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BY EMAIL and RESS

November 12, 2014
Our File No. 20140244

Ontario Energy Board
2300 Yonge Street
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Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2014-0244 – Hydro One/Haldimand County MAADs – SEC Submissions

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #2, these are SEC's submissions with respect to the Application.

Procedure

SEC continues to be concerned that Hydro One applications to acquire other LDCs are being considered by the Board without any opportunity to test Hydro One's evidence through cross-examination in an oral hearing.

This is of particular concern since many (perhaps a third) of the responses to interrogatories are either outright refusals, or non-responsive/incomplete. Any fair reading of the interrogatory responses must lead to a conclusion that Hydro One is seeking to avoid dealing with the key issues that arise in this Application.

In our submission, the Board should make a determination that the record in this proceeding is incomplete, and that an oral hearing is required to test the evidence of the Applicants, and thus complete the record.

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Our submissions on the substantive issues, below, are therefore intended to be in the alternative to this submission on procedure.

The "No Harm" Test - Structure

SEC's understanding of the "no harm" test, as elucidated by the Board in policy consultations and in EB-2013-0187/96/98, appears to be different from that of the Applicants. SEC requests that the Board make clear in its decision the components of the test, and how it should apply in fact. The following discussion seeks to set out the potential areas of interpretive disagreement between the Applicants and the ratepayers including SEC.

In our submission, the starting point is the nature of the "harm" that is being addressed. It appears to us that there is no disagreement on the overall components. Ratepayers can be harmed by a transaction in two general ways:

- Increase in the cost to serve, or
- Degradation in the quality of service.

Each of these two main areas has a number of issues that arise, both generally and on the specifics of this Application.

The "No Harm" Test – Cost to Serve and Rates

In the EB-2013-0187/96/98 Decision on the Norfolk acquisition, the Board described the cost to serve component of the no harm test as follows [at page 12]:

> *"The Board determined that to assess the ultimate impact on NPDI customers, it would need to examine the cost structures that would result from the transfer of NPDI's distribution system to HONI.* ***The Board considers that the relationship between costs and rates is of prime importance in understanding the impact of the proposed acquisition. Clearly increased or decreased costs would be expected to have a corresponding effect on future rates****."[emphasis added]*

The Board then goes on to talk about the impact on future costs and rates, saying [at page 14]:

> *"…the Board considers that an assessment of projected cost structures is required because of the impact of these cost structures on future rates for NPDI customers. This analysis will be done below. Concerning the setting of future rates, it is the Board's expectation that* ***at the time of rate rebasing HONI will propose rate classes for NPDI customers that reflect costs to serve the NPDI service area, as impacted by the productivity gains due to the consolidation****."[emphasis added]*

SEC interprets the Board's statements to mean that the no harm test is satisfied for costs and rates through what is essentially a two-stage test:

1. Will the overall costs to serve the directly-impacted customers (in this case, HCHI customers) stay the same or go down as a result of the transactions?

2. If yes, then will those directly-impacted customers get the benefit of those lower costs when rates are re-set, or harmonized, in the future?

Thus, SEC understands the Board to be saying that the HCHI customers will not have a rate increase that is directly caused by the transactions set forth in the Application.

The position of the Applicants on this is unclear, as – despite clear Board policy – the Applicants have refused to describe how rates will be set after the five year rate freeze.

SEC is concerned that the Applicants may be taking a more utilitarian view of costs and rates. We believe their actual position, and the basis on which they will propose rates in the future, is founded on the notion that as long as overall costs will go down across the entire Hydro One system as a result of the transactions, some ratepayers will benefit from those lower costs. This "greatest good for the greatest number" approach would say it is perfectly acceptable for HCHI customers to have higher, even much higher, rates in the future, as long as the net benefit to Hydro One legacy customers equals or exceeds the net increase to HCHI customers. On this theory, the "no harm" component is a total calculation for everyone, and some groups can be harmed in the interests of benefitting other groups.

Another way of putting the Hydro One position, consistent with their carefully worded Application and interrogatory responses, is that it is not a two-stage, but a three-stage, process:

1. The overall costs to serve all Hydro One and HCHI customers will go down.

2. The costs allocated to HCHI must be increased to Hydro One levels, which are much higher than HCHI levels (a 53.6% increase, based on the 2013 Scorecard results as set forth in Ex. I-2-2). This is based on the "postage stamp rates" principle that Hydro One has followed in the past.

3. Then, the cost savings associated with the acquisition (and any other acquisitions in the current period) will be applied (likely no more than 1-2%, given the overall size of Hydro One).

This scenario, which is exactly what Hydro One did when it harmonized the rates for the LDCs it acquired in the 1999-2002 period, has a net benefit for all customers based on the $2-3 million annual cost savings from the acquisition. However, the HCHI customers get a big increase, and the legacy Hydro One customers get a small decrease.

As we note below, there is also evidence that Hydro One may be willing to adopt an interpretation more consistent with that of SEC, but in the absence of an oral hearing we are not in a position to ask those questions of Hydro One witnesses directly. This leaves an ambiguity, which we discuss below.

