to the cost structures underpin NPDI's current rates. A downward impact on the entities' cost structures would tend to decrease rates, whereas an upward impact on the entities' cost structures would tend to increase rates. This will occur regardless of whether rate harmonization is ultimately sought.

> …In applying the "no harm" test, the Board will consider whether future revenue requirements will unduly burden rate payers.
>
> …The application of the Board's "no harm" test is intended to ascertain if the transaction will have an adverse effect in terms of the factors identified in the Board's objectives. The Board intends to do so by comparing prospective cost structures to existing cost structures and in consideration of non-financial impacts as well."

EBN requested BDR NorthAmerica Inc. ("BDR"), based on its experience in distribution cost analysis, rates and revenue requirements, and LDC mergers and acquisitions, to review the material as to cost structures that is on the record in this proceeding and available through other public sources including the regulatory record in other proceedings, and provide an opinion as to whether this information indicates that the future cost structures of the entities will increase or decrease as a result of the intended transaction. EBN also requested BDR to comment on any information available as to whether the quality of service to consumers was likely to increase or decrease (non-financial impacts).

The Board also indicated that it would consider the issue of "whether the purchase price is set at a level that would create a financial burden on the acquiring utility". To inform the Board, BDR has provided a summary of purchase and premiums paid in prior LDC acquisition transactions in Ontario. It is of concern to EBN that the size of HONI and the scope of its access to credit make it possible for HONI to finance transactions at excessive prices for these reasons:

- If HONI's offers are such that other potential consolidators withdraw from the market, it will become impossible for further consolidation in the industry to occur through mergers and acquisitions other than with HONI, even though other possible consolidations might provide better cost efficiencies than a transaction with HONI;
- While the impact of the acquisition of NPDI alone will not be sufficient to impact HONI's future cost of capital, there will come a point at which the aggregate effect of continued LDC acquisitions by HONI at above-market premiums will increase its cost of capital to the detriment of all HONI consumers, both currently existing and acquired.
- If, rather than withdrawing from competition with HONI, other LDCs pursue acquisitions at prices that would create a financial burden for those LDCs.

Thus, while the Board has said its focus is on the transfer of ***NPDI's*** distribution system and licence, and the costs that underpin ***NPDI'***s rates [emphasis added], the potential exists for a long term negative effect on the efficiency of the industry and the costs to consumers of a continued program of acquisitions by HONI at prices so considerably above what any other purchaser might be expected to pay.

The report therefore consists of three parts. In section 2, information as to cost structures is reviewed. In section 3, the issue of financing and the competitive market for LDC mergers and acquisitions is addressed, with a view to drawing conclusions about the potential financial burden on the proposed acquirer in this transaction and in transactions that may be expected to follow. In section 4, a computation is presented to estimate the impacts on the bills of NPDI customers what would result from harmonization with HONI rates, once the proposed five-year freeze at reduced rates has expired.

2 COST STRUCTURES OF HONI AND NPDI

2.1 *Conceptual Overview*

This portion of the analysis is intended to draw on filed and other public information in order assess whether such information supports a conclusion as to whether aggregate future cost structures of HONI and NPDI will increase or decrease as a result of the proposed transaction.

For clarity, it is BDR's view that only changes that result from the proposed transaction should be considered in the "no harm" test. For example, if certain cost efficiencies that are planned following the transaction would otherwise have been achieved or achievable by the acquired LDC on a stand-alone basis (i.e. if no transaction takes place), then these should not be considered as net benefits of the transaction. Furthermore, it is possible, depending on the circumstances of an individual LDC, that existing arrangements creating synergies or cost efficiencies before the transaction will be lost as a result of the transaction. For example, if an LDC shares resources with its municipal shareholder (for example, shared billing of electricity and water), and thereby reduces costs to the electricity ratepayer, these reductions may be lost when the LDC is acquired and transitions to the billing system of the acquiring LDC. Similarly, benefits of synergies with affiliates or through joint action consortia may be lost. If this is the case, then in our view it is the net effect that should be considered.

While the evidence filed by the Applicants in this case points from time to time to the conclusions of the Sector Review Panel to the effect that productivity gains are generally expected from LDC consolidation[1], it is not necessarily true that a specific proposed merger or acquisition will produce cost efficiencies or produce them in any specific timeframe. Therefore each specific transaction proposal should, in our view, be assessed on its individual merits and not accepted merely because there is a general consensus in favour of consolidation.

Since only the Applicants have access to the detailed internal information and plans that should be gathered and developed in connection with the proposed transaction,

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[1] For example, in Exhibit I Tab 5 Schedule 20 Page 1 of 2

the other participants in this proceeding are restricted to reviewing what has and has not been provided by them as evidence in this proceeding, and any other information in the public domain. BDR has applied these two tests to the evidence filed:

- whether it appears to be internally consistent; and
- whether it appears consistent with what we know of the way business is generally carried on by electricity distributors. Here we drew on our own sector experience, and our consultation with senior management with EBN for facts and experience related to current operations of LDCs.

2.2 *Important Business Conditions and Outputs that Affect the Costs to Serve NPDI's Customers*

According to NPDI's most recent cost of service application[2], we obtained the following data, which we believe would not have changed significantly enough since that time to invalidate their use to draw conclusions about the nature of NPDI's customer base, service territory and operations:

- The LDC serves approximately 19,000 customers
- The service territory is comprised of 144 square kilometres of high density urban area plus 549 square kilometres of low density rural for a total of 693 square kilometers; about 80% of the service territory is therefore rural.
- NPDI's population density (customers per square kilometre) is 27.4 which makes it one of only 8 LDCs in the province with a population density of less than 30 customers per square kilometre (as per the 2009 OEB Yearbook of Electricity Distributors).
- NPDI has a diverse distribution system with a large number of poles (11,020) and transformers (4,469) consistent with low density and multiple distribution voltages (4.16 kV, 8.32 kV and 27.6 kV). On this basis, each pole serves on average 1.7 customers, and each transformer 4.3 customers.
- Its system in 2011 included 765 km of lines, of which 85% were overhead. As reported the following year in the Board's 2012 Electricity Distribution Yearbook[3] the figure was 779 km, with a consistent percentage (about 85%) overhead.

