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Michael Janigan
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April 14, 2014

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: EB-2013-0187 – EB 2013-0196 – EB 2013-0198
Hydro One Networks Inc. (HONI)
Final Argument of the Vulnerable Energy Consumers Coalition (VECC)

Please find enclosed the Final Argument of VECC in the above-noted proceeding. We have also directed a copy of the same to the Applicant as well as all interested parties via email.

Yours truly,

Michael Janigan
Counsel for VECC

cc: HONI – Michael Engelberg – mengelberg@hydroone.com

EB-2013-0187
EB-2013-0196
EB-2013-0198

IN THE MATTER OF an application made by Hydro One Inc. for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. made pursuant to section 86(2)(b) of the *Ontario Energy Board Act, 1998;*

AND IN THE MATTER OF an application made by Norfolk Power Distribution Inc. seeking to include a rate rider in the 2013 OEB-approved rate schedule of Norfolk Power Distribution Inc. to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders), made pursuant to section 78 of the *Ontario Energy Board Act, 1998;*

AND IN THE MATTER OF an application made by Norfolk Power Distribution Inc. for leave to transfer Norfolk Power Distribution Inc.'s distribution system to Hydro One Networks Inc. made pursuant to section 86(1)(a) of the *Ontario Energy Board Act,* 1998;

AND IN THE MATTER OF an application made by Norfolk Power Distribution Inc. for leave to transfer/assign Norfolk Power Distribution Inc.'s distribution licence and rate order to Hydro One Networks Inc. made pursuant to section 18 of the *Ontario Energy Board Act, 1998.*

FINAL ARGUMENT OF THE

VULNERABLE ENERGY CONSUMERS COALITION

April 14, 2014

1. INTRODUCTION

On April 26, 2013 Hydro One Inc. filed an Application with the Ontario Energy Board for the acquisition of Norfolk Power Inc. (NPI). Specifically the Application sought the following approvals[1]:

- Hydro One Inc. sought leave to acquire all of the issued and outstanding shares of NPI from the County,
- Norfolk Power Distribution Inc. (NPDI) sought leave to transfer its distribution system to Hydro One Networks Inc. (HONI),
- HONI-Distribution requested approval to include a rate rider in the 2013 OEB-approved rate schedule of NPDI to give effect to reducing the approved 2012 base delivery distribution rates by one per cent,
- HONI-Distribution requested approval to defer the rate rebasing of HONI-NP (the former NPDI) for five years from the date of closing the proposed transaction,
- HONI-Distribution requested approval to continue the "Application for Tax Changes" rate rider currently approved for NPDI until HONI NP's rates are rebased and to true-up the balance at that time,
- Hydro One Inc. sought approval to utilize USGAAP for HONI-NP financial reporting.

With respect to the one percent rate reduction requested for NPDI and the request to defer the rate rebasing for HONI NP, the Application indicated[2] that the intent was that NPDI delivery rates would be frozen and the rate rider applied for five years from the date of the closing of the transaction. At the end of the five-year period, HONI-Distribution expected to apply under the Board's IRM to adjust HONI NP's rates until the earliest opportunity to rebase its rates along with HONI Distribution's rates, currently anticipated sometime in 2020[3]. At the time of the Application, HONI-Distribution also indicated[4] that it intended to harmonize distribution rates at the earliest opportunity after the five-year rate freeze period. Again, it was expected that this would be in 2020.

[1] Application, Exhibit A, Tab 1, Schedule 1 pages 3-5
[2] Application, Exhibit A, Tab 2, Schedule 1, page 4
[3] Application, Exhibit A, Tab 2, Schedule 1, page 6
[4] Application, Exhibit A, Tab 2, Schedule 1, page 7

