Ontario Energy Board
Commission de l’énergie de l’Ontario

DECISION AND ORDER

EB-2014-0213

HYDRO ONE INC., HYDRO ONE NETWORKS INC., WOODSTOCK HYDRO SERVICES INC.

Applications for the Acquisition of Woodstock Hydro Services Inc. by Hydro One Inc.

BEFORE: **Ellen Fry**
Member

Cathy Spoel
Member

September 11, 2015

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1 INTRODUCTION AND SUMMARY

This is the Decision of the Ontario Energy Board (OEB) regarding an application seeking various approvals filed by Hydro One Inc., Hydro One Networks Inc. (Hydro One) and Woodstock Hydro Services Inc. (Woodstock).

Hydro One Inc. requests OEB approval to purchase all of the shares of Woodstock Hydro Holdings Inc., which owns Woodstock. As part of this purchase, the OEB is also asked to approve: (a) a one percent reduction in Woodstock's 2014 electricity distribution rates, to be frozen for five years until 2020; (b) the transfer of Woodstock's distribution system to Hydro One; (c) the transfer of Woodstock's electricity distribution licence and rate order to Hydro One; and (d) deferral of rate rebasing for Woodstock for up to ten years from the date of closing the share purchase transaction.

The following sections of the Ontario Energy Board Act, 1998 (the Act) provide the OEB with authority to decide these applications:

- Section 86, which requires OEB approval for a merger, acquisition of shares, divestiture or amalgamation that results in a change of ownership or control of an electricity transmitter or distributor
- Section 78, which allows the OEB to set rates, including the rate reduction that Woodstock is proposing for electricity distribution service until 2020
- Section 18, by which the OEB may transfer an authority or a licence given by the OEB

The OEB's Combined Decision[1] established the scope of issues that the OEB considers in deciding section 86 applications and ruled that the relevant test is "no harm". Under the no harm test, the OEB considers whether the proposed transaction would have an adverse effect relative to the status quo in relation to the OEB's statutory objectives set out in section 1 of the Act. If the proposed transaction would have a positive or neutral effect on the attainment of the statutory objectives, then the OEB should grant the application.

In reaching its decision in this case, the OEB was assisted by the participation of intervenors and OEB staff.

[1] RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257

The OEB has determined that the proposed share purchase transaction and the proposed transfer of Woodstock's distribution system to Hydro One meet the no harm test.

The OEB approves these transactions as well as the proposed rate reduction and the transfer of Woodstock's electricity distribution licence and rate order to Hydro One.

The OEB is not prepared to grant the request for the deferral of rate rebasing for Woodstock for up to ten years from the date of closing the share purchase transaction. The OEB finds that there is insufficient evidence to support a ten year deferral and instead approves a deferral of rate rebasing for Woodstock for a period of five years from the date of closing of the share purchase transaction.

The OEB has placed certain conditions on its approval of these applications, which are set out in detail in this Decision.

2 THE APPLICATION

Hydro One Inc., Hydro One and Woodstock filed related applications with the OEB on July 11, 2014 for the following:

1. Hydro One Inc. applied for leave to purchase all of the issued and outstanding shares[2] of Woodstock Hydro Holdings Inc. under section 86(2)(b) of the Act.
2. Woodstock applied for inclusion of a rate rider in its 2014 OEB approved rate schedule to give effect to a 1% reduction relative to 2014 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act.
3. Woodstock applied for leave to dispose of its distribution system to Hydro One under section 86(1)(a) of the Act.
4. Woodstock applied for leave to transfer its distribution licence and rate order to Hydro One under section 18 of the Act.

The applications were amended on May 22, 2015 to add an additional request based on a new policy of the OEB released on March 26, 2015.

Hydro One requested approval to defer the rate rebasing of Woodstock for up to ten years from the date of closing of the proposed transaction.

As part of its proposal for deferral of rate rebasing, Hydro One has proposed an earnings sharing mechanism for years 6 to 10 after the date of closing.

The OEB issued its Notice of Applications and Hearing on July 31, 2014, inviting intervention and comment. The OEB approved intervention requests by the School Energy Coalition (SEC), the Corporation of the Township of Zorra and the Concerned Citizens against the Sale of Woodstock Hydro (Concerned Citizens).

The OEB provided for interrogatories and submissions on the application and held two days of oral hearing. At the end of the first day of hearing on January 15, 2015, the OEB adjourned the hearing to consider the relevance of documents provided on a confidential basis by Woodstock to the OEB hearing panel during the hearing. The OEB issued a decision on this issue on May 8, 2015. Hydro One and Woodstock filed a letter amending the application on May 12, 2015 and, at the request of the OEB, filed additional evidence on May 22, 2015. The OEB reconvened the oral hearing on May 27, 2015.