Variables such as customers and service territory were used by the Pacific Economics Group ("PEG") to create a model to evaluate and compare the efficiencies of LDCs in Ontario (the "PEG Report")[4]. Given a reasonable range of values for input variables,

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[2] Norfolk Power Distribution Inc., EB-2011-0272, Exhibit 2,Tab 1, Schedule 1, Page 2 of 9, Filed: August 26, 2011

[3] Obtained in MS Excel form from the Board's website as 2012_Electricity_Yearbook_excel.xls.

[4] Report of Pacific Economics Group Research, LLC, Empirical Research in Support of Incentive Rate Setting in Ontario: Report to the Ontario Energy Board,
May 2013

the PEG methodology evaluates distributor efficiency by comparing actual cost results with the results predicted by the model. The analysis ranked NPDI 31st of 73 Ontario LDCs, with a value of –4.8%, where negative values indicate a level of cost below the predicted value (i.e. relatively more efficient). While any LDC can theoretically become more efficient, and the regulatory regime is structured to provide incentive for them to do so, by this measure NPDI is a relatively efficient LDC, when its business conditions, especially its relatively low density customer distribution and large rural service territory, are taken into account.

We can therefore assume that very significant reductions in the cost of service to NPDI, if they can be achieved, must come from specifically identified changes in the way business would be carried on following the acquisition. We have therefore reviewed the evidence and considered whether a specific cost reduction plan has been identified, and if so, whether the elements appear to be (a) internally consistent; and (b) consistent with what experienced industry professionals understand as the typical manner in which Ontario LDCs do business.

2.3 *Applicants' Evidence as to Specific Benefits Available from the Transaction*

For the convenience of the Board and all parties, these comments are organized consistent with the Applicants' high-level categorization of savings opportunities, as set out in Exhibit I Tab 2 Schedule 2.

2.3.1 Local Area Operating and Capital Savings Resulting from a More Efficient Distribution System due to the Elimination of an Artificial Electrical Border (i.e. Benefits from Contiguity)

In setting out how they expect efficiencies to be achieved from contiguity, the Applicants say:

> Specific to NPDI, Hydro One has an operating centre located less than 2 km from the NPDI operating centre. Hydro One crews travel the same roads and drive by the same facilities as the existing line crews from NPDI. Every day staff in the Hydro One Field Business Centre in Dundas answer calls from local businesses and customers for operational services within the area of Norfolk County served by Hydro One. NPDI has customer service representatives that carry out similar functions for their neighbouring customers within Norfolk County. Rationalizing these functions over a larger service area will yield efficiency savings."[5]

This statement conveys the impression that redundancies in the resources for field activities (bases of operation, number of staff, vehicles and equipment) will be a source of significant cost reductions following the proposed transaction. However, the transaction will not reduce the major cost drivers, which are number of customers,

[5] Exhibit I Tab 2 Schedule 2 Page 5 of 8

connections, the system itself (number of poles and transformers, length of lines, etc.) and the events and plans that precipitate activities in the field. LDCs have achieved and can continue to achieve some efficiencies in this aspect of their business with improvements in communications to the field, better dispatch processes, and direct entry of data by field staff to work management systems. However, the Applicants have not identified that HONI brings to the transaction any specific systems that will create efficiencies, or more importantly, that any efficiencies available in this regard could not equally be achieved by NPDI on a stand-alone basis.

In fact, the evidence suggests that field staff levels are planned to remain close to current levels. Exhibit I Tab 5 Schedule 26, Figure 1 tells us that the number of outside staff will be reduced only by 2, from 15 to 13, and that the change in compensation level for these staff (from current NPDI pay rates to HONI rates) will mean higher total costs for the function, despite the reduction in number of positions. If the field staff complement remains approximately the same, it is not clear that there is a basis to assume, as suggested in Exhibit I Tab 2 Schedule 2 that "vehicle fleet" will be an important area for cost reduction. While one would anticipate the possibility that certain specialized equipment could be shared, no evidence has been provided of a plan to do so, perhaps because the two LDCs have already, separately or jointly, optimized this component of their costs.

The paragraph quoted above also suggests that there are redundant buildings and facilities that could be removed from the future cost structure. However, the evidence addresses only one facility closure, and that is the planned move of HONI's Dundas Field Business Centre from Hamilton to the Town of Simcoe[6]. The question sought to obtain an estimate of the "impact" of the move, and was answered to the effect that there was no "impact" to the change in location (presumably on service, rather than on cost) since it is not a service centre and its effectiveness is not dependent on geography.

In the February 10, 2014 update to this Exhibit, the Applicants state that $60,000 in rent would be avoided by utilizing the space in the Town of Simcoe, which reduction is included as a savings in the operation of NPDI and neutral to HONI. However, no proof has been offered that a move from the present Hamilton location is required, or that, if a move is required, no other building already owned by HONI could be utilized so as to avoid rent. In our view, therefore, there is no evidence that avoidance of a cost related to building use is dependent on HONI's acquisition of NPDI.

With regard to capital expenditures, the Applicants have projected significant cost reductions commencing immediately in all 3 scenarios at Exhibit I Tab 2 Schedule 2 Page 7 of 8 in the HONI scenarios as compared with the NPDI scenarios (i.e. HONI

[6] Exhibit I Tab 1 Schedule 4

is proposing capital spending reductions in the range of $1.5 to $2 million annually). In the October 25, 2013, the Applicants refused to answer as to the amount of capital spending in NPDI, as the rates would be lowered and frozen[7]. As a result, the scenarios are the only information provided by the Applicants as to the proposed differences in capital expenditures that they are claiming as benefits of the transaction, despite the efforts of EBN to obtain further information through interrogatories. No asset condition assessment or other detailed review has been provided to satisfy the Board and parties that the planned level of capital spending is adequate to maintain the quality of service to consumers.

