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July 8, 2016

VIA RESS AND COURIER

Ms. Kirsten Walli, Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli:

Re: EB-2016-0050 Hydro One Inc ("Hydro One") – Procedural Order No. 3

In accordance with Procedural Order No. 3 dated June 30, 2016, enclosed please find the Argument in Chief of Hydro One Inc.

Yours very truly,

McCarthy Tétrault LLP

Gordon M. Nettleton
GMN/mpf

Enclosures

EB-2016-0050

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

HYDRO ONE INC.

ARGUMENT IN CHIEF

July 8, 2016

Introduction

1. Hydro One Inc. ("HOI") is pleased to provide its argument in chief in accordance with the Ontario Energy Board's ("OEB" or "Board") Directions set out in Procedural Order No. 3 dated June 30, 2016.

2. This Application arises due to a commercial transaction involving, among others, HOI and Great Lakes Power Transmission Inc., the general partner and licensee of Great Lakes Power Transmission Limited Partnership ("GLPTLP"). As described in the Application,[1] HOI has agreed to acquire all voting securities of GLPT and thus requires leave of the Board in accordance with section 86(2)(b) of the *Ontario Energy Board Act*.

3. The transaction represents an important opportunity both for HOI and for Ontario transmission ratepayers. Operational efficiencies are one of the key drivers expected to be achieved through this consolidation transaction. During the normal course of the deferred rebasing period, it is proposed that GLPTLP's revenue requirement remains static, subject to annual inflationary adjustments.[2] HOI is provided the opportunity to recover transaction costs and premiums, and ratepayers share in cost savings and efficiencies commencing in year 6 through to year 10. In the longer term, achieved savings reflected in lower cost structures are ultimately passed onto all ratepayers through the rebasing process. Transactional premiums incurred by HOI are ones which ratepayers are protected from, as these amounts will not be recovered in transmission rates. Moreover, HOI's upfront commitment concerning the proposed methodology that GLPTLP will use to calculate its revenue requirement throughout the deferred rebasing period provides cost discipline and revenue requirement certainty to ratepayers.

4. The GLPTLP revenue requirement methodology proposal is in many respects consistent with approaches taken in other MAAD applications where distribution rates of the acquired entity were frozen or notionally increased during the deferral period.[3] Here, the same type of "static" principle applies albeit to the revenue requirement, rather than the rates, of the acquired entity. The Uniform Transmission Rate ("UTR") accounts for this difference.

[1] Exhibit A, Tab 1, Schedule 1, Pages 1-3.

[2] Unforeseen events beyond the control of GLPTLP resulting in Z-factor and capital factor events may be applied-for during the deferred rebasing period. See Exhibit A, Tab 1, Schedule 1, Page 9.

[3] See for example EB-2014-0213, EB-2013-0187/196/198 and EB-2014-0244.

5. This Application is also important because it is the first to be considered in the light of the Board's new Handbook to Electricity Distributor and Transmitter Consolidations, dated January 19, 2016 ("Handbook"). As noted in the Handbook, the stated objectives are to provide greater certainty and predictability of the principles used by the Board in its consideration of MAAD applications for both distribution and transmission transactions. These principles inform all parties of the information and relevant issues considered when the Board applies the "no harm" test.

The Transaction Satisfies the No Harm Test

6. The no-harm test is used to assess MAAD transactions. The Handbook states that the "no harm" test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB's statutory objectives. The primary focus in applying this test has been on impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the applicable sector.

7. The impacts of this transaction in relation to the Board's "no harm" test were addressed in Section 4 of Exhibit A, Tab 1, Schedule 1 and in the assessment found at Exhibit A Tab 2, Schedule 1, commencing at page 2 of 10. Five key conclusions were reached from this assessment to justify why the "no harm" test is satisfied:

    i. Neither Hydro One Networks Inc. ("Hydro One") nor GLPTLP will seek to increase future revenue requirements recovered from customers in order to recover transaction costs and premiums associated with this transaction;

    ii. The amount of consideration paid by HOI in this transaction will not have a material impact upon its financial position. The purchase price will not be subject to financing and is approximately 2% of the value of HOI's overall fixed assets;

    iii. The adequacy, reliability and quality of service of GLPTLP's transmission service will not be impacted;

    iv. Longer-term synergy savings opportunities are reasonably expected to result in reductions to underlying cost structures. These opportunities would not arise but for the transaction; and

v. While longer-term synergy savings opportunities are reasonably expected, the magnitude of these savings is not likely to result in significant reductions to the UTR, given the relatively small size of the GLPTLP revenue requirement when compared to the overall revenue requirement recovered through the UTR.