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[2] Hydro One Inc.states that for purposes of tax planning it will use a numbered company to own the purchased shares on an interim basis, but that Hydro One Inc. will then become the owner of the shares.

3 REGULATORY PRINCIPLES

3.1 The No Harm Test

The OEB's decision in RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257 (the Combined Decision) established the scope of issues that the OEB considers in deciding section 86 applications and ruled that the relevant test is "no harm". The Combined Decision has been considered in detail in recent OEB decisions[3].

The no harm test involves consideration of whether the proposed transaction would have an adverse effect in relation to the OEB's statutory objectives. If the proposed transaction would have a positive or neutral effect on the attainment of the statutory objectives, then the application should be granted. The statutory objectives to be considered are those set out in section 1 of the Ontario Energy Board Act:

a) To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service
b) 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
c) To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario, including having regard to the consumer's economic circumstances
d) To facilitate the implementation of a smart grid in Ontario
e) To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities

At the time the Combined Decision was issued, the Act contained only the first two of its current section 1 objectives.

The issues raised by the parties in this proceeding relate to the first three objectives. However, the OEB must be guided by all five objectives in section 1, if they are relevant

[3] Hydro One Inc./Norfolk Power Distribution Inc. EB-2013-0196/EB-2013-0187/EB-2013-0198
Cambridge and North Dumfries/Brant County Power Inc. EB-2014-0217/EB-2014-0223
Hydro One Inc./Haldimand County Hydro Inc. EB-2014-0244

to the application before it. In this case, the OEB finds that there is no reasonable indication that harm could potentially be caused by the proposed transaction in relation to the last two objectives in section 1 and is therefore focusing its consideration of the no harm test in relation to the first three objectives.

While each of these objectives is considered separately, the OEB does not agree with the submission made by SEC that each objective must be individually satisfied in order to pass the no harm test. The OEB considers whether the no harm test is satisfied based on an assessment of the cumulative effect of the transaction on the attainment of the objectives.

3.2 OEB Policy on Rate-making Associated with Consolidation

The OEB set out its policies on rate-making associated with consolidation in its report entitled "Rate-making Associated with Distributor Consolidation" issued July 23, 2007 (the 2007 Report) and a further report which was issued on March 26, 2015 (the 2015 Report).

2007 Report

The 2007 Report permitted distributors that apply to the OEB for approval of a consolidation transaction to defer the rate rebasing of the consolidated entity for up to five years from the date of closing of the transaction to allow a time period in which efficiency gains due to the consolidation could offset transaction costs.

The 2007 Report stated that the issue of rate harmonization of the utilities comprising the consolidated entity is better examined at the time of rebasing of rates of the consolidated entity. While the application to approve the transaction would not address the setting of new rates for the consolidated entity, parties are required to indicate in their 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.

The 2007 Report also stated that it is not appropriate for a distributor to be permitted to recover an acquisition premium or net consolidation losses in whole or in part through rates while retaining the realized benefits of the transaction over the deferral period.

2015 Report

In response to concerns that the existing OEB policy on rate setting for consolidation may be adversely impacting further consolidation in the electricity distribution sector, the OEB issued a revised policy in March of 2015. In the 2015 Report, the OEB extended the potential rate rebasing deferral period, stating that consolidating distributors may apply to defer rebasing for a period of up to 10 years after the closing of the transaction. The OEB set out its expectations for the deferral period as follows:

a) For the extended period (i.e. the period between year 5 and year 10), the OEB requires the consolidating entity to implement an earnings sharing mechanism (ESM) of 50:50 sharing with customers where the return on equity (ROE) for the consolidated distributor is greater than 300 basis points above the allowed ROE for the consolidated distributor.

b) A distributor who is on a Price Cap IR or Annual IR may apply for an Incremental Capital Module (ICM) that includes normal and expected capital investments during a deferred rebasing period.

c) The following incentive rate plans will apply during any deferred rebasing period after a distributor's original incentive regulation (IR) plan is complete:

   I. A distributor on Price Cap IR will continue to have its rates based on the Price Cap adjustment mechanism during the remainder of the deferral period.

   II. A distributor on the Annual IR will continue to have rates based on the Annual IR index, until it selects a different option.

   III. A distributor on Custom IR will move to having rates based on the Price Cap IR adjustment mechanism, during the remainder of the deferral period.

4 APPLICATION OF THE PRINCIPLES TO THE APPLICATION

4.1 The No Harm Test

Price, Cost Effectiveness and Economic Efficiency

Hydro One submitted that the proposed transaction protects Woodstock customers through: (a) a commitment to freeze base electricity distribution delivery rates for a period of five years from closing of this transaction, and (b) a 1% reduction on base distribution delivery rates for that period. In Hydro One's view, these measures provide Woodstock customers with protection against rate increases that could have occurred over that same time period if the transaction had not proceeded.