In the absence of any explanation from the Applicants, BDR considered the possible reasons why HONI's forecast of capital expenditure might be lower than the capital expenditure plan of NPDI's management. One possible reason is that HONI expects it can deliver the same capital programs planned by NPDI while incurring significantly lower costs. However, HONI has not offered this as an explanation, or provided any evidence that HONI is a more cost efficient constructor than NPDI. The other possible explanation for the lower HONI capital expenditure scenarios is that HONI plans to postpone or cancel specific projects that NPDI had planned to implement. Any management can postpone or cancel a capital project, and NPDI's management could, on a stand-alone basis, have reduced its capital program if they were prepared to live with any consequences in terms of reliability or future costs. Therefore in our view, a reduced capital program is not a cost saving related to the transaction, unless it can be shown that the transaction offered an alternative that would achieve the required result at lower cost. No evidence has been filed to show that the capital expenditure reductions reflect the achievement of system improvements as a direct result of the transaction.

If the capital expenditure reductions are in fact not related to either of these possible explanations, then the situation is simply that HONI has a different opinion of the necessary level of capital level expenditures than NPDI's management. No evidence has been provided as to the review process that HONI carried out to determine the needed level of capital expenditures, or which if any specific projects can prudently be cancelled or postponed. If the capital project being postponed or cancelled are in fact necessary projects, this may result in negative effects on customers, including reduction in reliability and/or higher costs in the future, and cost reductions could not be considered as a saving or benefit.

HONI has not offered any proof that the reduced capital expenditure program constitutes a "saving" (i.e. that it meets the needs of customers for reliable supply at a reduced cost). Until rates are rebased, a reduction in capital expenditures from planned levels provides no benefit to customers, while resulting reductions in service quality or future cost increases resulting from deferral of needed projects can create harm to customers.

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[7] Exhibit I Tab 5 Schedule 2.

BDR therefore concludes that the Applicants have not shown that any significant reductions in costs related to field operations. The planned reductions in capital work have not been shown to be prudent, and may be the source of harm to customers.

2.3.2 Savings due to the elimination of redundant administrative and processing functions (i.e., back office savings or scale efficiencies)

As filed on February 10, 2014, Exhibit I Tab 5 Schedule 26 Page 2 of 2 tells us that HONI intends to realize more than $1.9 million annually in savings by the elimination of 30 positions within NPDI, after accounting for compensation scale differences between HONI and NPDI. Schedule 27 of the same Tab goes on to explain that "Hydro One's plan is to integrate acquired NPDI staff into Hydro One's combined workforce, thus providing broader career opportunities and allowing for the renewal of Hydro One's workforce as staff retire." Our understanding of HONI's stated expectation is that the current NPDI would thus continue to be employed (within HONI) and enjoy "broader career opportunities", while achieving, between the two organizations, a net reduction of 30 positions. We are told that "Once integration of Norfolk is completed, the operating systems of HONI, both back office and field, ***which are generally fixed costs***, will be utilized to service an overall larger customer base and therefore reduce the per unit cost to serve for all HONI customers.[8] [emphasis added]. Exhibit I Tab 2 Schedule 2 Page 7 of 8 tells us that HONI expects the full amount of these benefits to be achieved as early as 2015, as indicated by the comparison of the HONI OM&A cost lines with the NPDI cost lines.

HONI has provided no information to support that 19,000 customers, 779 km of line, and one LDC organizational structure with accounts, a licence, rates, etc., is within the relevant range in which its cost of management, professional and "indirect" services are truly fixed in the sense that no incremental effort is required to add their activities to the resources of HONI. If it is assumed that the resource levels included in HONI's recently filed Custom IR application are efficient levels to carry out the functions of HONI as it now exists, some, and probably most, of the positions now within NPDI would probably continue to be needed.

If this is not the case, and if HONI can add operation of NPDI to its current load without additional staff, it appears clear that HONI must have unused capacity in its staffing. If the transaction scenario is that NPDI staff fills vacancies within HONI as they arise, it seems to us a reasonable conclusion that in the absence of the transaction, HONI could eliminate approximately the same number of positions, thereby reducing future costs to existing HONI customers from currently forecast levels.

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[8] Exhibit I Tab 4 Schedule 4

We then reviewed the evidence to find more specific examples of functions where it is not apparent that the level of work needed to manage, plan and operate what is now NPDI would diminish, at least in the first several years following the transaction.

Function	Reference and Conclusion
CDM	At Exhibit I, Tab 1, Schedule 6, the Applicants state that CDM targets for NPDI "will remain separate". While some implementation cost savings should reasonably be expected to be realized, assuming that the activities can be fully integrated with those of HONI, this approach will result in continued separate costs related to administration, monitoring and verification, and compliance reporting related to CDM.
Corporate costs	It has not been stated by the Applicants that following the transaction, HONI would plan to wind up NPDI as a corporation. In that case, there would be continued costs for all corporate compliance filings, financial statement preparation, independent audits, tax returns, etc. The Applicants state that there would be a reduction of $70,000 in costs now incurred to maintain NPDI's board of directors, but have not stated how requirements for independent directors would continue to be met at no cost.
Accounting and Service Level Agreements	As long as NPDI continues to exist separately, it would require separate accounts. If the intent is to administer and manage NPDI, and to provide professional services to it with HONI staff (as we understand from Exhibit I, Tab 2, Schedule 2) the provisions of the Affiliate Relationships Code ("ARC") would require service level agreements to be prepared and administered, and, in the case of "shared corporate services" as defined by the ARC, charges to be made by HONI to NPDI on the basis of fully allocated cost, determined by a reasonable method. This involves, if not an incremental level of effort from current accounting and administrative functions, at least a significant level of effort into the future. The evidence indicates that NPDI costs will continue to be tracked separately from HONI's "legacy" accounts; that a separate sub-account will be created to track LRAM, and that USGAAP will be adopted.
Taxation	The evidence at Exhibit I, Tab 3, Schedule 16 suggests that a small business tax credit valued at $33,000 would be lost on acquisition by HONI.
System Planning and Design, Management of System	There is no explicit evidence stating how the work of system planning and design, development of maintenance plans, etc. would be carried out within HONI at the same staffing levels that are adequate in the status quo case. Section 2.2 above quotes