On November 8, 2013 a Supplemental and Amended Application was filed with the Board. The Amended Application clarified how the transaction would proceed once authorization to acquired shares of NPI was received. It specifically noted[5] that the transaction was essentially a two-step process and that the transfer of the NPDI distribution system (to HONI) and the consequent cancellation of the NPDI distribution license could only occur following the completion of the necessary business system integration tasks. As a result the approvals sought were amended[6] such that NPDI would be granted approval to give effect to a 1% rate reduction relative to the 2012 base electricity distribution rates at the same time as the Board granted approval for Hydro One Inc.'s purchase of the shares. Then upon notice (expected to occur within 18 months) of completion of the integration of Norfolk Power Distribution Inc. operations into Hydro One Networks Inc.:

- NPDI would be granted leave to transfer its distribution system to Hydro One Networks Inc.,
- NPDI would be granted leave to transfer its rate order to Hydro One Networks Inc.,
- NPDI's distribution license would be cancelled,
- Hydro One Networks Inc.'s distribution license would be amended to include the area formerly served by NPDI but reflect the fact it would be administered separately or a separate electricity distribution license would be issued to Hydro One Networks Inc. to serve the customers of the former NPDI.

Consistent with the last request, the November 2013 Supplemental Evidence indicated[7] that, following the NDPI asset transfer, Hydro One Networks Inc. planned to establish a new business unit that would have responsibility for the acquired NPDI distribution business which would allow rate making and regulatory reporting during the five-year freeze period for NPDI's customers to occur. It also indicated in the Amended Application[8], that (former) NPDI's assets would be tracked as a separate business unit and that OM&A costs would be charged to the Norfolk Distribution Business using fully

[5] Amended Application, Supplemental Evidence, page 2
[6] Exhibit I, Tab 1, Schedule 10, page 2
[7] Pages 2-3
[8] Exhibit A, Tab 2, Schedule 1,page 3

allocated pricing, similar to what is now done to record costs to its Transmission and Distribution businesses.

In addition the Amended Application indicated[9] that Hydro One intended to rebase the consolidated entity (Hydro One Networks Inc. – Distribution and NPDI) from a financial perspective in 2020 for rate setting purposes, i.e. one revenue requirement. However, from a rate design perspective, Hydro One was still investigating options which included i) creating a new acquired customer class; ii) moving acquired customers to an appropriate Hydro One Networks Inc. rate class existing at that time or iii) some other option. Finally, the Amended Application[10] did not specifically indicate that an IRM based rate application would be submitted for HONI-NP after the rate freeze but rather just that a rate application would be filed and that the ability to have a separate revenue requirement for the Norfolk Distribution Business in 2019 would be maintained.

2. VECC's Interest in the Application

VECC's interest in the Application is two-fold. First, and foremost, does the Application meet the Board's "No Harm" test? In this regard, VECC agrees with the characterization of the No Harm test as set out in the Applicants' Joint Submission[11] and notes that VECC's interests, in this Application, lie mainly in the first of the two questions

> *The "no harm test" considers whether a proposed transaction is expected to result in an overall adverse effect relative to the status quo and in relation to the Board's statutory objectives under section 1 of the Ontario Energy Board Act, 1998 ("the Act"). This test is assessed through consideration of two questions:*
>
> > *1. What impact will the transaction have on the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service?*
> >
> > *2. What impact will the transaction have on economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and on the maintenance of a financially viable electricity industry?'*
>
> *The SEC Decision clarifies that in the present circumstances the "no harm test" will be applied through the consideration of the likely effects of the transaction, namely, whether adverse effects are likely to arise in respect of the Board's*

[9] Exhibit I, Tab 1, Schedule 11, page 1

[10] Exhibit A, Tab 2, Schedule 1, pages 7-8 (November 8, 2013)

[11] Pages 2-3

objectives in section 1 of the Act." Hydro One submits that this is achieved through: (1) consideration of prospective transaction cost structures and rates relative to the status quo; (2) consideration of the transaction on the financial viability of the acquiring utility relative to the status quo; and (3) consideration of non-financial impacts, including the adequacy and reliability of electricity service arising from the proposed transaction relative to the status quo.

VECC's second interest is with respect to Hydro One Networks Inc.'s conformance with Board policy as set out in the Report – Rate-Making Associated with Distributor Consolidation (EB-2007-0028).