In its application and response to Board Staff Interrogatory No. 1, Hydro One has provided a description of where it expects to achieve cost savings and operational efficiencies through the proposed transaction and an outline of expected capital expenditure savings.

Hydro One's evidence is that operational efficiencies from the elimination of duplication and economies of scale in various aspects of utility operations result in operating and capital savings, both immediate and over time, which will provide long-term benefits to ratepayers relative to the status quo.

Hydro One identified geographic contiguity benefits resulting from being situated immediately adjacent to Woodstock’s service area. These include rationalization of local space needs through the elimination or re-purposing of duplicate facilities such as service centres, more efficient scheduling of operational and maintenance work and dispatch of crews, and more efficient utilization of work equipment. Hydro One submitted that this leads to lower capital replacement needs over time, and more rational and efficient planning and development of the distribution system.

Hydro One submitted that efficiency gains are also expected from the elimination of redundant administrative and processing functions. These include reductions in back-office and senior management staff, corporate governance costs, the number of regulatory filings, information technology costs, and the use of external consultants and contractors. Hydro One also argued that savings due to economies of scale can be expected due to the larger customer base resulting from consolidation. This would apply to functions such as billing, customer care, human resources and financial systems.

Hydro One provided a year over year comparative cost structure analysis for the proposed transaction, reflecting overall expected operations, maintenance and administrative (OM&A) savings based on comparing Woodstock, remaining as a stand-alone distribution utility, to having the Woodstock operations integrated into Hydro One's existing operations. Hydro One presented three scenarios with respect to efficiency savings: a medium cost scenario representing the base case and high and low cost scenarios illustrating a plus/minus 20% variation on Hydro One's forecast. Using the medium cost scenario, Hydro One projected net annual cost savings from the transaction of approximately $3.0 million in OM&A costs and approximately $1.0 million in capital expenditure costs. Hydro One submitted that ongoing OM&A savings will result in downward pressure on the Woodstock ratepayer's cost structure.

Hydro One confirmed in its testimony[4] that the forecasted OM&A costs do not include overhead costs whereas the Woodstock status quo scenario does. Hydro One's evidence is that costs for Woodstock as a stand-alone utility take into account depreciation and interest costs whereas costs of this nature will form part of the broader Hydro One asset portfolio as Woodstock operations become integrated with Hydro One's existing operations. Hydro One did state, however, that the costs used to underpin future rate designs will include the full allocation of common costs, including corporate overheads.

OEB staff submitted that the evidence provided by Hydro One supported the claim that the proposed transaction can reasonably be expected to result in cost savings and operational efficiencies, but that the forecasted savings can be expected to be lower than projected as the forecast of the Hydro One costs does not include all the OM&A costs that will be allocated to Woodstock.

OEB staff submitted that if the OEB approves the transaction, the OEB should require Hydro One to file a report with the first rate application for the Woodstock existing customers that includes all costs associated with serving the Woodstock service area, delineating the savings achieved as a result of the proposed transaction and how those savings will be allocated. Hydro One submitted that it plans to report to the OEB on the achieved savings resulting from the acquisition both on an annual and on a cumulative basis, in the same format as Table 2 in Hydro One's documentary evidence[5]. Hydro One submitted that all actual incremental OM&A and capital expenditure costs arising as a result of the transaction would be included in this report.

[4] OEB Oral Hearing Transcript, Volume 2, May 27, 2015, pgs 53-56
[5] Table 2 projects the incremental costs required to serve Woodstock's service territory, so as not to double count cost expenditures already required to serve Hydro One's legacy customers.

Hydro One submitted that it is reasonable to believe that its costs to serve Woodstock's customers would be less than Woodstock's costs of serving its customers based on a comparison of its OM&A forecast to serve customers in its high density residential rate class (UR) ($181 per customer per year) to Woodstock's forecast OM&A cost ($277 per customer per year).

SEC submitted that it was not clear from the evidence whether Hydro One intends to ensure lower costs for Woodstock customers after the rate freeze, or whether the cost savings from the acquisition will be spread across Hydro One's entire system, resulting in lower rates for existing Hydro One customers but higher rates for Woodstock customers. SEC urged the OEB to clarify its expectations with respect to future rates in consolidation situations, particularly whether the cost and rate component of the no harm test applies specifically to the directly impacted customers or all customers of the consolidated utility.

Concerned Citizens argued that the savings for Woodstock customers are minimal and that the lower cost structure will be to the benefit of Hydro One's existing customers rather than the current customers of Woodstock.

Hydro One submitted that future rates will reflect the cost to serve the Woodstock customers as impacted by the productivity gains resulting from consolidation.

OEB Findings

The OEB is satisfied that the evidence provided by Hydro One meets the no harm test as it relates to the price of electricity service. The OEB has set out in past decisions that it bases its decision on the cost drivers associated with the proposed transaction. While the OEB takes note of the one percent reduction in rates for a five year period, it is not determinative. The OEB considers the cost drivers from the proposed transaction in order to assess whether there will be harm.