Sustainment	from NPDI's 2012 rate application to the effect that it has a complex urban and rural system with multiple service voltages. To the degree that this system is different from HONI's systems, it would require incremental work to plan and sustain this system, including provision for replacement components as needed.
Local and Field Supervision	Since no provision is made in HONI's staffing plan for a position to supervise and manage field operations related to NPDI, it is assumed that HONI believes the existing supervisory resources can take on this additional responsibility, located in HONI's contiguous area so that adequate field presence and interaction with the staff could be achieved. No information has been provided as to the ratio of supervision to field staff that HONI maintains, or as to why there is reason to believe that existing HONI supervisors in the area could effectively supervise an additional 13 field staff. If the existing HONI supervisors can effectively add 13 staff to their teams, it suggests that the ratio of supervisors to field staff is currently below cost efficient levels.
Call centre	It does not seem clear from the evidence how the call centre requirements of 19,000 additional customers are intended to be added to HONI work load without incremental costs being incurred, whether through additions to HONI staff or through outsourcing.
Rate and Customer Administration	The proposal is for a separate schedule of regulated rates and charges to be applicable to NPDI customers, at least for a five-year period. This entails establishing a separate series of rate classes within HONI's systems to be accounted for, administered, billed and reconciled. While some administrative efforts would be avoided if the Board approves a rate freeze, there would continue to be changes in the charges paid by customers, resulting from rate riders, adjustments to the energy charges and related variances, etc. Each change typically involves the implementation, entry, and verification of rates on the system, advice to customers, updates to websites, printed materials, etc. A related element is the administration of Terms and Conditions of Service. It is not clear at what point HONI intends, or would be permitted under these conditions, to substitute its own Terms and Conditions of Service, contract provisions and other policies for the existing ones applicable to NPDI. Until this is done, separate administration costs can be expected.
Regulatory Filings and	While it is not stated explicitly in the Applicants' evidence, we have assumed that if the Board approves a five-year rate freeze,

Compliance	there will be a saving in the normal costs that an LDC incurs to prepare, file, support and implement the results of its annual rate changes under an IRM regime. However there would be a continuing need for approval of rate riders and other adjustments, which would entail filings with the Board. We have not found in the evidence any reference to the effort required for on-going compliance requirements, such as the filing of RRR data, audits, etc., but in our view it is reasonable to assume that there would be such costs, and that they would be incremental to HONI's status-quo resource requirements.

Based on the foregoing analysis, which is general and qualitative given the absence of detailed evidence as to the costs involved and the plans to address them, ***BDR has drawn the conclusion that the Applicants' savings estimate is overstated, and that such benefits which may be achievable would not be achieved immediately.*** Furthermore, if HONI is in fact able to eliminate 30 positions within NPDI, while maintaining its own level of FTEs at levels determined for its legacy service territory and customers, it suggests that HONI's resources are above the efficient levels to serve the legacy service territory and customers.

It is noted that HONI appears to be pursuing other LDC acquisitions. Therefore, even if NPDI, an LDC of 19,000 customers, could be operated by HONI without complement additions, this could not be true for an indefinite number of additional acquisitions. If another LDC is acquired, and results in additions of staff in HONI, both of the acquired LDCs must be considered to be incremental in the economic sense, and contribute to the need for staff, since HONI could alternatively have acquired the other LDC first, and then NPDI, resulting in the acquisition of NPDI being the trigger for staff additions.

2.3.3 Savings due to lower financing costs

HONI claims in its evidence that an important benefit to be realized by the acquisition is the more competitive financing costs that it and its parent can obtain from the capital markets by virtue of size, as compared with small LDCs. However, no specific facts or analysis has been presented to substantiate:

(a) that similar levels of interest rates to those available to HONI would not be available to an LDC, and that NPDI has not obtained capital for similar terms at similar rates;

(b) that if the transaction takes place, NPDI would in fact receive the benefit of any reductions in financing costs; or

(c) that there are no other factors which can be expected, over time, to erode the ability of HONI or its parent to finance at favourable rates.

We reviewed NPDI's previous cost of service application EB-2011-0272[9] for information as to NPDI's current sources of financing and the rates that apply. From this, we can see that they include $28.2 million in long term debt for 2012, of which $15.2 million is sourced from Infrastructure Ontario. The most recent issue was for $6 million at a rate of 4.39%, with borrowings in 2010 as low as 3.72%. Rates of course reflect the term of the loan, as well as the credit worthiness of the borrower, and for the past number of years the rate has been higher for longer terms than for shorter terms.

Funding from Infrastructure Ontario is made available to municipalities and their LDCs in order to enable needed infrastructure to be constructed by reducing the cost of borrowing.

Since HONI has provided no analysis or comparisons, public source information was used to compare the rates at which HONI currently or recently obtains funding with the rates at which a municipally-owned LDC can finance through Infrastructure Ontario. The website of the Chicago Tribune newspaper (see attachment) provided the information that last October, HONI obtained financing for a 5-year term at 2.78%, and for a 30-year term at 4.59%. We compared these rates to the rates available to municipal LDCs from Infrastructure Ontario now, which are 2.18% for a 5-year term and 4.18% for a 30-year term—lower than the rates at which Hydro One has recently financed. If the HONI acquisition proceeds, the lower Infrastructure Ontario rates will no longer be available and this will increase NPDI's cost base.