3. <u>No Harm Test</u>

3.1 <u>Costs and Rates</u>

In VECC's view, the No Harm test must be considered from the perspective of both Hydro One Networks Inc.'s existing customer base and from the perspective of NPDI's existing customer base. Furthermore, in VECC's view, it is important that the No Harm test include a long term perspective and not just look at the impacts immediately after the transaction as Hydro One Networks appears to suggest[12]. The current application, which includes a short term rate reduction and rate freeze for the former NPDI customers, is a good illustration as to why consideration of the long-term is important. While the rate reduction/rate freeze is a consideration in the assessment of the No Harm test it is important that the Board look beyond this and consider what the longer term implications are relative to the status quo. To do otherwise, would create a precedent for future transactions and encourage potential purchasers to circumvent the intent of no harm test by offering short term discount discounts to mask what might otherwise be longer term negative impacts on customers.

Hydro One Distribution

For Hydro One Networks Inc.'s existing distribution customers there are two issues to be addressed within the context of the No Harm test as it applies to costs and rates. The first is whether there will be any negative impacts (i.e., increases) for their rates as a result of the rate reduction/5-year rate freeze proposed for NPDI's customers. The

[12] Exhibit I, Tab 3, Schedule 11

second is whether, over the long term, the acquisition of NPDI will increase the rates for these legacy customers relative to the status quo.

Hydro One Networks Inc. has indicated that the costs of operating and maintaining the former NPDI service territory will be tracked separately and therefore have no effect on its legacy customers[13]. Furthermore, Hydro One Networks has indicated that common costs will be allocated to the Norfolk Distribution Business consistent with its current common corporate cost allocation model[14]. This later allocation is likely to lead to a slight reduction in the cost to be recovered from its legacy customers, since the fully allocated share of common costs will likely exceed any incremental increase in the cost of providing these common services[15]. Finally, Hydro One Networks has confirmed that its five-year cost of service rate application (2015-2019) will be based on its existing customer base and not include any of the capital or OM&A costs associated with the former NPDI service territory[16].

One outstanding source of potential impact on legacy customers' costs is Hydro One Networks' commitment to provide job security to all NPDI staff[17]. The Applicants' April 4, 2014 Joint Submission[18] indicates that this will involve Hydro One's employment of 30 of the NPDI staff, while the remaining 16 will be retained in NPDI. Given the size of Hydro One Networks workforce and its employee demographics[19], it seems reasonable to suggest that these former NPDI employees will be able to be "absorbed" with minimal cost.

Over the longer term, Hydro One Networks has indicated that it intends to rebase the consolidated entity in 2020, i.e., establish one revenue requirement[20]. But that it is still exploring options in terms of rate design and customer classification. As such Hydro One Networks has stated that "a comparison of revenues for Norfolk customers at

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[13] Exhibit I, Tab 2, Schedule 1, part e) and Exhibit A, Tab 2, Schedule 1, page 3 (November 8, 2013)
[14] Exhibit A, Tab 2, Schedule 1, page 3 (November 8, 2013)
[15] Exhibit 1, Tab 2, Schedule 3 part a) and Exhibit I, Tab 4, Schedule 4
[16] Exhibit A, Tab 2, Schedule 1, page 2
[17] Exhibit A, Tab 2, Schedule 1,page4 (November 8, 2013)
[18] Page 7
[19] Exhibit A, Tab 3, Schedule 1, Attachment 7, pages 26 and 76
[20] Exhibit I, Tab 1, Schedule 11

existing Norfolk and HONI rates is not appropriate"[21]. At the same time Hydro One Networks also asserts that since "the rate classes for Norfolk customers at the end of the five-year rate freeze has not been determined ... any analysis at this stage would be speculative and would not have a bearing upon whether the transaction is likely to cause adverse effects to rate payers relative to the status quo scenario".[22]

However, as noted earlier in VECC's view it is important that the Board assess the issue of No Harm beyond the short-term period covered by the rate freeze and required some basis for doing so. Given the uncertainty regarding rate treatment of these customers in the long term, VECC submits that the most appropriate basis for such an assessment is the current rates for Norfolk and HONI and the likely implications that the transaction will have.