SEC submits that the Board can assist all stakeholders by clarifying its expectations with respect to future rates in consolidation situations. In particular, the Board can identify whether the cost and rate component of the no harm test applies specifically to the directly-impacted customers, as SEC has proposed, or whether it imports the notion of the greatest good for the greatest number, thus making it acceptable to visit significant negative impacts on the customers of the acquired utility.

Contrary Evidence on Costs and Rates

The above describes SEC's understanding of Hydro One's position on future rates, consistent with its past harmonizations and its statements in this Application.

There are two pieces of evidence in this proceeding that are inconsistent with that understanding.

First is the attachment to Ex. 1-2-1, which is Interrogatory #1 from intervenor Linda Rogers. (This attachment appears to be inadvertently omitted from in the interrogatory responses, but it is on the Webdrawer, and is in any case Exhibit K1.2 from EB-2013-0187/96/98.) This is a presentation by Hydro One to Haldimand County Council on December 10, 2013.

On page 5 of the presentation, Hydro One talks specifically about what will happen to rates for HCHI customers after the five year freeze. The slide says:

> *"Post year 5, Hydro One will make a rate application for Haldimand customers:*
> - *Consistent with Regulatory Ratemaking principles*
> - *Promote consolidations going forward by mitigating rate impacts*
> - *Based on cost to serve, current rates would over-recover*
> - *Hydro One seeking rates reflective of cost."*

The slide goes on to talk about how that might be accomplished:

> *"New "acquired" urban rate*
> - *Generally, larger urban-based utilities left in the province*
> - *Acquired LDCs have a single rate for all their service terrorities*
> - *Continuity of rates is key"*

It would appear to SEC that this presentation may have promised, to the Haldimand County decision-makers, rates after five years based on a new set of rate classes, including only the current batch of acquired LDCs, and aggregating all of their costs so that their rates would be much lower than existing Hydro One rates for similar classes.

This is consistent with the chart on the same page, which shows:

> *"HCHI + 5% = $189.56*
> *HCHI @ CPI = $163.98*
> *H1 Proposal = $147.88"*

The last of these three figures appears to be the forecast of the average monthly residential bill in year 6 that Hydro One is proposing, and it is in fact lower than current monthly bills.

This, if correct, would be consistent with SEC's interpretation of the Board's expectations on future rates for customers of acquired LDCs.

The second piece of evidence is in response to SEC Interrogatory #16 (Ex. I-3-16), where, at page 3, Hydro One sets out its forecasts of the costs to serve HCHI customers for years 1-5, and years 6-10. The latter, which would apply to the period after the proposed rate freeze, shows a decrease of more than 40% in OM&A costs (including all imputed costs), and a decrease in annual capital spend of more than 25% each year. SEC estimates that these reductions in the costs allocable to HCHI customers would reduce HCHI revenue requirement, and therefore HCHI distribution rates, by about 25% starting in year six.

SEC submits that, on the evidence before the Board in this proceeding, Hydro One is forecasting that the costs allocable to HCHI customers, and the rates to be charged to HCHI customers, in year 6 will be lower than the current costs and rates. This is consistent with the presentation to the municipal councillors who ultimately made the decision to sell on behalf of the Vendor.

SEC requests that the Board stipulate, in any decision approving the Applications, that it expects the rate application for HCHI customers in year 6 to result in a reduction in rates and monthly bills for HCHI customers, consistent with the evidence in this proceeding.

The "No Harm" Test – Quality of Service

There are three elements relating to quality of service in which the evidence appears to demonstrate that Hydro One is not going to be able to achieve the Board's expectations, as described in the Norfolk decision [at page 12] as follows:

> *"The Board also considers it important that its assessment of whether the proposed transaction would have an adverse effect take into account both current and forward looking considerations. For example, continuous improvement is a key regulatory policy consideration.* ***The Board expects that the benefits of continuous improvement to customers should have no less potential of occurring as a result of a transaction. Otherwise there would be harm done to those customers****." [emphasis added]*

The first of the quality of service issues relates to customer service metrics. In Ex. 1-2-8, Intervenor Linda Rogers sets out the 2013 Scorecard results for HCHI and Hydro One, with the Hydro One results obviously much worse. The question asks Hydro One to comment on how it will achieve levels similar to HCHI in the future.

Hydro One does say it expects to achieve the "Appointments Met" level HCHI experienced, 100%. Hydro one is already at 98.4%, a good achievement level in itself.

However, Hydro One does not say it can achieve the "Telephone Calls Answered on Time" metric. After a lengthy description of their wonderful system, which currently is achieving a 63.9% level, Hydro One does not say that they can achieve for HCHI the current HCHI level of 81.1%. The Hydro One internal target is only 80%, and they have been well below that level three of the last five years (and will be for 2014, they say in the response).

We should note that, if Hydro One fails to meet the customer service metrics, it has to pay $100,000 to the Vendor. Although when asked if this is material Hydro One did not answer [Ex. 1-3-26], it is clear that their materiality level is at least an order of magnitude higher than this payment. In any case, it doesn't go to the ratepayers, who suffer the service degradation. It goes to the Vendor.