HONI has not been explicit when questioned as to its plans to refinance in order to reduce the cost of debt for NPDI. At Exhibit I, Tab 2, Schedule 2, page 4 of 8, HONI says that one benefit is "Lower overall debt costs on the acquired LDC's existing rate base, relative to the status quo, ***assuming Hydro One refinances higher-cost debt assumed in the transaction***". [emphasis added]. HONI has not made any commitment in evidence as to how it or its parent intends to address NPDI's debt.

Furthermore, as discussed in Section 3, the risk exists that significant further acquisitions, combined with the need to fund capital expenditures in the legacy distribution system and in the transmission system, will have a negative effect on Hydro One's future financial costs.

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[9] Exhibit 5, Tab 1 Schedule 2, Page 6 of 6, filed August 26, 2011

BDR concludes that the Applicants have not supported their claim that lower costs of debt are a certain benefit of the transaction, both because NPDI can and has already obtained cost effective debt capital from Infrastructure Ontario, and because there has been no commitment that Hydro One will refinance the higher-cost debt assumed in the transaction.
Even if Hydro One's costs of capital could be shown to be significantly lower today (which has in fact not been demonstrated), there is no evidence that this will continue into the future, when its cost of capital may be impacted both by increasing demands for borrowing to fund infrastructure and by the effects of having borrowed to fund the premiums of acquisition which may or may not be repaid to the shareholder through cost efficiencies.

2.4 *Service Quality*

The applicants have not provided any specific evidence as to how and to what extent there will be an impact on the service quality to NPDI customers following the transaction, except that they say at Exhibit I Tab 2 Schedule 2 Page 4 of 8 that HONI will be able to provide extended hours of call centre service and a smart phone application for real time updates on outage restoration.

However, there is no evidence offered that extended call centre hours would be a sufficient service improvement if customers are not satisfied with the timing and accuracy of their bills or the method of handling payments. According to the attached media articles dated February 4, 2014, the Ontario Ombudsman is investigating complaints from HONI customers about delayed bills, incorrect bills, estimated bills, huge and unexpected withdrawals from their bank accounts, and difficulty addressing these issues through HONI's call centre. These indications that NPDI customers may experience lower levels of service with HONI are of additional concern given HONI's evidence that it will not be adding to current staff complement in order to render timely and accurate bills to 19,000 customers, to resolve any errors that occur, and to talk to these customers on the telephone.

Nor is there any evidence that customers would be satisfied with updates on their smart phones if there is a deterioration in time taken to restore service, or an increase in the number of outages. HONI has not presented evidence that it can meet the standards of restoration that NPDI customers are accustomed to, or that it will maintain the standards of reliability (SAIDI, SAIFI, CAIDI) that now prevail in NPDI's service territory.

The Unit SQR tab of the Board's 2012 Electricity Yearbook [10] reports that NPDI in 2012 responded to emergencies in its rural areas within the required two hours 100%

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[10] Obtained in MS Excel form from the Board's website as 2012_Electricity_Yearbook_excel.xls

of the time, while HONI reported responding in its rural areas within two hours only 81.4% of the time. In urban areas, NPDI responds within one hour more than 82% of the time, while HONI, despite having high density service areas, reported "N/A" for that statistic. At the same tab, reliability statistics can be compared as follows:

	NPDI	HONI
SAIDI	2.28	11.29
SAIFI	1.47	3.68
CAIDI	1.55	3.07

When questioned on these matters, as well as on comparative OM&A cost, HONI pointed out that its distribution service territory includes significant rural areas, with low customer density and difficult conditions of access. However, it is of concern that there is no evidence of a commitment and plan to maintain the current service levels for NPDI customers. In fact, the reduction of the capital expenditure plan supports a conclusion that future capital plans for these customers will be designed with reduced service quality objectives in mind. Lower levels of service constitute a harm to NPDI customers.

With regard to Service Quality, BDR has concluded that information from public sources provides a basis for concern that NPDI customers may experience a decline in levels of service with HONI. This information has not countered by evidence from the Applicants. BDR is also concerned that service quality and reliability may be reduced as a result of lower capital spending on the distribution system, resulting in harm to the customers.

3 THE ONTARIO LDC M&A "MARKET"

3.1 *Issue Context*

A key factor in the assessment of the purchase prices in corporate acquisition transactions paid is the premium over overall book value (which approximates Rate Base). Purchase prices in excess of overall approved rate base are costs for the shareholder account as the Board does not permit such costs to be included in utility Revenue Requirements at any time (including cost of service applications at re-basing periods). The costs therefore cannot be passed directly to consumers through regulated rates, and it is therefore investors who take the risk associated with recovery of premiums through savings realized during the period allowed before such savings are re-allocated to customers through the rebasing process.

Nonetheless, if excessive borrowing lowers the credit status of LDC owners and thus raises the cost of borrowing, this will be a negative impact to ratepayers as long as the Board approves third party "market" interest in the revenue requirement.

Furthermore, the Board has a mandate to assure a financially viable industry, able to obtain resources to develop and sustain sector infrastructure at reasonable cost. If premiums paid for acquisitions cannot be recovered in reasonable timeframes through savings, the credit of the industry as a whole may suffer. It is also, in our view, important to note that the Board's regulatory provisions, which put shareholders at risk for the cost of premiums on acquisition, protect the public effectively in the context investor-owned utilities whose equity is provided by private capital. Hydro One and the municipal utilities of Ontario are public sector entities, meaning that taxpayers and municipal ratepayers are at risk if Hydro One or municipal utilities make excessive or imprudent investments in acquisitions. If Hydro One continues a practice of offering high premiums for acquisition, municipal utilities may choose to compete with high offers of their own and thereby create difficulties for their shareholders and customers through reductions in financing capability for rate base investment and/or higher interest costs.

