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BY E-MAIL

November 10, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Walli:

**RE: BOARD STAFF SUBMISSION
APPLICATIONS BY HYDRO ONE INC. AND HALDIMAND
COUNTY HYDRO INC.
EB-2014-0244**

In accordance with Procedural Order No. 2, please find attached Board Staff's submission with respect to the above referenced applications.

Yours truly,

Original Signed by

Judith Fernandes
Project Advisor
Applications Division

Attachment

cc: All Parties to the Proceeding



ONTARIO ENERGY BOARD

Board Staff Submission

APPLICATION BY HYDRO ONE INC. FOR LEAVE TO PURCHASE ALL OF THE ISSUED AND OUTSTANDING SHARES OF HALDIMAND COUNTY UTILITIES INC.

APPLICATION BY HALDIMAND COUNTY HYDRO INC. SEEKING TO INCLUDE A RATE RIDER IN ITS 2014 ONTARIO ENERGY BOARD APPROVED RATE SCHEDULE TO GIVE EFFECT TO A 1% REDUCTION RELATIVE TO 2014 BASE ELECTRICITY DELIVERY RATES (EXCLUSIVE OF RATE RIDERS)

APPLICATION BY HALDIMAND COUNTY HYDRO INC. FOR LEAVE TO TRANSFER ITS DISTRIBUTION SYSTEM TO HYDRO ONE NETWORKS INC.

APPLICATION BY HALDIMAND COUNTY HYDRO INC. FOR LEAVE TO TRANSFER ITS DISTRIBUTION LICENCE AND RATE ORDER TO HYDRO ONE NETWORKS INC.

EB-2014-0244

November 10, 2014

INTRODUCTION

Hydro One Inc. and Haldimand County Hydro Inc. (“Haldimand”) filed related applications on July 31, 2014 with the Ontario Energy Board consisting of the following:

1. An application by Hydro One Inc. under section 86(2)(b) of the Ontario Energy Board Act, 1998 (the “Act”) requesting leave to purchase all of the issued and outstanding shares of Haldimand County Utilities Inc.;
2. An application by Haldimand under section 78 of the Act seeking the inclusion of a rate rider in its 2014 Board approved rate schedule to give effect to a 1% reduction relative to 2014 base electricity delivery rates (exclusive of rate riders);
3. An application by Haldimand under section 86(1)(a) of the Act for leave to transfer its distribution system to Hydro One Networks Inc. (“Hydro One”);
4. An application by Haldimand under section 18 of the Act for leave to transfer Haldimand’s distribution licence and rate order to Hydro One.

The Board issued its Notice of Application and Hearing on September 3, 2014. On September 26, 2014, Procedural Order No. 1 was issued approving the intervention requests received from School Energy Coalition (“SEC”) and Linda Rogers. Procedural Order No. 1 set out the deadlines for the filing of interrogatories by Board Staff and intervenors and for the applicants’ interrogatory responses. Interrogatories were filed by Board Staff and intervenors on October 7, 2014 and were answered by Hydro One on October 20, 2014.

On October 30, 2014, the Board issued Procedural Order No. 2 providing an opportunity for parties to file written submissions on the applications.

RELEVANT REGULATORY PRINCIPLES

The “No Harm” Test

The Board’s decision in RP-2005-0018/EB-2005-0234/EB-2005-0254 and EB-2005-0257 (the “Combined Decision”) established the scope of issues that the Board will consider in determining applications for leave to acquire shares or amalgamate (“Merger, Amalgamation, Acquisitions and Divestitures” or “MAAD”) under section 86 of the Act and ruled that the “no harm” test is the relevant test. The “no harm” test is a consideration of whether the proposed transaction would have an adverse effect relative to the status quo in relation to the Board’s statutory objectives. These objectives are set out in section 1 of the Act. According to the no-harm test, if the proposed transaction would have a positive or neutral effect on the attainment of the statutory objectives, then the application should be granted.

Board Report on Rate-Making Associated With Distributor Consolidation

The Board’s policy on key rate-making issues that may be associated with consolidation in the electricity distribution sector is set out in a report of the Board entitled “Rate-making Associated with Distributor Consolidation” issued July 23, 2007 (the “2007 Report”).

The 2007 Report, states that “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 2007 Report also indicates that a “distributor will be required to specify its proposal for rate rebasing as part of the MAAD application”. With respect to rate harmonization, the 2007 Report indicates that “the issue of rate harmonization in the context of a consolidation transaction is better examined at the time of rebasing”. Nevertheless, the 2007 Report states that parties should indicate in the MAAD application “whether they intend to undertake a rate harmonization process after the proposed transaction is completed and, if they do, to provide a description of the plan”.

SUBMISSION

The Board’s statutory objectives include, among others, protection of the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity

service, promotion of economic efficiency and cost effectiveness in, *inter alia*, the distribution of electricity, and maintenance of a financially viable electricity industry.

Board Staff submits that the evidence in this proceeding reasonably demonstrates that the proposed transaction meets the “no harm” test and the rate rebasing proposal is consistent with the 2007 Report.

