

April 14, 2014

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

Dear Ms. Walli:

**Re: Applications by Hydro One Inc., Norfolk Power Distribution Inc. and Hydro One Networks Inc. –  
EB-2013-0196/EB-2013-0187/EB-2013-0198 – Purchase Transaction – Final Argument of the  
Consumers Council of Canada**

Please find, attached, the Final Argument of the Consumers Council of Canada in the above-referenced proceeding.

Yours truly,

*Julie E. Girvan*

Julie E. Girvan

CC: All parties, by e-mail  
Ken Whitehurst, Consumers Council of Canada

**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 CONSUMERS COUNCIL OF CANADA**

**April 14, 2014**

### **INTRODUCTION:**

Hydro One Networks Inc. ("HON") and Norfolk Power Distribution Inc. ("NPDI") and Hydro One Inc. ("HOI"), HON's parent company (the "Applicants") filed related Applications on April 26, 2013, with the Ontario Energy Board ("Board") for the following approvals:

1. HOI applied seeking leave to acquire all of the issued and outstanding shares of NPDI from the County;
2. NPDI applied to dispose of its distribution system to HON;

3. If the Board grants leave NPDI requested that its electricity licence be cancelled. HON requested that its distribution licence be amended to include the portion of Norfolk County formerly served by NPDI;
4. HON requested approval to include a rate rider in the 2013 Board approved rate schedule of NPDI to give effect to reducing the approved 2012 base delivery distribution rates by 1%;
5. HON requested approval to defer the rate rebasing of HON NP (the former NPDI) for five years from the date of closing the proposed transaction, consistent with the Report of the Board entitled, "Rate-Making Associated with Distributor Consolidation" dated July 23, 2007. At the end of the period HON indicated that it expected to apply the Board's Incentive Regulation Mechanism ("IRM") to adjust NPDI's rates until the earliest opportunity to rebase its rates along with HON Distribution rates in 2020.
6. HON also requested approval to continue the "Application for Tax Changes" rate rider currently approved for NPDI until HON NP's rates are rebased and to true up that balance at the time; and
7. HON requested approval to utilize USGAAP for HON NP financial reporting. (Exhibit A/T1/S1/pp. 3-5)

The Board determined it would consider the applications together in a consolidated proceeding.

On November 8, 2013, HON, in response to a direction from the Board, filed a Supplemental and Amended Application setting out changes to the evidence and the relief sought. In that updated evidence HON indicated that it was seeking approval of a transition period as a condition to the original relief sought. That transition period is required to facilitate various integration steps required to complete the transaction. During the transition period NPDI will continue to operate its regulated distribution business and NPDI and HON will continue to carry out all necessary system integration issues. It is HON's position that none of these changes will affect the proposed rate reduction and five-year rate freeze period as described in the applications. (Supplemental Evidence, pp. 3-4)

In its updated evidence, HON set out its proposals with respect to NPDI's rates, assuming the transaction is ultimately approved by the Board:

1. HON proposes to defer the rate rebasing of the former NPDI – HON NP – to the earliest opportunity after 5 years from the closing date of the proposed transaction. From HON's perspective this will give HON time to retain savings to offset costs while protecting the interests of consumers across both existing service areas;

2. At the end of the rate freeze in 2019, HON expects to apply the Board's IRM to adjust HON NP's rates until the earliest opportunity to rebase, expected in 2020;
3. As industry rates evolve over the next five plus years, HON expects to file an application to set rates for HON NP consistent with Board rate-making principles (e.g. fair, clear, rate stability and effective cost recovery of the revenue requirement). The rate application at that time may propose to : (i) create new acquired customer rate classes; (ii) move acquired customers to an appropriate HON rate class existing at that time; or (iii) some other option;
4. It is not possible to say which option will be adopted since it will depend upon the situation at the time of setting new rates for Norfolk. Some considerations in deciding on rate strategies include the number and characteristic of the acquired utilities, customer growth in the acquired utilities and potential development within the electricity regulatory arena in Ontario. (Exhibit A/T2/S1 pp. 7-8 – updated November 8, 2013).

These are the submissions of the Consumers Council of Canada ("Council") regarding the Applications before the Board and the relief requested by HON, HOI and NPDI.

#### **BACKGROUND:**

In assessing mergers, acquisitions, amalgamation or divestiture transactions the Board applies the "no harm" test. The "no harm" test was established in RP-2005-0018/EB-2005-0234/EB-2005-0234 and EB-2005 at the time the Board was considering three separate acquisition applications in a combined proceeding. In that proceeding the Board set out the factors to be considered in approving an application to acquired shares or amalgamate under section 86 of the *Electricity Act, 1998*.

The Board acknowledged that in carrying out its statutory obligations it should be guided by the following two objectives:

1. To protect the interests of consumers with respect to prices, and the adequacy, reliability and quality of electricity service; and
2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.