3.2 *History of Recent Transactions and Premiums*

The Ontario Merger and Acquisition market for distribution companies in its "modern" form (following the re-structuring of the electricity industry over the 1998/1999 period) began with the acquisition by Hydro One of some 88 local distribution companies in the first phase which ended at the end of 2001 (with the implementation of the PILS regime).

The Table below is representative of transactions in which government owned utilities purchased 100% interests in LDC's. It indicates that the average premium paid by publicly owned distribution companies including Hydro One was about 30-40%. This ratio is on an enterprise basis, which means that the price (the numerator) assumes that the purchaser will take on the existing long term debt (whether or not that is refinanced later), and the book value (the denominator) also includes debt.

In 2013, Hydro One initiated a new era in premiums paid with the announcement of the acquisition of Norfolk Power. BDR calculates that the premium proposed to be paid by Hydro One on an enterprise basis is in excess of 60%, which is substantially higher than premiums previously paid by government-owned entities.

Another way to view the same issue is to compare the premiums paid in relation to only the equity book value of a utility, as is done in the right column of the Table. The equity approach ratios the price paid assuming acquisition of the shares, but not the debt, to the book value of the equity. Until 2013, generally the Hydro One acquisition price amounted to about a 70% premium. BDR calculates that the premium proposed to be paid by Hydro One for NPDI is in excess of 150% which is substantially higher than premiums previously paid by government-owned entities.

In late 2013, Hydro One announced that it has reached an agreement to purchase Haldimand Hydro for a premium that appears to approximate the premium proposed to be paid for Norfolk Power both in terms of premiums to Rate Base and to Equity Book Values. While other acquisition plans by Hydro One are in the rumour stage rather than facts for evidence, there is certainly no evidence that Hydro One would cease its initiative if it successfully acquires NPDI and Haldimand Hydro.

In the following table[11], Hydro One acquisition transactions are highlighted.

Transaction Date	**Utility Acquired**	**Purchaser**	**Enterprise price/book**	**Equity price/book**
Jun-00	Carleton Place	Hydro One	**1.32**	**1.73**
Apr-01	Owen Sound	Hydro One	**1.26**	**1.65**
May-01	Port Hope	Veridian	**1.35**	**1.88**
Jul-01	Brampton	Hydro One	**1.29**	**1.72**
Aug-01	Caledon	Hydro One	**1.25**	**1.37**
Dec-01	Richmond Hill	Markham/Vaughan	**1.33**	**1.79**
Sep-05	Gravenhurst	Veridian	**1.56**	**2.40**
Sep-05	Aurora	PowerStream	**1.29**	**1.75**
Sep-05	West Nipissing	Sudbury	**1.28**	**1.70**
Overall Avg			**1.35**	**1.78**

[11] Excludes partial acquisitions (including mergers) and excludes any transactions involving private sector participants in the industry. Source is OEB data and information from the companies as to price. The information for this table was compiled on an on-going basis by BDR as transactions occurred in the sector.

The comparable figures for the acquisition of NPDI by Hydro One are 1.63 for the ratio of Enterprise price to book value, and 2.50 for the ratio of Equity price to book value.

The above data (and more recent possible transactions) suggest that substantial risk transfers are taking place between one set of rate-payers/taxpayers and another set of rate-payers.

This analysis is made in the context that municipalities, which are the shareholders of almost all of the non-HONI electricity distribution in Ontario, are governed by strict legislated rules as to the types of businesses they can enter and the level of risk they can assume.

3.3 *Ability of Purchaser to Fund a High Premium Transaction*

As of September 30, 2013, Hydro One reports total assets in excess of $21 billion. Hydro One also reported debt of about $8.5 billion. In terms of asset allocation, Hydro One has about $12 billion in transmission assets and about $9 billion in distribution assets. Hydro One has substantial funding needs in the context of its capital spending program for its legacy system. It is also imperative that Hydro One maintain its current credit ratings so as to minimize its cost of capital in the interests of both its customers (ratepayers) and its owners (tax-payers).

Although the proposed acquisition of NPDI involves Hydro One paying a substantial premium, in dollar terms the magnitude of the premium is only about $40 million, which is not large as a fraction of Hydro One's total capital structure or debt levels. However it appears that Hydro One now has a strategic plan to acquire multiple utilities (especially in Central and Southern Ontario). Therefore, while it is clear that the current transaction alone would not be sufficient to impair Hydro One's credit, the Applicants have not provided any basis for confidence that an aggressive program of acquisitions will not, at some point, be detrimental both to customers and to the public. Since the issue is the aggregate total of acquisitions, and not an individual acquisition, the NPDI customers acquired now (and the legacy HONI customers) could be harmed by a series of high premium acquisitions that take place after this transaction.

3.4 *Assessment as to Effect on the Potential for Competition in LDC Consolidation*

In the current environment in Ontario, the strategic action plan by Hydro One in proposing to pay excessive premiums for utility assets is already having an adverse impact on the ability of entities to compete in any auction process.

If Hydro One continues to make offers at the level of the offer for NPDI, one of two outcomes will occur:

- Municipally-owned LDCs will cease to compete for acquisitions or to attempt consolidation through mergers, with the result that Hydro One will be the only purchaser for any willing seller. This raises the risk that HONI will reach a level of acquisitions that could potentially harm its credit rating, while removing the possibility of consolidation transactions that would be as beneficial, or more beneficial to consumers; or
- Municipally-owned LDCs will continue to attempt acquisitions by offering very high premiums in competition with Hydro One. Depending on the relative size of the acquiring and acquired LDCs, these transactions may result in risk of credit issues for LDCs that are successful in competing with Hydro One to make acquisitions.

In either case, the higher premiums create no benefits to consumers, and carry with them a risk of harm as the consolidation process moves forward.