Hydro One Networks did not provide requested information indicating into which of its existing customer classes NPDI's customers would be classified[23]. However, Hydro One Networks' interrogatory responses indicate that NPDI's current (2013) rates for its Residential, GS<50 and GS>50 customers result in bills that are somewhere between those experienced by Hydro One Networks' Urban and R1 customers for the comparable customer class[24]. If, in the extreme, all of the NPDI customers were considered to be Urban customers and classified accordingly after 2020, the difference in revenue (at 2013 rates) would be about $570,000[25] which would have to be recovered from Hydro One Networks' legacy customers. However, offsetting this impact would be any anticipated net efficiency gains[26].

Hydro One Networks has provided a high level forecast of the projected OM&A and capital expenditure savings expected from the Norfolk acquisition[27]. However, it has only discussed in general terms how these savings will arise and has not provided a detailed work up of the savings. Thus, while Hydro One Networks states that "it is

[21] Exhibit I. Tab 3, Schedule 4, part d)
[22] Exhibit I, Tab 2, Schedule 5, part c) & d)
[23] Exhibit I, Tab 2, Schedule 5
[24] Exhibit I, Tab 3, Schedule 4
[25] Exhibit I, Tab 3, Schedule 4
[26] Exhibit I, Tab 2, Schedule 2
[27] Exhibit I, Tab 2, Schedule 2, Table 1

entirely unclear how EBN's consultants have cogently reached the conclusion that the savings forecast in the Table 1 Analysis are in some way *"overstated'* or do not materialize as a result of the transaction" it is equally unclear to VECC precisely how the savings set out in Table 1 will arise, apart from specific references to $70,000 in savings associated with the Norfolk Power Board of Directors. In addition Hydro One Networks has also documented savings in staffing of approximately $2 M per year[28] but these must be reduced by any incremental costs in providing common services to the former NPDI service area which have not been documented. Overall, while the transaction may satisfy the No Harm test in terms of Hydro One Networks' legacy customers VECC submits that it has not been clearly demonstrated and documented.

Norfolk Power Distribution Inc.

As Hydro One Networks has pointed out repeatedly in is Application and interrogatory responses, NPDI's former customers will clearly benefit in the short-term from the 1% rate reduction and five-year rate freeze. However, what is of concern to VECC is the longer term prognosis for these customers vis-a-vis the No Harm test.

Even if the annual savings reach the $5 M plus level forecast by Hydro One Networks[29] with financial consolidation of the two entities in 2020 and the creation of one revenue requirement these savings will be spread over Hydro One Networks entire consolidated customer base of which the former NPDI customers represent roughly 1.5%[30] in terms of customer numbers and likely materially less in terms of kWh sales. In contrast if the former NPDI customers are re-assigned after 2020 to Hydro One Networks' existing customer classes for those that fall into the R1 Residential or GS classification, the response to SEC interrogatory #4 indicates that that they will see a rate increase of over 50%[31] which is far more than what can be offset by the projected savings. As a result, the available evidence suggests that the No Harm test will not be met in the long term with respect to Norfolk's former customers if any of them are folded into Hydro One Networks' existing R1 customer classes. It is therefore VECC's submission that the

[28] Exhibit I, Tab 5, Schedule 26
[29] Exhibit I, Tab 2, Schedule 2
[30] Exhibit I, Tab 5, Schedule 1
[31] Compare total revenues of $11.5 M at Norfolk's 2013 rates versus $17.6 M at HONI's R1 rates.

Board should not approve the transaction until there is further clarification regarding the long term rate treatment of the current NPDI customers. If approval is granted then, at a minimum, specific conditions attached to the approval that acknowledge this to be an outstanding issue and that will serve to protect the long-term interests of Norfolk's customers as they pertain to rates.