8. Importantly, no intervenors found it necessary to file evidence contradicting HOI's views in respect of any of these conclusions.

9. HOI's evidence relating to pricing impacts from the transaction is found at Exhibit A, Tab 2, Schedule 1 pages 8-9. The UTR impact of the transaction *at the end of the 10 year rate rebasing deferral period* (relative to current 2016 UTR rates) is forecast to be an increase of approximately $0.02 to the Network Service Rate and $0.01 to the Transformation Connection Service Rate under the Base Case scenarios (i.e. capital and OM&A). Under the High Case scenarios, the Network Service Rate in 2026 is forecast to increase by approximately $0.01 from current 2016 rates. This minimal increase in rates over a ten year period provides benefits in the form of rate certainty and stability for Ontario ratepayers. Conversely, under the "without transaction" scenario, two further opportunities for GLPTLP to rebase rates would arise during that same 10 year period. Thus, under a "without transaction" scenario, ratepayers would be subject to greater risk of rate increases, as opposed to the anticipated minimal and more certain rate increase over a ten year period that is associated with the "with transaction" scenario.

10. HOI's evidence relating to adequacy, reliability and quality of electricity service was also described in Exhibit A, Tab 2, Schedule 1 pages 9-10. Each of Hydro One and GLPTLP are regulated transmitters and must comply with applicable reliability and quality standards. Each of Hydro One and GLPTLP have managed reliability standards on a comparable basis. The evidence is that the transaction is not expected to adversely affect or change those performance levels. HOI's stated objective is that amalgamation will allow development of uniform best practices that could improve reliability metrics in the future.[4]

11. The opportunity for synergy savings and productivity improvement resulting from this transaction was described in Exhibit A, Tab 2, Schedule 1. Two cost scenarios were

[4] Exhibit A, Tab 2, Schedule 1, Page 10

developed for the deferred rebasing period (i.e. 2017-2026) comparing a “without transaction” to two “with transaction” scenarios. The “with transaction” scenarios were defined by two sensitivity cases (“base” and “high” cost saving scenarios).

12. Under the Base Case “with transaction” scenario, capital cost savings are expected to commence in year 3 and continue throughout the remainder of the deferred rebasing period. When comparing Table 2 to Table 3, found in Exhibit A, Tab 2, Schedule 1, accumulated forecast capital savings are expected to range from $17 million to $30 million during the deferred rebasing period. These expected cost structure reductions will extend beyond 2026 and will be to the ultimate benefit of all ratepayers.

13. Impacts to OM&A costs were also considered using the same “with” and “without” transaction approach and assessment of a Base and High savings scenarios. The Base case scenario was conservatively estimated to achieve a 10 percent cost savings level relative to the GLPTLP “without transaction” in years 3 through 10 of the deferral period. The High Case increased savings to a 30% level. Overall, OM&A savings expected to be realized on an accumulated basis during the deferral period range from $12 million to $32 million. Reductions in OM&A cost structures in the deferral period will also provide ratepayers ongoing benefits when rebasing occurs in 2027.

Clarifications Provided Through the Interrogatory Process

14. Questions posed by Intervenors and Board Staff in the interrogatory process included the timing and duration of the rate rebasing deferral period, HOI’s proposed methodology for determining future GLPTLP revenue requirements, and the future reliability of the transmission system.

15. Intervenors and Staff sought clarification regarding when the deferred rebasing period would take effect and its subsequent duration. HOI’s deferred rate rebasing period is intended to commence from the closing of the transaction and will continue for 10 years.[5] This approach is consistent with the OEB Handbook where the duration of the deferral

[5] Exhibit I, Tab 1, Schedule 5

period is no longer a matter requiring justification.[6] The Handbook expressly allows Applicants the opportunity to select a duration period of up to 10 years.[7]

16. One of the unique circumstances involved in this transaction that bears upon timing of amalgamation is the impracticality of GLPTLP and Hydro One legally amalgamating before 2023. This is due to certain covenants contained in outstanding GLPT debt commitments. Penalty provisions would apply if legal amalgamation took place before maturity in 2023. Deferring legal amalgamation will not inhibit operational integration activities from commencing at the outset of the acquisition. In 2017 and 2018, GLPTLP and Hydro One will begin to identify areas where longer-term operational savings and synergies may be achieved. Realized savings will be achieved in 2019 and beyond i.e., before legal amalgamation occurs.