A current example of escalating acquisition premiums may be the recent offer made by Entegrus Inc. to acquire a 14% interest in Essex Power Corporation from the Town of Amherstburg at a premium of more than three times book value, despite the fact that premiums paid for minority interests are typically less than those commanded by full or controlling interest. The existence of the offer and the magnitude of the price have been reported in the media. At the date of this report, the Town of Amherstburg is evaluating the offer and its other options, and no transaction has yet taken place[12].

4 Comment on Issues Related to Rate Harmonization and Transfer of Cost

This section offers for consideration of the Board a possible scenario for the rate impacts that might be experienced by NPDI small (residential and GS<50kW) customers at the end of the five-year distribution rate freeze being proposed by the

[12] The Town of Amherstburg has retained BDR to assist with valuation of its interest in Essex Power, evaluate the offer of Entegrus, and provide advice to Council.

Applicants. The Applicants have not proposed any specific plan for rates to NPDI customers at the expiration of the freeze. It is possible that by 2019 an entirely different rate proposal may be brought forward by HONI. However, we believe that HONI's custom IR Filing (EB-2013-0416) is the best indication available at present of the potential rate classes into which NDPI ratepayers will be harmonized.

The following table shows the impacts of a transition for NPDI's customers to HONI rates, assuming:

- that the distribution rates approved by the Board for NPDI in its Revised Rate Order dated May 24, 2012 in EB-2011-0272 are reduced by 1% and applied unchanged until 2019; and
- that HONI's rates for 2019 as applied for in EB-2013-0416, Exhibit G1, Tab 4, Schedule 2, Attachment 5 are approved and would then apply.[13]

It is important to note, that although NPDI has a service territory that includes rural areas, unlike HONI it has no density rates. For the analysis, it was not possible to incorporate an estimate of the number of NPDI customers that would transition to each of HONI's UR, R1 and R2 rates, as HONI has said it is unable to provide a breakdown. BDR reviewed EB-2013-0416 Exhibit G1, which at Tab 2 Schedule 1 provides the density related criteria for each class, but does not have the information to make an independent determination as to how many (if any) NPDI customers would qualify for the UR (i.e. lowest) rate.

The analysis has assumed a residential customer with monthly consumption of 750 kWh per month, and a General Service customer with monthly consumption of 7500 kWh (for example, a customer with demand of 25 kW and a load factor of 41%.

The analysis includes only distribution rates, excluding any rate riders or adders or other adjustments that may apply at the time.

On this basis, an NPDI residential customer would experience a 10% decrease in distribution charges if transitioning to HONI's UR rate; however the customer would receive an increase of 42% if assigned to R1, and a 238% increase if assigned to R2. A general service customer transitioning from NPDI's rate to HONI's UGe or GSe rate would receive an increase of or 162% and 218% respectively on this basis. These changes do not include the higher commodity charges each NPDI customer will face due to HONI's higher line losses.

[13] The 2019 HONI rates are those proposed in its EB-2013-0416 recent multi-year custom IR filing and have not been considered or approved by the Board. This includes any proposed changes to the revenue-to-cost ratios and/or the density of the customer classes.

Residential	Rates	Bill Change $	Bill Change %
Norfolk Base 2012 Rates			
Residential Fixed	20.77		
Residential Variable	0.0217		
Norfolk Base Reduced by 1%			
Residential Fixed	20.5623		
Residential Variable	0.021483		
Assumed Typical Consumption, kWh/Month	750		
Monthly Distribution Bill without Riders or Adders	$ 36.67		
HONI 2019 UR			
Residential Fixed	19.57		
Residential Variable	0.01779		
Assumed Typical Consumption, kWh/Month	750		
Monthly Distribution Bill without Riders or Adders	$ 32.91	$ (3.76)	-10%
HONI 2019 R1			
Residential Fixed	27.89		
Residential Variable	0.03227		
Assumed Typical Consumption, kWh/Month	750		
Monthly Distribution Bill without Riders or Adders	$ 52.09	$ 15.42	42%
HONI 2019 R2			
Residential Fixed	81.74		
Residential Variable	0.05637		
Assumed Typical Consumption, kWh/Month	750		
Monthly Distribution Bill without Riders or Adders	$ 124.02	$ 87.34	238%

Small General Service	Rates	Bill Change $	Bill Change %
Norfolk Base 2012 Rates			
GS<50kW Fixed	49.74		
GS<50kW Variable	0.0155		
Norfolk Base Reduced by 1%			
GS<50kW Fixed	49.2426		
GS<50kW Variable	0.015345		
Assumed Typical Consumption, kWh/Month	7500		
Monthly Distribution Bill without Riders or Adders	$ 164.33		
HONI 2019 Gse			
Fixed	32.47		
Variable	0.06532		
Monthly Distribution Bill without Riders or Adders	522.37	$ 358.04	218%
HONI 2019 Uge			
Fixed	27.82		
Variable	0.03184		
Monthly Distribution Bill without Riders or Adders	266.62	$ 266.62	162%

This table sets out the approved line losses for NPDI and HONI. The rate impacts identified in the comparison of distribution charges do not reflect the levels of line losses in the two LDCs. Assuming that HONI's line losses are applied to NPDI's customers on harmonization, the customers will face increases in the amounts that they pay for generated electricity and for transmission services as a result, in addition to increases in the distribution charges.

5 COMPARISON OF LOSS FACTORS, NPDI AND HONI		
NPDI – all classes		1.0564
HONI	Residential Urban	1.078
	Medium Density	1.085
	Low Density	1.092
	Urban General Service Energy	1.092
	Other General Service Energy	1.092

APPENDIX A – COMPLIANCE WITH SECTION 13A.03, ONTARIO ENERGY BOARD RULES OF PRACTICE AND PROCEDURE

This evidence has been prepared by BDR NorthAmerica Inc. (“BDR”) on behalf of Essex Powerlines Corporation, Bluewater Power Distribution Corporation, and Niagara-on-the-Lake Hydro for filing with the Ontario Energy Board. In providing this this evidence, BDR and its individual consultants, Paula Zarnett and John McNeil, accept their responsibilities as experts as set out in Section 13A.03 of the Ontario Energy Board’s Rules of Practice and Procedure.