The OEB accepts Hydro One's evidence concerning the cost drivers that are likely to result in savings being achieved. While, as submitted by OEB staff, the projected savings may be lower than shown in Hydro One's forecasts, and while it is not clear which of Hydro One's cost projection scenarios will turn out to be most accurate, the OEB finds that the no harm test is met.

Future rates for the current customers of Woodstock will be determined in a future rates proceeding. Hydro One's evidence is that rates will be determined based on the costs to service Woodstock customers. The OEB wants to ensure that Hydro One is able to provide the Board with full information on the costs and savings associated with providing service to Woodstock customers. Therefore, the OEB will require Hydro One to report on the following at such time as Hydro One applies for future rates for the existing customers of Woodstock:

a) All costs (including overhead corporate costs) associated with serving the Woodstock service area, recorded and reported both on an annual and cumulative basis from the time of the closing of the share purchase transaction
b) Actual savings achieved (being the difference between the total costs in a) and the costs of Woodstock as a stand-alone utility)
c) An indication of how those savings have or will be allocated

Hydro One has argued that requiring this type of reporting reduces efficiencies. However, the OEB's ability to discharge its duty to protect the public interest by understanding the costs of serving Woodstock customers overrides this concern. The OEB finds that this reporting is necessary to properly inform the OEB's future decisions on rates for the Woodstock service area.

Reliability and Quality of Electricity Service

Hydro One's evidence indicates that it is committed to the retention of Woodstock's existing operations personnel and will retain local knowledge and skills to allow it to maintain or improve reliability and service quality. Hydro One plans to construct a new operating centre to consolidate operations between Hydro One's Beachville Operating Centre and Woodstock's Operating Centre on Graham Street in Woodstock. Hydro One submits that this will provide a larger operating presence with reduced distance to travel; and bring additional resources within the City of Woodstock to support Hydro One's ability to deliver reliable service.

Based on the OEB's 2013 Electricity Distributor Scorecard (Scorecard), SEC and Concerned Citizens questioned Hydro One's reliability performance, which the Scorecard indicates is significantly lower than that of Woodstock. Hydro One's evidence was 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 Woodstock service area.

Hydro One provided a comparison of reliability statistics from 2011-2013 for Hydro One customers in the vicinity of Woodstock to Woodstock's reliability statistics. Hydro One argued that this comparison indicated that these Hydro One customers experienced a level of service in terms of duration and frequency of interruptions comparable to Woodstock customers. SEC and Concerned Citizens disagreed and argued that Hydro One has constructed an arbitrary measure based on data from only one feeder, which is insufficient. SEC argued that Hydro One could have provided more compelling evidence by providing its reliability statistics for other communities similar to Woodstock that are served by Hydro One.

SEC and Concerned Citizens expressed concern about the maintenance of reliability and service quality once operations are integrated as no specific data will be available for Woodstock. They also expressed concern with respect to Hydro One's billing practices and customer service operations that were being investigated by the Ontario Ombudsman and how this would affect Woodstock customers.

SEC presented a comparison of the Scorecard customer service statistics of Hydro One and Woodstock, stating that Woodstock came out ahead on every reported statistic. SEC argued that this meant customer service levels will fall for Woodstock customers following the acquisition by Hydro One. Hydro One responded that 2013 represents an anomaly for Hydro One owing to problems it experienced with the implementation of a new billing and customer information system.

OEB staff submitted that, based on the evidence provided, Hydro One can reasonably be expected to maintain the service quality and reliability standards currently provided by Woodstock.

OEB Findings

The OEB finds that there is no reason to believe that reliability will decline as a result of the merging of the operations.

The OEB notes that comparative data and analysis has been provided by Hydro One showing similar reliability however that data has been challenged by intervenors as not being representative. A key difference between the two customer groups is that Woodstock serves a mix of 15,000 residential and industrial customers whereas Hydro One serves approximately 700 customers in the Woodstock area.

However, in making its finding, the OEB considered the benefits of Woodstock operations, including Woodstock service personnel, being consolidated in an operating centre in Woodstock.

Regarding customer service, the OEB accepts Hydro One's evidence that those customer service issues arose from a new billing system and have now largely been resolved. Hydro One is required to maintain service quality and service levels in accordance with various codes, rules and other regulatory requirements. It is the OEB's compliance group that deals with Hydro One and service standards. The OEB expects Hydro One to report to the OEB the information set out in Schedule 6.9 of the Share Purchase Agreement[6]as part of its application for new rates for the existing Woodstock customers

In imposing this requirement, the OEB wishes to ensure that reliability and customer service performance are maintained and subject to continuous improvement. Discrete reporting of the statistics set out in Schedule 6.9 will allow the OEB to track these measures. Given that the Share Purchase Agreement contemplates the collection of this data, compliance with this condition should not prove onerous for Hydro One.