17. Another common area of interrogatories concerned acceptance or non-objection of HOI's proposed methodology for determining GLPTLP's revenue requirement during the last eight years of the deferred rebasing period. Unique facts and circumstances have given rise to this request.

18. Hydro One Transmission filed its 2017 and 2018 revenue requirement application on May 31, 2016 and the application review process is underway. GLPTLP is expected to file its own cost of service application for 2017 and 2018 rates in 2016. The transacting parties have attempted to find a balance with the commercial realities of closing this transaction; the regulatory requirements of providing ratepayers with certainty over how rates will be established during the deferral period; providing certainty to HOI that efficiencies and savings achieved in the deferral period may be used to offset transaction costs and premium; and also committing to a revenue requirement that is consistent with the principles set out in the Handbook.

19. HOI submits this balance is achieved by having GLPTLP's 2019-2026 revenue requirement calculated by using the OEB-approved 2018 revenue requirement and adjusting this amount for annual inflation.[8] HOI appreciates the fact that the GLPTLP 2018 revenue requirement has not yet been approved. This should not be viewed as a

[6] OEB Handbook, Page 12

[7] *Ibid.*

[8] Exhibit I, Tab 1, Schedule 5.

restriction to approving the relief sought in this application. HOI is prepared to use the outcome of the Board's decision on GLPTLP's 2018 revenue requirement to adjust GLPTLP's 2019-2026 revenue requirements.

20. Another area of common questions raised during the interrogatory process concerned HOI's rationale for not including a productivity factor in the GLPTLP 2019-2026 revenue requirement adjustment mechanism. HOI submits that this approach is reasonable. The proposed method of establishing GLPTLP's revenue requirement in years 3-10 of the deferred rebasing period adopts incentive based mechanisms intended to balance the interests of the consolidating entities and those of ratepayers. If a productivity adjustment was included in the revenue requirement adjustment mechanism, ratepayers would be entitled to cost savings that should first be afforded to the consolidating entity to offset transaction costs and premiums. Such an approach would fundamentally shift the risks and rewards associated with a consolidation transaction and would be inconsistent with the principles set out in the Handbook. Consolidating parties would have less incentive to participate in such transactions. To the consolidating transmitter, additional financial risk would be borne by shareholders without any incremental reward; to the ratepayer windfalls would be provided without undertaking any incremental risk. This outcome is resolved by the approach proposed. Consolidation risk and rewards are kept in balance such that win-win opportunities are provided to shareholder and ratepayers alike.

21. GLPTLP's future quality and reliability of transmission service was another area of clarification in the interrogatory process. HOI's evidence is that Hydro One's regional reliability indices are equal to if not better than GLPTLP's. Consolidation therefore is not expected to cause any adverse impacts.[9] Hydro One is committed to continuous productivity improvement and to maintaining a safe and reliable transmission system across the province.

[9] Exhibit A, Tab 2, Schedule 1 Page 9-10

Conclusions

22. HOI submits that the evidentiary record in this proceeding satisfies the requirements to grant relief sought:

- The transaction has been reasonably demonstrated to not cause harm to the Board's fulfillment of its statutory obligations. Leave to purchase all outstanding voting securities of GLPT should therefore be granted.

- The proposed rate rebasing period accords with the duration requirements described in the Handbook and therefore should be accepted.

- The proposed ESM is reasonable and should be accepted as it comports with the principles set out in the Handbook.

- The proposed methodology to calculate GLPTLP's 2019-2026 revenue requirement during the deferral rebasing period should be accepted as it accords with the principles set out in the Handbook and provides a practical way of balancing the unique circumstances and interests involved in this transaction.

ALL OF WHICH IS RESPECTFULLY SUBMITTED BY HYDRO ONE INC. ON THIS 8th DAY OF JULY, 2016.

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Gordon M. Nettleton
Counsel to Hydro One Inc.