Purchase Price and Financial Viability

According to the application, the purchase price is \$75 million and the net book value of Haldimand’s assets is approximately \$51 million.

With respect to price, the Combined Decision states:

The Board is of the view that the selling price of a utility is relevant only 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. This position is in keeping with the “no harm” test.

In its decision on a Motion by the School Energy Coalition in the Hydro One/Norfolk Power Distribution Inc. proceeding (EB-2013-0196/EB-2013-0187/EB-2013-0198), the Board further confirmed:

In applying the “no harm” test, it is not relevant for the Board to consider whether the purchase price of NPDI has been set at an appropriate level. The issue for the Board to consider is whether the purchase price is set at a level that would create a financial burden on the acquiring utility and whether any premium in the purchase price finds its way into rates.

Hydro One has stated that the premium paid will not be recovered through rates and will not impact any future revenue requirement. Hydro One has also stated that the proposed transaction will not have a material impact on Hydro One’s financial position as the price represents approximately 1% of Hydro One’s’ net fixed assets.

In Board Staff’s view the evidence presented by Hydro One suggests that the premium will not be funded by rate payers and that the premium paid will have no material

impact on Hydro One's financial viability.

Economic Efficiency and Cost Effectiveness

Operational Efficiencies

Hydro One identified quantitative efficiencies arising in the following areas:

- a) Geographic contiguity benefits – Hydro Ones' existing service area is situated immediately adjacent to Haldimand's service area and the service area of Hydro One Norfolk. Hydro One asserted that the elimination of the artificial electrical service area boundary allows for economies of scale to be realized at the field or operational level through:
 - i. Rationalization of local space needs through the elimination or repurposing of duplicate facilities like service centres;
 - ii. More efficient scheduling of operational and maintenance work and dispatching of crews over a larger service area;
 - iii. More efficient utilization of work equipment (e.g. trucks and other tools), leading to lower capital replacement needs over time.
 - iv. More rational and efficient planning and development of the distribution system and reduced capital expenditures required to eliminate the existing load transfers between distributors (currently 128 between Haldimand and Hydro One and 17 between Haldimand and Hydro One Norfolk).

According to the application, all of the above provide the potential to result in operating and capital savings, both immediate and over time which will provide long-term benefits to ratepayers relative to the status quo.

- b) Elimination of redundant administrative and processing functions – Hydro One submitted that efficiency gains are expected to be realized through eliminating duplication in the following administrative and transaction processing functions:
 - i. Reduction in back-office staff (\$1.4-\$1.6 million forecasted annual savings);
 - ii. Reduction in senior management and corporate governance costs(\$0.9-\$1.0 million forecasted annual savings);
 - iii. Consolidation of 36 of the 52 positions currently required to operate Haldimand into positions in Hydro One Networks that would otherwise need to be filled due to retirements and attrition(\$1.9 million forecasted annual savings);
 - iv. Reduction in the number of regulatory filings, Conservation and Demand

Management program administration costs, vehicle fleet and information technology costs and the use of external consultants and contractors.

- c) Economies of scale savings from a larger customer base such that costs for processing systems like billing, customer care, human resources and financial are spread over a larger group of customers.

Cost Effectiveness

Hydro One projected that the resultant cost structures from proceeding with the transaction will result in ongoing operations, maintenance and administrative (“OM&A”) savings of over \$4.0 million per year and reductions in capital expenditures of over \$1.5 million per year. In response to SEC interrogatory No. 9, Hydro One indicated that ongoing OM&A savings will result in downward pressure on the Haldimand ratepayer’s cost structure, which would tend to decrease future rates. These savings will be reflected in lower than status quo OM&A costs, which will be allocated to the customer classes in which the Haldimand ratepayers are placed.

Hydro One provided a ten year comparative cost structure analysis for the proposed transaction relative to the status quo, emphasizing that the overall expected savings are based on comparing Haldimand, remaining as a stand-alone distribution utility, to having the Haldimand operations becoming integrated with Hydro One’s existing operations.

According to the application, Haldimand has 13 customers per kilometer in its overall service territory, with a 2014 forecast monthly OM&A cost of \$385 per customer. This is comparable to Hydro One’s average 2015 forecast monthly OM&A cost of \$275 per customer, applicable to Hydro One’s R1 rate class customers with a customer density of at least 15 customers per kilometer. Hydro One submitted that as such, it is reasonable to believe that Hydro One’s cost to serve Haldimand’s customers would be less than Haldimand’s current costs of serving its customers.

Board Staff submits that the evidence provided by Hydro One supports the claim that the proposed transaction can reasonably be expected to result in cost savings and operational efficiencies. As well, Board Staff notes that Hydro One’s forecasted OM&A cost of serving medium density residential customers is lower than Haldimand’s forecasted cost. Board Staff submits, however, that should the Board approve the transaction, the Board should require Hydro One to file a report with the first rate application that includes costs associated with Haldimand’s service area, delineating the savings achieved as a result of the proposed transaction and how those savings

will be allocated. It is Board Staff's view that this information would assist the Board in its review of the rate application.