Accordingly, the Board determined that it would be guided by two basic questions in assessing these types of transactions:

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 the 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? (RP-2005-0018/EB-2005-0234/EB-2005-254/EB-2005-0257 Decision, p. 5)

In addition, with respect to price, the Board determined that the selling price of a utility is only relevant if the price paid is so high as to create a financial burden on the acquiring company, which adversely affects economic viability as any premium paid in excess of the book value of assets is not normally recoverable through rates. (Decision, p. 7).

In its Decision regarding a motion by the School Energy Coalition (“SEC”), dated January 24, 2014, to compel answers to a number of interrogatory responses, the Board confirmed its application of the “no harm” test indicating that it will approve a transaction if it is satisfied that the transaction will not have an adverse effect in terms of the factors identified in the Board’s statutory objectives.

In assessing acquisition applications the Board is also guided by its Report entitled, Rate-making Associated with Distributor Consolidation, dated July 23, 2007. In that Report the Board set out policies on a number regarding rate-making issues relevant to consolidation transactions.

The Council notes that since this application was filed the Board has announced that it is undertaking a review of its policies related to service area amendments and rate-making associated with merger, amalgamation, acquisition and divestiture (“MADDs”) transactions. That process will begin in May 2014.

Three local distribution companies, Essex Powerlines Corporation, Bluewater Power Distribution Corporation and Niagara-On-The-Lake Hydro (together “EBN”) sponsored expert evidence pursuant to the Applications by BDR. BDR was asked: to review the cost structures and 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; to consider and comment on whether the purchase price is set at a level that would create 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 (Evidence of Paula Zarnett/BDR, February 26, 2014).

BDR concluded that:

1. 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 planned capital program reductions;
2. The Applicants savings estimate is overstated, and that the benefits that are achievable would not be achieved immediately;
3. The Applicants have not supported their claim that lower costs of debt are a certain benefit of the transaction;
4. With regard to service quality information from public sources provides a basis for concern the NPDI customer may experience a decline in level of service with HON. There is no evidence that HON plans to maintain the historic local service levels in its service to NPDI; and
5. Customers transitioning to HON's currently proposed rates for 2019 could experience significant rate increases relative to NPDI 2012 base rates less 1%. (Evidence of Paula Zarnett/BDR, February 26, 2014)

As set out in its Argument-in-Chief it is NPDI's position is that "the benefits of integration are in stark contrast to any form of adverse effect contemplated by the "no harm" test and that the "no harm" test has been satisfied (NPDI Argument-in-Chief "AIC", p. 6). In addition, NPDI submitted that the cash proceeds from the sale of NDPI represent an extremely important "community trust" that will benefit current and future citizens of Norfolk County. (AIC, p. 3).

With respect to the BDR evidence NPDI urged the Board to put little weight, if any on it. It is NPDI's view that it constituted argument, not evidence. (AIC, p. 23). With respect to the interventions of EBN and the SEC NPDI has characterized them as an attempt to re-litigate the "no harm" test and use the Board's regulatory process as part of a broader strategy to oppose HON's participation in the distribution sector consolidation.

HON's position with respect to the transaction can be summarized by the following submission:

The commercial arrangements before the Board are significant. For the County the contemplated transaction provides a path forward that allows for the monetization of assets on a fair and competitive process. For Hydro One, the commercial transaction achieves the opportunity to realize cost and scale efficiencies intended to benefit ratepayers. For all parties the transaction is another important step towards achieving the overarching public policy objectives of LDC sector consolidation, as described in the Ontario Distribution Sector Panel Report "Renewing Ontario's Electricity Distribution Sector: Putting the Consumer First," as well as the Commission on the Reform of Ontario's Public Services: "A Path to Sustainability and Excellence" ("the Drummond Report"). (HON Argument-In-Chief, p. 2)

With respect to BDR HON also challenged the evidence arguing that it represented opinions made by people who do not have experience running the day to day affairs of an electrical distribution utility, “let alone the experience of actually carrying out the asset integration of a small distribution utility into an organization such as Hydro One.” (HON, AIC, p. 8). HON in its AIC essentially took issue with each of the conclusions reached by BDR.

These applications are being considered by the Board through a written hearing process.