(a) Name, Business Name and Address, and General Area of Expertise

This evidence was prepared by:

Paula Zarnett, Vice President
BDR NorthAmerica Inc.
34 King Street East, Suite 1000
Toronto, Ontario M5C 2X8

Paula has 30 years broadly based experience specializing in regulatory compliance, regulated rates and pricing issues for electricity and gas utilities.

Paula was assisted in the portions of this evidence related to the history of acquisition transactions in Ontario and to the capital markets by:

John McNeil, President
BDR NorthAmerica Inc.
34 King Street East, Suite 1000
Toronto, Ontario M5C 2X8

(b) Qualifications, including relevant educational and professional experience in respect of each issue in the proceeding to which the expert’s evidence relates.

Paula’s evidence in this proceeding relates to:

- Whether future cost structures of the entities will increase or decrease as a result of the intended transaction;
- whether the quality of service to consumers was likely to increase or decrease (non-financial impacts);
- whether the purchase price is set at a level that would create a financial burden on the acquiring utility; and
- the likely impacts on customers of NPDI if rates are harmonized with HONI’s rates, following the proposed five year distribution rate freeze to NPDI’s customers.

Selected projects illustrating her experience and expertise in analyzing cost information related to the operation of electricity distributors include:

- a study on behalf of the Toronto Hydro-Electric System Ltd. to allocate the costs of service to customers who are individually metered suites in multi-unit residential buildings (2010-2011).
- For the City of Edmundston/Energy Edmundston – a business plan and cost forecast reflecting acquisition of distribution service territory and new supply contracts with NB Power
- Numerous studies to support the allocation of shared costs and to develop transfer pricing in support of regulated revenue requirements.

Selected projects illustrating her experience in analysis of the impacts of LDC mergers and acquisitions include:

- **Markham Hydro Distribution Inc. and Town of Markham** – Due diligence services in support of amalgamation with Hydro Vaughan Distribution Inc. to form PowerStream Inc.

- **City of Guelph** – independent advisor to the City with regard to fairness of ownership proportion in proposed merger; analysis of ownership options, including development of financial projections in support of valuation

- **A**nalysis and support to the City of Edmundston/Energy Edmundston in support of its negotiation to acquire 3,000 customers from the contiguous service territory of New Brunswick Power

With regard to rates and rate design, Paula has a decade of direct experience designing rates for all customer classes for Toronto Hydro, and before joining Toronto Hydro, performed rate analysis and design functions for gas utilities in Manitoba, Albert and British Columbia. As a consultant, she has performed rate design studies for electricity, steam and water.

She participated on behalf of a client in the Ontario Energy Board's stakeholder processes regarding cost allocation for electricity distribution service, and was an instructor in cost allocation and rate design (advanced) at CAMPUT's annual utility regulation course in 2006, 2007 and 2008. She has testified before the regulators in Ontario, New Brunswick, Prince Edward Island and British Columbia, and has been accepted as an expert in cost allocation by the Ontario Energy Board.[14]

Formerly a manager at Toronto Hydro with responsibilities in customer service, CDM, business project analysis and rate designs, Paula is knowledgeable in the

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[14] EB-2010-0142, Transcript dated March 29, 2011, page 20.

typical business processes of distribution utilities and their affiliates, and has direct experience in the analysis and planning carried out in support of reorganizing and reallocating resources following utility consolidation. She prepared evidence in support of FortisOntario's shared cost allocation and transfer pricing approach in successive cost of service applications since 2006, and for Kingston Hydro in an application for its 2011 cost of service, both of which involve allocation of shared costs among different utility operations.

Paula is a Certified Management Accountant, and has an MBA degree (finance) from the University of Calgary.

John McNeil, who assisted Paula in preparation of the portions of the evidence related to acquisition transactions of Ontario LDCs and to the capital markets, is lawyer by training and an independent investment banker by profession. He has over 30 years' experience in the areas of business and enterprise valuations, financing and capital markets activities, and mergers and acquisitions (M&A). In his consulting practice, John has advised Ontario municipalities and utility clients considering mergers, acquisitions and divestitures, joint ventures, and the formation of service affiliates. In addition to his expertise in the business and operational issues associated with combining operations, John has expertise concerning the regulatory issues that arise from mergers and business combinations.

For 20 years, he held senior management and executive positions in major investment banks, with responsibility for merger and acquisition transactions and financing. He has provided advice in financial restructuring and financing strategy to LDCs including PUC Distribution and PowerStream.

John has led teams in many Strategic Options studies for both shareholders and Board of Directors/management teams such as for Burlington Hydro, Centre Wellington Hydro, Fortis Inc., the City of Guelph, the City of Markham, Oakville Hydro, Orangeville Hydro, PowerStream, the Town of Halton Hills, Hydro One, Thunder Bay Hydro and Westario Hydro. His direct experience in merger and acquisition transactions in the sector is listed on his detailed résumé.

(c) Instructions provided in Relation to the Proceeding and to the Issue

EBN has requested BDR to:

- Review evidence as to cost structures to determine whether they are likely to increase or decrease as a result of the intended transaction;
- To comment on non-financial impacts, such as quality of service; and
- To consider and comment on whether the purchase price is set at a level that would create a financial burden on the acquiring utility; and
- To develop and present a possible scenario for estimation of the impacts of harmonization of rates, once the proposed rate freeze period expires.

(d) Specific Information and Documents Relied on in Preparing the Evidence

BDR reviewed the record in this proceeding, with particular emphasis on revised interrogatory responses filed on February 10, 2014, as well as information publicly available from the Board's website and information from other public sources. Sources are footnoted in the body of the report. No proprietary or confidential information was obtained or relied on.

(e) Points of Agreement and Disagreement with other Expert's Evidence

Not applicable.