3.2 Reliability and Quality of Electric Service

Hydro One Networks claims that the "reliability in its Simcoe Operations area, which consists of the balance of Norfolk County not served by Norfolk Power, is already equal to or better than the reliability experienced by Norfolk Power customers"[32]. While Hydro One Networks' reliability is better than NPDI's on some fronts (e.g. SAIDI and SAIFI[33]), it is worse on others (e.g. CAIDI and Emergency Response[34]). Based on these mixed results, there is no clear evidence to suggest that Hydro One Networks' current service practices will lead to either lower or higher levels of reliability and quality of service for NPDI's former customers.

One area of concern going forward is the 40% reduction in capital spending forecast for the former NPDI service area over the next 10 years[35]. While this reduction is characterized as "savings" no real detail is provided as to how the savings will be achieved and whether it will be through real efficiency gains or delays/cancellations of previous planned spending required to maintain the reliability and quality of service. This issue was raised in the evidence[36] filed by EBN but was not addressed in the Applicants' joint submission.

In VECC's submission, Hydro One Networks has failed to supply sufficient evidence that its planned reductions in capital spending will not impact on the reliability of supply in the former NPDI service area and thereby demonstrate that the No Harm test has been satisfied.

4. Board's Policies on Rate-Making Associated with Distributor Consolidation

[32] Exhibit I, Tab 1, Schedule 5
[33] Exhibit I, Tab 5, Schedule 10 - comparison based on 3-year average of values without LOS
[34] Exhibit I, Tab 5, Schedule 10 and Schedule 12
[35] Exhibit I, Tab 2, Schedule 2, Table 1
[36] EBN Evidence, page 12

The Report of the Board – Rate-Making Associated with Distributor Consolidation (EB-2007-0028) contains a number of policy directions that are relevant to the proposed NPDI acquisition. The first is with respect to the timing of rebasing where the Report states[37]:

> *Distributors that apply to the Board for approval of a consolidation transaction may propose to defer the rate rebasing of the consolidated entity for up to five years from the date of closing of the transaction. The closing date often occurs within 12 to 18 months of approval of the transaction by the Board, which is within the 18-month period during which a MAAD transaction approval typically remains in effect before expiring.*

Hydro One Networks claims[38] that its proposal to freeze for five years and then rebase the former NPDI's rates at the earliest opportunity is consistent with this policy. However, this is clearly not the case. The policy states that a distributor may propose to defer rate rebasing for the consolidated entity. In contrast, in Hydro One's case what is being sought is approval to defer rebasing of the rates associated with Norfolk's former service area while at same time proposing to increase the rates for it legacy customers over each of the next five years[39].

The Report also indicates[40] that distributors, at the time of their MAADs applications, need to provide a statement as to whether they intend to undertake rate harmonization or not. Hydro One Networks has not done so. Rather it has indicated[41] that it is considering a range of rate design options including both rate harmonization and establishing separate rate classes for the acquired customers. As discussed above, this lack of clarity makes it difficult for parties (including the Board) to determine if the proposed transaction is consistent with the No Harm test, particularly in regards to NPDI's (former) customers.

5. Conclusions

[37] Page 5
[38] Exhibit A, Tab 2, Schedule 1, page 7 (November 8, 2013)
[39] As set out in its 2015-2019 Rate Application (EB-2013-0416)
[40] Page 8
[41] Exhibit A, Tab 2, Schedule 1, page 7 (November 8, 2013)

Overall, VECC submits that there is considerable uncertainty as to whether the proposed transaction meets the No Harm test, particularly in regards to NPDI's customers and the Board should not approve the transaction until Hydro One Networks has more clearly demonstrated that this will be the case.

In the event that the Board decides to approve the transaction then VECC submits the Board should:

- Adopt the second alternative outlined by Hydro One Inc. in its Application and issue a separate licence to Hydro One Networks Inc. to serve the customers of the former NPDI[42].
- Require, as part of the licence condition, that Hydro One Networks maintain a separate Norfolk Business Unit, where costs are tracked and rates are set separately until otherwise approved by the Board.

6. Costs

VECC respectfully submits that it has acted responsibly and efficiently during the course of this proceeding and requests that it be allowed to recover 100% of its reasonably incurred costs.

[42] Exhibit A, Tab 1, Schedule 1, page 2 (November 8, 2013)