### **SUBMISSIONS:**

The Council has a number of concerns with respect to the Applications by HON, HOI and NPDI:

1. HON is proposing to purchase NPDI at a premium of approximately 70% above the depreciated value of the net book value of the utility. The Council questions the extent to which paying such a significant premium ultimately benefits HON’s existing customers, especially in a period of significant capital spending requirements. In addition, with HON continuing to pay significant premiums for LDCs, the rational consolidation of the distribution sector is potentially compromised, as HON has become a dominant buyer;
2. Historically HON has purchased over 80 electric LDCs. Initially, the rates of those LDC rates were not harmonized with HON’s legacy customers, but eventually they were. Upon harmonization many “acquired” customers were subject to significant rate increases. The increases for many customers were so significant that they needed to be phased in over a number of years. The evidence is that this is likely to happen to NPDI after the rate freeze period given the rate proposals embedded HON current 2015-2019 rate application;
3. HON has not satisfied the “no harm” test on the basis of the evidence filed. HON has proposed a rate freeze and an arbitrary rate reduction (not based on any savings calculations) of 1% for a period of five years. HON has not set out what NPDI’s rates will be once the five-year period ends. In effect, HON has not established that NPDI’s customers will not be subject to harm. Based on the evidence to date, we have no idea what NPDI’s customers will pay in rates in 2020, relative to what they would pay assuming the transaction did not occur;
4. HON has stated that when it rebases in 2020 it does not know how NPDI’s customers will be treated from a rate design perspective. It will be considering options. One option is to create a new “acquired” customer class. Accordingly, the ultimate impact on HON’s customers of the transaction is still unknown. Although intuitively when a high cost LDC acquires a lower cost LDC this should benefit the customers of the acquiring LDC, the evidence

does not definitively make the case that this will happen. The “no harm” test with respect to HON’s legacy customers has not been met.

5. This transaction is being considered at a time when the Board is reviewing policies related to MADDs transactions. There is a risk that approval of this transaction will ultimately be inconsistent with the policies that arise out of that policy review.
6. The Board has indicated it intent to review rate design and move to a 100% fixed charge. It is unclear how that initiative will impact the rates paid by NPDI’s customers; and
7. The Board’s Report, “Rate-Making Associated with Distributor Consolidation” (EB-2007-0028), requires that LDCs, at the time of their MADDs applications, need to provide a statement as to whether they intend to undertake rate harmonization or not. HON has simply indicated, at this time, that it is considering options regarding harmonization (Exhibit A/T2/S1/p. 7). In effect, HON is not complying with Board policy in this regard.

Overall, the Council recognizes that the test in this case is very narrow. The Board has determined that it will adhere to the “no harm” test when considering these types of applications.

Although this proceeding is not dealing with the broader issues regarding distributor consolidation, and whether HON’s policies are creating efficient or inefficient consolidation, the Council urges the Board to consider these issues in the context of its current MADDs review (EB-2014-0138). The Council urges the Board to consider broadening the scope of its review to include issues regarding how to facilitate cost-effective distributor consolidation in the best interests of Ontario ratepayers.

In addition, from the Council’s perspective, the Government of Ontario needs to articulate how it intends to facilitate efficient and effective consolidation of Ontario LDCs. Its policies, and the policies related specifically to HON, have not been articulated to date. Electricity ratepayers in Ontario need to be assured that their interests are being protected. In the absence of a clear articulation of the Ontario Government’s policy regarding consolidation it makes the Board’s role in assessing MADDs applications difficult.

## **CONCLUSIONS:**

The Council submits that Board approval of the applied-for transaction is premature at this time on the following basis:

1. With respect to NPDI’s customers the Applicants have not satisfied the “no harm” test. It is likely that NPDI’s customers will be subject to significant



rate increases when their rates are eventually harmonized with HON's rates. It is important for the Board to look beyond the proposed 5-year transition period when looking at the impact of the transaction on NPDI's customers and applying the "no harm" test. In any event, HON has not indicated what rates NPDI's customers will be subjected to once the rate freeze ends;

2. With respect to HON's legacy customers it is unclear as whether the "no harm" test has been satisfied. The evidence is not definitive as to whether or not HON's legacy customers will be better off, or not harmed as a result of the transaction;
3. The Board has initiated a review dealing with MADDs transactions. It may be appropriate to defer consideration of this transaction until that review is complete;
4. The Board has also initiated a review with respect to revenue decoupling and rate design. It may be appropriate to defer consideration of this transaction until this review is complete:
5. The transaction is not compliant with the Board's policies regarding distributor consolidation (EB-2007-0028) regarding rate harmonization. The Report requires that distributors, at the time of their application, provide a statement as to whether they intend to undertake rate harmonization or not. HON has indicated that is considering a range of options. HON has not articulated what its intent is regarding rate harmonization; and
6. EBN has presented evidence that challenges the evidence of HON regarding savings expected from the transaction. EBN's evidence has not been subject to cross-examination in this proceeding, nor has HON's evidence. If the Board intends to draw conclusions regarding that evidence it is the Council's position that it should do so in an oral proceeding.

#### **COSTS:**

The Council requests that it be allowed to recover 100% of its prudently costs incurred during the course of this proceeding. The Council has acted responsively and efficiently during the course of this proceeding.

All of which is respectfully submitted,

CONSUMERS COUNCIL OF CANADA