Therefore, SEC submits that, on the evidence, the Board must conclude that customer service will likely deteriorate for HCHI customers after the transactions, and that in this respect the no harm test will not be met.

The second of the quality of service issues is reliability. Ex. 1-2-9 sets out the large differences in reliability between HCHI and Hydro One. In fact, for neither metric, and in none of the years shown, has Hydro One done better than HCHI, and in many cases the difference is double or worse.

Hydro One's response is to refer to a table in their Application, in which they have cherry-picked data from some of the areas around HCHI, and for only three of the five scorecard years, to "demonstrate" that Hydro One reliability in the local area is around the same as that of HCHI. Those figures are not from any identifiable source, and have not been tested in any way. In our submission, only the Scorecard figures should be used.

As with customer services, reliability is subject to the $100,000 penalty payment. As noted above, that payment is insignificant to Hydro One, and in any case would not go to the affected ratepayers.

Based on the evidence before the Board, SEC believes the Board should conclude that there is a reasonable likelihood the HCHI ratepayers will be harmed by lower reliability as a result of the transactions proposed in the Application.

The third of the quality of service issues, which may also be related to the second area, is distribution system investments. Hydro One proposes that, after the transactions, capital spending on the HCHI system will decline by 25-50% annually, and stay at that lower level for at least ten years [Ex. I-3-16].

Despite this excessive drop in capital investment, Hydro One, when asked to justify the reduction, declined to do so [Ex.1-3-14]. Instead, Hydro One said that they will be able to achieve economies of scale in the capital program.

This, of course, cannot be true. As the Applicants admit in Ex.1-3-13, compensation levels for Hydro One direct labour are almost double those of HCHI, so the starting point for capital work is that it will cost a lot more to achieve the same results. Hydro One has provided no evidence

that it can achieve economies of scale sufficient even to offset this wage differential, let alone drive substantial net reductions in overall capital spending.

In fact, Hydro One has no idea whether it can achieve economies of scale in this capital program. HCHI has a Distribution System Plan, recently (April 16, 2014) approved by the Board in EB-2013-0134. When asked for the new Distribution System Plan underpinning the new capital program [Ex. 1-3-15], the Applicants replied "A new five-year distribution system plan has not been developed."

SEC submits that, on the only evidence currently before the Board, Hydro One plans to implement significant reductions in capital investment in the HCHI system, but has no evidence to show that this will be sufficient, or that there is any credible plan to ensure that it is sufficient.

The situation in this case is even worse than it first appears. At the time that the Board was approving the Distribution System Plan, the Applicants had been negotiating their deal for more than ten months (since at least August 8, 2013 – See Ex.A-3-1-App. 6- Section 1.1(p)). Shortly thereafter, the final agreement was approved by the municipal council. Therefore, at the time that the Board was being asked to approve the Distribution System Plan, the Applicants knew or ought to have known that they had no intention of implementing that DSP.

In our submission, the Board has made a determination as to the appropriate capital investment for the benefit of HCHI customers in the next five years, by approving the DSP. If, as a result of the proposed transactions, the Applicants plan material deviations from that DSP, the onus is on the Applicants to show that the current Board-approved plan is no longer appropriate, and that a new plan will serve the HCHI customers while satisfying the no harm test. That onus has not been satisfied.

SEC therefore submits that, on the evidence before it, the Board can only reasonably conclude that:

- The current Board-approved DSP will not be implemented;
- The unit costs for labour for capital investments will be higher as a result of the proposed transactions;
- The overall amount spent will be lower as a result of the transactions, which combined with the last issue will result in much lower net investment in the system;
- There is no evidence as to any new capital investment plan, and in fact the Applicants admit that they have no such plan; and
- Therefore, it is likely that HCHI customers will be harmed by lack of sufficient, and/or sufficiently planned, investment in the HCHI distribution system.

On the basis of all three of the non-rate components of the non-harm test, SEC submits that the proposed transactions fail to meet that test.

Conclusion

Fundamental to our submissions in this matter is that it is another example of a high cost, poor results utility with lots of money seeking to purchase a smaller utility. SEC does not understand

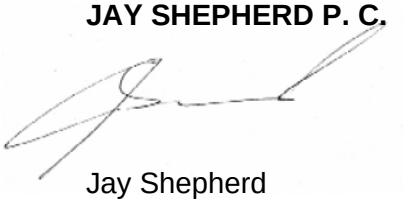
how it can be in the interests of ratepayers for a utility that is the second least efficient in the province to buy any other utility, but certainly not one like HCHI that has outperformed its peers on cost, and has also done well on quality of service.

Consistent with the Renewed Regulatory Framework for Electricity, SEC believes that the likely outcomes for the ratepayers in this case – lower quality of service and higher costs and rates – do not satisfy the no harm test.

SEC has asked for an oral hearing, in order that the record in this matter might be completed so that the Board can get a more comprehensive view of the proposed transactions and their impacts. In the event that the Board does not agree with SEC's request, SEC submits that the Board should deny approval of the proposed transactions, on the basis of multiple failures to meet the no harm test.

All of which is respectfully submitted.

Yours very truly,
JAY SHEPHERD P. C.



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cc: Wayne McNally, SEC (email)
Interested Parties