Financial Viability

The purchase price to be paid by Hydro One is $46.2 million. This price includes a premium of approximately $20.2 million above the $26 million net book value of Woodstock’s assets.

Hydro One gave evidence that the premium paid will not be recovered through rates and will not impact any future revenue requirement. Hydro One submitted that the proposed transaction will not have a material impact on Hydro One’s financial position as the total purchase price is approximately 1% of the value of Hydro One’s net fixed assets. OEB staff agreed with Hydro One’s assertions based on the evidence presented; no submissions were made by other parties.

OEB Findings

The OEB has indicated in the Combined Decision that it will not make a finding with respect to the appropriateness of the purchase price paid for the assets that are proposed to be transferred in the consolidation transaction. That is outside the scope of the OEB's review. However, the OEB does consider whether the amount of the purchase price would affect rates or financial viability of the acquiring entity. The OEB accepts Hydro One’s evidence that the premium paid above net book will not have a

[6] Hydro One Inc./Woodstock Hydro Services Inc. Application EB-2014-0213-Exhibit A, Tab 3, Schedule 1, Attachment 6

significant impact on Hydro One's financial viability. The OEB also notes Hydro One's confirmation that the premium paid will not be recovered through rates.

Conservation and Demand Management (CDM)

SEC and Concerned Citizens submitted that Hydro One has not demonstrated that it has a plan to continue the strong CDM performance of Woodstock and raised concern that CDM performance is therefore likely to deteriorate.

Hydro One has committed to continuing to offer CDM. Its evidence is that it will adopt the best of the Woodstock CDM programs in addition to continuing to offer Hydro One programs.

OEB Findings

The submissions of SEC and Concerned Citizens indicate a very active level of interest and engagement of the community in the Woodstock service area with respect to CDM. Hydro One has committed to continuing to offer CDM but its evidence indicates that it has not done any concrete planning with respect to CDM for the Woodstock service area.

As indicated in the 2015-2020 CDM Guidelines (issued on December 19, 2014), it is now the IESO rather than the OEB that has the mandate to review CDM results from individual distributors. However, as indicated above, in determining whether the no harm test has been met, the OEB needs to consider the objective in s 1(3) of the OEB Act:

> To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario.

Accordingly, the OEB will require Hydro One to report one year following the closing of the transaction on which existing Woodstock CDM programs it has eliminated or added to and the reasons why.

4.2 Rate-making Associated with Consolidation

As indicated earlier, the OEB set out its policies on rate-making associated with consolidation in two reports, the 2007 Report and the 2015 Report. On May 22, 2015, Hydro One amended the rate relief sought through the application so as to seek the benefit of the additional elements in the OEB's policy as set out in the 2015 Report.

Deferral of Rate Rebasing

The 2007 Report permitted the deferral of rate-rebasing for up to five years from the closing of a transaction during which time efficiency gains due to consolidation were expected to offset transaction costs. However, the 2015 Report indicated that the OEB would be open to extending the rate rebasing deferral period for up to 10 years after the closing of the transaction This potential extension is intended to encourage consolidation by providing additional time for distributors to recover transaction costs, if appropriate given the circumstances of their individual transactions.

Hydro One has proposed to defer rate rebasing for distribution rates in the Woodstock service area for up to ten years from the closing date of the proposed transaction.

OEB staff argued that consideration of Hydro One's proposal for the deferral of rate rebasing for Woodstock rates is a complex issue. It involves not only this application, but also Hydro One's current cost of service rates term, which ends in 2017, and the OEB's approval of a 5 year deferral for Haldimand and Norfolk. OEB staff submitted that given these circumstances it is more appropriate that the length of the deferral period be examined in Hydro One's next rate application rather than in this proceeding.

Woodstock argued that OEB staff's suggestion creates a significant amount of commercial uncertainty.

SEC submitted that the deferred rebasing period approved should be for a fixed term of ten years from closing of the transaction, unless Hydro One can demonstrate at the time of an earlier application that there has been a material change in circumstances that justifies an earlier rebasing so that the Woodstock ratepayers would have the benefit of rate certainty for 10 years.

Hydro One submitted that the 2015 Report states that there is no requirement for the consolidated entity to wait until the deferred rebasing period is completed to apply to the OEB for rebasing.

OEB Findings

The OEB is not prepared to grant the request by Hydro One to defer rate rebasing for distribution rates in the Woodstock service area for up to ten years from the closing date of the proposed consolidation transaction.