Price of Electricity Service

Hydro One confirmed that future rates will reflect the cost to serve the Haldimand customers as impacted by the productivity gains resulting from consolidation, discussed in the previous section of this submission. Hydro One also asserted that the proposed transaction protects Haldimand customers through a commitment to freeze base electricity distribution delivery rates for a period of five years from closing of this transaction, and provides a 1% reduction on base distribution delivery rates for that period. Hydro One submitted that these measures provide Haldimand customers with protection against rate increases that could have occurred over that same time period if the transaction had not proceeded.

In Board Staff's view, Hydro One's statement regarding future rates for Haldimand customers sufficiently addresses the Board's considerations with respect to price of electricity service for the proposed transaction given the "no harm" test discussed earlier. Future rates of Haldimand customers will be fully considered in subsequent rate applications and will require the approval of the Board before they are implemented.

Service Quality and Reliability

Hydro One submitted that it will endeavor to maintain or improve reliability and quality of electricity service for all of its customers. Hydro One's evidence indicated that it is committed to the retention of Haldimand's existing operations personnel thereby retaining local knowledge and skills to ensure that it meets its service quality obligations. Hydro One plans to maintain the existing Haldimand operating centre located in Caledonia and has committed to adding a satellite operating centre in Dunnville. In response to Board Staff Interrogatory No. 4, Hydro One stated that the existing operating centre is located in northwest Haldimand county and the new operating centre will allow for better response to customers' needs in the southern portion of the county as Haldimand's service territory encompasses a large geographic area. Hydro One submitted that distribution system planning will be done on a consolidated basis across Norfolk and Haldimand counties which should result in the maintenance or improved level of service.

Intervenors asked questions regarding the reliability performance of Hydro One, which

according to the Board's 2013 Electricity Distributor Scorecard, is significantly lower than that of Haldimand. Hydro One pointed out that these statistics reflect reliability across Hydro One's entire service area, which is not representative of the reliability level that can be expected in the Haldimand service area. Hydro One provided a comparison of reliability statistics from 2011-2013 reflecting that Hydro One customers in the vicinity of Haldimand county experienced a comparable level of service in terms of duration and frequency of interruptions in comparison to Haldimand customers. Hydro One submitted that it anticipates that reliability will improve through the combination of the satellite operating centre and local staff resources being optimized in Haldimand county.

Based on the evidence provided by Hydro One, Board Staff submits that Hydro One can reasonably be expected to maintain the service quality and reliability standards currently provided by Haldimand.

Rate Rebasing and Rate Harmonization

Hydro One has proposed to defer rate rebasing for distribution rates in the Haldimand service area for five years from the date of closing the proposed transaction. Hydro One submits that this will give it time to retain savings to offset costs while protecting the interests of consumers across both service areas.

In response to SEC Interrogatory No. 18 relating to rate harmonization, Hydro One stated that it has not performed any analysis or made any decisions regarding integration of Haldimand customers into either (i) a currently established Hydro One distribution rate class; or (ii) a newly-created rate class for those aforementioned customers. Hydro One submits that whichever approach is adopted for setting the rates of acquired utilities, any future proposed rate applications will be subject to Board approval and will reflect the actual cost to serve these customers, including the anticipated productivity gains resulting from consolidation.

Consistent with the 2007 Report, Board Staff submits that the issue of rate harmonization is better examined at the time of rebasing as this is when the consolidated entity would apply for its combined revenue requirement and the particular details of any proposed rate harmonization plan or any other rate proposal from Hydro One can then be fully explored. While Hydro One has asserted that future rates will reflect the cost to serve the Haldimand customers as impacted by the productivity gains resulting from consolidation, Board Staff notes that it is not certain whether those savings will be allocated to existing rate classes,

or to a Haldimand-specific rate class. As submitted above, Board staff recommends that should the Board approve the transaction, the Board should require Hydro One to file a report with the first rate application that includes costs associated with Haldimand's service area, delineating the savings achieved as a result of the proposed transaction and how those savings will be allocated.

Other Requested Approvals

As part of this MAAD application, Haldimand has requested Board approval to:

- Extend the rate rider Funding Adder for Renewable Energy Generation to be in effect until the effective date of the next cost of service application;
- Continue to track costs to the regulatory asset accounts currently approved by the Board for Haldimand and to seek disposition of their balances at a future date;
- Utilize USGAAP for Haldimand financial reporting.

Should the Board decide to grant the four applications that would allow the acquisition of Haldimand by Hydro One Inc., Board Staff submits that these requested approvals also be granted. Similar requests were filed in the Hydro One/Norfolk Power Distribution Inc. proceeding and were granted by the Board.

CONCLUSION

Board Staff concludes that the evidence provided by Hydro One reasonably demonstrates that the proposed transaction meets the "no harm" test. Accordingly, Board Staff submits that the applications should be approved.

All of which is respectfully submitted.