The OEB denies the request for two reasons. First, the evidence to support the request is insufficient. The transaction was negotiated on the basis of a five year deferral period. The original application as filed was on the basis of five years. No evidence was filed to demonstrate that the business case changed and therefore more time was necessary to recover the transaction costs. Testimony at the hearing confirmed that the business case has not changed. Second, the OEB is not satisfied that Hydro One has presented an earning sharing mechanism (ESM) that would protect the interests of ratepayers if the maximum deferral period was allowed as set out in the 2015 Report. The OEB will consider each of these elements in turn.

The purpose of the 2015 Report, in allowing for a potential 10 year deferral period, is to incent parties to enter into consolidation transactions in situations where a five year deferral period would be unlikely to provide sufficient time to recover transaction costs through productivity gains. The 2015 Report acknowledges that "distributors stated that it may take anywhere from six to ten years to reach a break-even point, where the cumulative savings exceed the cumulative acquisition and integration costs"[7] Therefore when an applicant applies to be granted a longer deferral period, the applicant must demonstrate that a longer deferral period is necessary.

The OEB finds that in this application the evidence did not support a conclusion that this was an issue for Hydro One particularly as the application had been filed under the 2007 OEB policy and was amended following the close of the first part of the hearing. Hydro One filed very little evidence in support of the amended application seeking a longer deferral period and no evidence that unless the extended deferral period was granted there would be a barrier to consolidation. Evidence that was supplied was general in nature. The submission was made that additional time would allow transaction costs to be recovered over a longer period of time. The expectation of the OEB is that the applicant will provide the OEB with specific evidence as to why the deferral is necessary in the specific transaction. General statements do not help the OEB assess whether a need for an extended period is warranted.

[7] “Rate-making Associated with Distributor Consolidation" issued March 26, 2015 (the 2015 Report), p. 5

The OEB in seeking more specific evidence as to how circumstances might have changed to warrant a further period of five years to recoup transaction costs, asked Hydro One how the business case for the proposed transaction had changed. Hydro One confirmed at the oral hearing that the business case for the consolidation, which was based on a five year deferral period, has not changed since the request for a five year deferral period was made. With little or no evidence to support the further five year deferral period, the OEB finds that the need for a 10 year deferral period has not been demonstrated.

Woodstock asked the OEB to confirm that the extended deferral period applies to all electricity distributors that have either already undergone a consolidation transaction or who may enter into a sale, merger or amalgamation transaction in the future. The OEB finds that while the relief outlined in the 2015 Report is available, applicants must justify a 10 year deferral period.

Earnings Sharing Mechanism (ESM)

As set out previously, the 2015 Report requires consolidating distributors who request a deferred rebasing period of greater than five years to implement an ESM. Hydro One has committed to implement an ESM of 50:50 sharing with customers where Hydro One's return on equity (ROE) is greater than 300 basis points above the allowed ROE for Hydro One.

SEC argued that under this proposal, as Hydro One has never earned more than 300 basis points over the OEB-approved ROE, and is unlikely ever to do so, the purpose of the OEB's policy - to ensure that ratepayers benefit from the efficiencies generated - would be thwarted in the case of all Hydro One transactions.

SEC argued that while the wording of the 2015 Report does suggest that all customers of the consolidated entity should share in the earnings sharing, in SEC's view, this is not consistent, in this case, with the intention of the policy. SEC submitted that the Board should make clear in its decision that it is the earnings relative to the Woodstock service territory, calculated on a stand-alone basis, that should be subject to earnings sharing.

The OEB further notes that the proposed ESM was not supported by the intervenor group representing ratepayers. When asked by the OEB why the ESM was being applied to all Hydro One customers and not just the Woodstock customers, Hydro One replied that the ESM is spread across all of its customers, because it can only calculate an ROE for the consolidated entity.

OEB staff submitted that following the 18 month period provided for the completion of the consolidation transaction, an ROE can only be calculated for the consolidated entity as Woodstock will cease to exist as a stand-alone entity.

OEB Findings

The OEB considers that the proposed ESM does not meet the intent of the policy outlined in the 2015 Report. The 2015 Report specifically states that the OEB believes that the requirement to include an ESM will address ratepayer concerns that accumulated savings achieved over a potential 10 year period could result in a windfall for shareholders. An ESM which equally divides potential savings between ratepayers and the utility was meant to alleviate this concern.

The OEB is concerned that the ESM as proposed by Hydro One would not ensure that potential savings would be seen by existing customers within the Woodstock service territory. While Hydro One’s interpretation of the OEB's policy may be technically compliant with some of the 2015 Report, the OEB is concerned that in this situation, the proposal put forward by Hydro One would not meet the intent of the 2015 Report. Hydro One testified that it had never achieved returns that would trigger the ESM. An ESM that has virtually no chance of being actualized does not in the OEB's view, constitute a satisfactory ESM. There must be a workable ESM in place that will achieve the purpose of protecting ratepayer interests.

Requests for Incremental Capital Module (ICM)

The OEB previously approved Woodstock’s request for the extension of its ICM rate rider relating to the Commerce Way Transformer Station until rates are rebased in 2020 or until such other date as may be approved by the OEB, and to true-up the balance at the time of rebasing.

SEC raised a concern that the extension of this rate rider until the next rebasing of rates for Woodstock would result in an over-collection, if the OEB approved Hydro One’ s proposal to defer rebasing of Woodstock up to ten years.

In response to SEC's concern, Hydro One submitted that upon closing, it would review the ICM rate rider, assess the balance on the account and determine the required timeframe of the rider. Hydro One would then make a separate application to the OEB to adjust the ICM rate rider, if necessary.

It is clear from the evidence that if a 10 year deferral were granted, and the ICM rate rider was extended to years 6 through 10, there would be a significant over collection. This would be a significant issue for the OEB to consider if a 10 year deferral period were approved at this time.

The OEB is not rejecting the request for an extended deferred rebasing period on the basis of the ICM. However, the OEB notes that ICM extension for years 6-10 as proposed by Hydro One in its amended application did not meet the intent of the 2015 Report. Neither the 2015 Report nor the OEB policy on ICMs supports proposals that lead to significant over-recovery.

Rate Setting and Rate Harmonization

Hydro One has committed to freeze Woodstock's base electricity distribution delivery rates for a period of five years from closing of the MAAD transaction[8], and also to apply a rate rider which results in a 1% reduction on base distribution delivery rates for that period. At the commencement of year 6, Hydro One has proposed that Woodstock's base distribution delivery rates be set according to the OEB's Price Cap Index formula, applied to the Woodstock 2014 base delivery rates (i.e. the rates prior to making the 1% reduction).

OEB staff submitted that the Price Cap Index formula should be applied to the base delivery rates, after deducting the 1%, arguing that to do otherwise would increase rates in 2020 beyond the rate of inflation. SEC agreed with OEB staff.

Concerning Hydro One's rates, SEC argued that according to the 2015 Report Hydro One, once it finishes its current Custom IR plan in 2018, will go on Price Cap IR for years 4-10. Hydro One argued that the intent of the policy is to provide distributors with the flexibility to manage their own unique circumstances and that Hydro One should not be forced to pursue Price Cap IR for years 4 to 10 due to an MAAD application.

Concerning harmonization of the rates of the elements of the consolidated entity, Hydro One stated that it has not decided whether Woodstock customers will be integrated into an existing Hydro One rate class or put into a newly-created rate class for Woodstock customers. Hydro One submitted that whichever approach is adopted rates will reflect the actual cost to serve Woodstock customers, including the anticipated productivity gains resulting from consolidation.

[8] Merger, Acquisition, Amalgamation, Divestiture (MAAD)

OEB Findings

The OEB approves Hydro One's proposal to freeze Woodstock's base electricity distribution delivery rates for a period of five years from closing of this transaction, and the application of a rate rider which results in a 1% reduction on base distribution delivery rates for that period.

The OEB has not approved the deferral period beyond five years and therefore need not consider the treatment of the 1% rate reduction in years 6-10. However, the OEB notes that Hydro One's proposal would have raised a significant issue if the OEB had approved a deferral period of up to ten years. The OEB notes, among other things, that terms of the transaction, including the 1% reduction in rates for five years, were negotiated between the parties with the expectation that rates would be rebased after five years.

The OEB also does not need to consider the issue of what rate plan Hydro One would follow under the 2015 Report, given that it has not approved an extended deferral period. However, the OEB notes that the parties have raised significant issues in this regard.

5 OTHER REQUESTED APPROVALS

As part of these applications, Hydro One requested OEB approval to:

- Continue to track costs to the deferral and variance accounts currently approved by the OEB for Woodstock and to seek disposition of their balances at a future date
- Utilize USGAAP for Woodstock financial reporting.

OEB staff supported the granting of these requested approvals if the OEB approves the consolidation transaction. OEB staff indicated that similar requests were granted in prior proceedings[9].

OEB Findings

The OEB grants approval to continue to track costs to the deferral and variance accounts currently approved by the OEB for Woodstock and to seek disposition of their balances at a future date The OEB accepts Hydro One's argument for the utilization of US GAAP for financial reporting and grants this request.

[9] Hydro One Inc./Norfolk Power Distribution Inc. EB-2013-0196/EB-2013-0187/EB-2013-0198
Hydro One Inc./Haldimand County Hydro Inc. EB-2014-0244

6 CONCLUSION AND DECISION

The OEB concludes that the consolidation proposed in the applications satisfies the no harm test, subject to the conditions set out below. The OEB approves the applications subject to the following conditions:

- That Woodstock transfer its distribution assets to Hydro One within 18 months of the date of this decision

- That Hydro One reports on the following, until Hydro One applies for new rates for existing Woodstock customers:

  a) All costs (including overhead corporate costs) associated with serving the Woodstock service area, recorded and reported both on an annual and cumulative basis from the time of the closing of the share purchase transaction
  b) Actual savings achieved (being the difference between the total costs in a) and the costs of Woodstock as a stand-alone utility)
  c) Indication of how those savings have or will be allocated

- That Hydro One reports to the OEB on the statistics as set out in Schedule 6.9 of the Share Purchase Agreement as part of its next rate application.

- That Hydro One reports to the OEB specific details regarding the CDM programs that it offers in the Woodstock service area post transaction. The reporting shall be in the form of a letter to the OEB filed one year after the close of the transaction setting out the programs that were offered in the previous year and include a list of CDM programs that were discontinued and the reasons for the discontinuance.

Woodstock is granted inclusion of a rate rider in its 2014 OEB approved rate schedule to give effect to a 1% reduction relative to 2014 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act.

The OEB's approval of Woodstock's proposal for a 1% reduction relative to 2014 base electricity delivery rates results in changes to Woodstock's approved Tariff of Rates and Charges (EB-2013-0182). The OEB requires Woodstock to file a draft Rate Order, reflecting the OEB's findings in this proceeding, as outlined below. The draft Rate Order shall include a proposed effective and implementation date.

7 ORDER

THE OEB ORDERS THAT:

1) Hydro One Inc. is granted leave to acquire all of the issued and outstanding shares of Woodstock Hydro Holdings Inc.

2) The applicants shall promptly notify the OEB of the completion of the transaction referred to in paragraph 1 above.

3) Woodstock is granted leave to transfer its distribution system to Hydro One.

4) The applicants shall promptly notify the OEB of the completion of the transaction referred to in paragraph 3 above.

5) Once the notice referred to in paragraph 4 is provided to the OEB, the OEB will transfer Woodstock's electricity distribution licence ED-2003-0011 and Woodstock's Rate Order to Hydro One.

6) The leave granted in paragraphs 1 and 3 above shall expire 18 months from the date of this Decision and Order.

7) Hydro One is granted approval to use US GAAP for regulatory accounting purposes, in relation to Woodstock, following the closing of the transaction referred to in paragraph 1 above.

8) Woodstock is granted inclusion of a rate rider in its 2014 OEB approved rate schedule to give effect to a 1% reduction relative to 2014 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act.

9) Hydro One is granted approval to continue to track costs to the deferral and variance accounts currently approved by the OEB for Woodstock and to seek disposition of their balances at a future date.

10) Hydro One shall report on the following:

    a) All costs (including overhead corporate costs) associated with serving the Woodstock service area, recorded and reported both on an annual and cumulative basis from the time of the closing of the share purchase transaction

b) Actual savings achieved (being the difference between the total costs in a) and the costs of Woodstock as a stand-alone utility)
c) Indication of how those savings have or will be allocated

11) Hydro One shall report to the OEB on the metrics as set out in the Schedule 6.9 of the Share Purchase Agreement as part of its next rate application.

12) Hydro One shall report to the OEB specific details regarding the CDM programs that it offers in the Woodstock service area post transaction. The reporting shall be in the form of a letter one year after the close of the transaction setting out the programs that were offered in the previous year and include a list of CDM programs that were discontinued and the reasons for the discontinuance

13) Woodstock shall file with the OEB, and shall also forward to intervenors, a draft Rate Order that includes a proposed Tariff of Rates and Charges reflecting the OEB's findings in this Decision and Order by **September 21, 2015**.

14) Intervenors and OEB staff shall file any comments on the draft Rate Order with the OEB and forward to the applicants by **September 28, 2015**.

15) The applicants shall file with the OEB and forward to intervenors responses to any comments on the draft Rate Order by **October 5, 2015**.

16) Eligible intervenors shall file with the OEB and forward to the applicants their respective cost claims no later than 7 days from the date of issuance of the final Rate Order.

17) The applicants shall file with the OEB and forward to the intervenors any objections to the claimed costs of the intervenors within 17 days from the date of issuance of the final Rate Order.

18) Intervenors shall file with the OEB and forward to the applicants any responses to any objections for cost claims within 24 days from the date of issuance of the final Rate Order.

19) The applicants shall pay the OEB's costs of, and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

All filings to the OEB must quote file number EB-2014-0213 and be made electronically through the OEB's web portal at www.pes.ontarioenergyboard.ca/eservice/ in searchable/unrestricted PDF format. Two paper copies must also be filed at the OEB's address provided below. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, and be received no later than 4:45 p.m. on the required date.

ADDRESS

Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4
Attention: Board Secretary
E-mail: boardsec@ontarioenergyboard.ca
Tel: 1-888-632-6273 (Toll free)
Fax: 416-440-7656

DATED at Toronto September 11, 2015

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary