October 7, 2016

BY FAX & BY COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge St, Suite 2701
Toronto ON M4P 1E4

Ms. Walli:

Board File No. EB-2016-0025 --- LDC Co
Application for approval to amalgamate to form LDC Co.
and for LDC Co. to purchase and amalgamate with Hydro One Brampton Networks Inc.
Energy Probe – Argument

Pursuant to Procedural Order No. 5, issued by the Board on September 21, 2016, please find attached the Argument of Energy Probe Research Foundation (Energy Probe) in the EB-2016-0025 proceeding for the Board's consideration.

Should you require additional information, please do not hesitate to contact me.

Yours truly,

David S. MacIntosh
Case Manager

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EB-2016-0025

Enersource Hydro Mississauga Inc., Horizon Utilities Corporation, and PowerStream Inc.

Application for approval to amalgamate to form LDC Co. and for LDC C. to purchase and amalgamate with Hydro One Brampton networks Inc.

**ENERGY PROBE RESEARCH FOUNDATION
("ENERGY PROBE")**

ARGUMENT

October 7, 2016

ENERSOURCE HYDRO MISSISSAUGA INC., HORIZON UTILITIES CORPORATION, AND POWERSTREAM INC.

EB-2016-0025

ARGUMENT OF ENERGY PROBE RESEARCH FOUNDATION

A- INTRODUCTION

Enersource Hydro Mississauga Inc. ("Enersource"), Horizon Utilities Corporations ("Horizon") and PowerStream Inc.("PowerStream"), collectively called the applicants, filed an application with the Ontario Energy Board ("Board") on April 18, 2016 under section 86 of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 (Schedule B) ("Act") seeking approval of, among other things, the amalgamation of Enersource, Horizon and PowerStream to form LDC Co. and the LDC Co. share purchase and amalgamation with Hydro One Brampton Networks Inc. ("Hydro One Brampton") and continuing as LDC Co.

An application was also made under Section 18 of the Act requesting approval for the transfer of the distribution licences and rate orders for each of the applicants and Hydro One Brampton to LDC Co.

A notice of the application of hearing was issued by the OEB on May 16th, 2016. Procedural Order No. 1 was issued June 15, 2016 accepting certain intervention requests and setting the process for discovery, as well as submissions on the applicant's request for confidential treatment of some of the filed information.

The applicants provided a presentation of the application to the Board panel and intervenors on June 23, 2016. Procedural Order No. 2 was issued on July 29, 2016, making provision for a transcribed technical conference to clarify any matters arising from the interrogatories. The technical conference was held on August 24, 2016. Procedural Order No. 2 also set out the schedule for the oral hearing and the subsequent submissions.

The Board issued a decision on the confidentiality request in Procedural Order No. 3 on August 12, 2016, in which it made it an amendment to the submissions schedule as well.

On September 2, 2016 the OEB issued its decision on the confidentiality request made with respect to the interrogatory responses.

The oral hearing was held over five days (September 7, 9, 15, 16 & 26). The applicants provided their argument-in-chief on September 26, 2016.

Energy Probe Research Foundation ("Energy Probe") has provided submissions on what it considers to be the key points with respect to the amalgamation and purchase ("merger") application.

B - SUBMISSIONS

i) General Support for Consolidation

Energy Probe supports the consolidation of electricity distributors where it can be shown that ratepayers will benefit through increased efficiency and productivity gains of the merged entity relative to that of the separate entities, while ensuring that service quality does not deteriorate.

In the current merger application, the applicants have provided high level estimates of the net synergies that are projected for the first 10 years of the merger (Exhibit B, Tab 6, Schedule 1, Figure 25). The high level estimate of the net synergies related to OM&A and capital expenditures over the 10 year period is approximately $426 million.

Energy Probe is concerned that the applicants have not been able to provide much detail to support these high level estimates. Specific savings have not been identified and no bottom up estimates have been provided, according to the applicants, because at this point in the merger process this has not yet been done at that level of detail.

However, despite this concern, Energy Probe submits that there should be significant net synergies achieved. In fact, Energy Probe submits that the high level estimated net synergies provided in the evidence is most likely a very conservative estimate of those savings. As Mr. Basilio indicated (Tr. Vol. 1, pages 85-86):

> *As well, from a shareholder perspective which -- you know, the business case was something presented to shareholders, and shareholders are generally interested in what's the downside, and what we don't want to present, you know, generally speak -- I can tell you as a CFO, the last thing you want to do is promise something more in terms of an earnings potential when, in fact, there is a significant risk that you might not get there.*

In other words, under promise and over deliver.

With respect to service quality, the applicants have indicated that they will continue to report all the service quality indicators for each of the four rate zones (Tr. Vol. 5, page 8) for the first 3 years of merger and at their discretion for the years beyond that.

However, the applicants have also indicated that they cannot guarantee that none of the service quality indicators will deteriorate. They have indicated that as a merged entity, more resources would be available to deal with issues that may arise in one area or in one rate zone. Energy Probe submits that this is a reasonable assumption and that the Board should interpret this to mean that service quality should not deteriorate as a result of the merger.

ii) The No Harm Test – Necessary But Not Sufficient

The applicants have relied, almost exclusively, on meeting the no harm test to obtain approval from the Board for this application. Energy Probe submits that meeting the no harm test is a necessary but not a sufficient test. This is because the Board policy with respect to distributor consolidation is not the only policy in play in this application. The other Board policy is that set out in the Renewed Regulatory Framework for Electricity Distributors ("RRFE"). The renewed regulatory framework is a comprehensive performance-based approach to regulation based on the achievement of outcomes that ensure that Ontario's electricity system provides value for money for customers. This policy emphasizes results and is designed to better respond to customer preferences. This policy determined that the following outcomes are appropriate for distributors: customer focus, operational effectiveness, public policy responsiveness and financial performance.

Energy Probe submits that not all aspects of these outcomes need to be addressed in the current application. For example, the method of setting rates for each of the four rate zones during the rebasing deferral period has been determined in the distributor consolidation policy. Rates at rebasing will be determined based on a cost of service application and the issue of the appropriate revenue requirement will be determined at that time. Undoubtedly, the historical costs incurred and the savings generated throughout the rebasing deferral period will be examined in detail to determine if the revenue requirement for the rebasing year or years (under a custom IR) is appropriate.

Similarly, the issue of rate harmonization will be dealt with upon rebasing since it is not possible to adjust rates based on cost causation until a cost allocation study is done, which in turn requires a cost of service rebasing application.

The merger application does, however, have to deal with other aspects of the RRFE, such as responding to customer preferences, and ensuring that continuous improvement in productivity and cost performance is achieved and the distributors deliver on system reliability and quality objectives. As well, distributors need to be responsive to public policy considerations while maintaining financial viability and ensuring that savings from operational effectiveness are sustainable.

The RRFE framework sets expectations that electricity distributors will seek out efficiencies to increase productivity and manage costs. One way to accomplish this is through mergers and acquisitions. Energy Probe submits that the applicants have not fulfilled these outcomes and expectations within their current merger proposal. These deficiencies are highlighted in the following submissions.

iii) Ratepayer Benefits

Energy Probe submits that there are two ratepayer benefits that can and should be achieved through a merger. The first is enhanced system reliability and service quality. Energy Probe has already discussed this above and submits that the larger organization should be able to respond more quickly and more effectively to reliability and quality issues that may arise in any given portion of its service territory because it will have greater resources than each of the individual distributors that can be shifted and moved around based on need.

The second ratepayer benefit is related to rates, which in turn is driven by customer preferences. Ratepayers have overwhelming indicated in survey after survey that high and increasing rates for electricity are their number one issue. Ratepayers are told that mergers will result in either lower rates or rates that will not increase as fast as they would in the absence of a merger. Those promises have to be kept and they have to be kept in a timely manner. Savings are a key benefit for ratepayers.

Ratepayers will only receive enhanced value for money if they receive both of the above benefits.

iv) Ratepayer Savings

Ratepayer savings are at the heart of the desire for consolidation. The report of the Ontario Distribution Sector Review Panel issued in December, 2012 set of a vision for consolidation that would result in less costly and more efficient delivery of electricity, with a predicted cost savings of $1.2 billion over the next 10 years. The current application, with net synergies of $426 million, represents more than one-third of these predicted cost savings.

The Minister of Energy responded to the Panel's report by indicating that he expected that the sector would find ways to achieve the savings through more efficient service delivery, including negotiated consolidations. This view was reflected in the government's Long Term Energy Plan ("LTEP") of December, 2013 wherein it was stated that the government expected electricity distributors to pursue innovative partnerships and transformative initiatives that would result in savings for electricity ratepayers.

Energy Probe submits that there are three sources of possible ratepayer savings associated with a merger. These three sources are the net synergies (gross synergies less transition costs) accomplished during the rebasing deferral period, sustainable savings in the rebasing year and subsequent years, and potential savings during the rebasing deferral period due to the different rate setting mechanisms used as compared to the status quo approach for each of the affected applicants.

Each of these three sources of savings, which are discussed in the following sections, is based on assumptions and projections. Energy Probe submits that these assumptions and projections are not all equal in terms of reliability. As a result, the Board should give different weights to the potential savings figures.

a) Savings Beyond the Rebasing Deferral Period

The applicants have estimated the net present value of savings for ratepayers beyond the 10 year rebasing deferral period to be in the neighbourhood of $306 million (Tr. Vol. 1, page 82). Energy Probe submits that the Board should disregard these savings for a number of reasons.

The proposal put forward by the applicants and contemplated in the Board merger policy is that all sustainable savings that have resulted from the merger would flow through to ratepayers in a cost of service or custom IR proceeding following the end of the deferred rebasing period. Mr. Basilio agreed with this statement (Tr. Vol. 1, page 51).

Energy Probe submits that there are a number of issues with this approach when considering a 10 year rebasing deferral period that need to be considered by the Board.

Chief among these issues is uncertainty. Energy Probe submits that there is no certainty that LDC Co. would rebase following the 10 year deferral period. This is the case for a number of reasons.

First, there could be a different regulatory construct in place 10 years from now. As the Board is aware, the regulatory environment, combined with government policy, is an ever changing beast. One only has to go back a few years to see how quickly and significantly the rate setting process has changed. There was no custom IR rate setting methodology. There was no incremental capital module or advanced capital model. Price cap rate setting in Ontario was in its infancy. Electricity rates for 2006 were set based on historical 2004 costs with some adjustments. The government imposed a rate freeze.

To assume that the regulatory environment and methodologies that exist today will exist 10 years in the future ignores the rapid change that has taken place in the last 10 years. No one expects that the regulatory environment will be frozen in time for the next 10 years.

Second, the savings on which the net present value of $306 million is based are only high level estimates. As indicated in Exhibit B, Tab 6, Schedule 1, page 2, OM&A expenditures beyond the rebasing deferral period are continued at a rate of approximately 15% annually while capital expenditures are forecast to be $8 million per year lower for LDC Co. relative to the status quo.

The applicants have provided no detailed evidence to support these figures. Indeed, it would be suspicious if they attempted to do so. Electricity distributors have only recently been required to forecast out 5 years for the distribution system plans and custom IR applications. Some distributors have an outlook that extends to 10 years. Energy Probe is not aware of any distributor that forecasts at a detailed level beyond 10 years.

In addition, the applicants have not provided any credible evidence that the savings realized in the rebasing deferral period are sustainable in perpetuity.

Unlike the analysis done for the shareholders where the applicants provided 50% and 75% attainment of synergies as sensitivity analysis, it did not do so for ratepayers beyond the rebasing deferral period. One can only assume that if the savings beyond the rebasing deferral period are 50% of the projection provided, then the net present value of those savings would fall to 50% of the projection, or about $150 million.

The third issue with respect to the post rebasing deferral savings that Energy Probe has is that there is no certainty that ratepayers will receive these benefits, or that they will receive them after 10 years.

The applicants are not able to guarantee any of the benefits to ratepayers that they are projecting for the years following the rebasing deferral period (Tr. Vol. 1, pages 52-53). There is uncertainty associated with the level of savings that can be generated and sustained. The applicants agreed that this is the case.

Energy Probe submits that there is also uncertainty associated with the timing of when ratepayers would receive any of the sustainable benefits. This is partly due to the potential of changes in the regulatory environment and methodologies that may exist following the rebasing deferral period, as discussed above. The uncertainty with respect to the timing is also related to the current policies of the Board.

As set out in the July, 2007 Report of the Board on Rate-making Associated with Distributor Consolidation, a merged distributor that merges with another distributor during the rebasing deferral period can extend the rebasing deferral period (page 6 of the Report):

> *Some flexibility should be afforded where a consolidated entity whose rebasing has been deferred through the application of the above policy subsequently enters into a further consolidation transaction before the end of the deferral period. The Board may therefore allow a new deferral period of up to five years, from the date of closing of the new consolidation transaction, where parties to the consolidation demonstrate in their MAAD application the need for, and benefits of, such a deferral.*
>
> *This is not intended to allow the deferral of rate rebasing indefinitely, especially to the extent that ratepayers may somehow be disadvantaged. In some consecutive consolidations, especially those entered into near the end of a deferral period, extending the deferral by another five years may not be appropriate. The onus will be on the applicant(s) to clearly justify the need for, and benefits of, a further deferral and to demonstrate to the satisfaction of the Board that ratepayers will not be adversely affected by the deferral.*

An interpretation of the second paragraph above would indicate that no extended deferral period would be provided because this clearly deprives ratepayers of the benefits that were to start flowing to them following the rebasing deferral period. On the other hand, the Board policy could be changed to allow for an extended deferral period in order to encourage further consolidation among distributors. This was acknowledged by the applicants (Tr. Vol. 1, pages 53-54) in that they would be compliant with whatever policy that was in place at the time of the filing.

Energy Probe notes that the applicants have indicated that no such transaction is in the offing, but also notes that the strategic plan filed on September 13, 2016 clearly demonstrates that the strategy of the merged entity includes the objective to "Grow the core business through mergers and acquisitions and regional and community planning initiatives".

The fourth issue with waiting 10 or more years for benefits to flow to ratepayers is related intergenerational inequity. Under the applicants proposal for a 10 year rebasing deferral period, it would be half a generation later before ratepayers receive benefits. Many of the ratepayers that receive the benefits a decade from now are not ratepayers, their parents are. Many of the current ratepayers will never see any of the benefits because, sadly, they will be deceased by the time the benefits are scheduled to flow.

In summary, Energy Probe submits that asking ratepayers to wait for benefits to flow to them eleven years, or even more, in the future is not appropriate. All of the risks associated with the quantum and timing of these benefits are shouldered by ratepayers. The merged entity incurs no such risks.

b) Savings During the Rebasing Deferral Period Due to Different Rate Setting Mechanisms

The applicants claim that ratepayers will save a net present value of $98 million during the 10 year rebasing deferral period (Tr. Vol. 1, pages 82-83) based on the projected difference in MergeCo distribution revenue (including ICM revenue) and the standalone distribution revenue requirements of the four distributors shown in the attachment to Undertaking JTC1.3 which was also included as page 1 in Exhibit K1.2 (Energy Probe Compendium).

For the reasons that follow, Energy Probe submits that the Board should give little weight to these projected savings.

First, the key assumption used by the applicants is that the status quo for each distributor is a custom IR application that results in significant rate increases for customers. A review of the attachment to Undertaking JTC1.3 shows that the revenue requirement under the status quo scenario for PowerStream increases in one year by 6.8%, for Enersource by 8.5% for Hydro One Brampton by more than 16%. The total average annual percent increase across the 10 year period and all four distributors is 4%, double the current rate of inflation and the 2% forecast in the models used by the applicants.

The Deliotte model provided in the response to Undertaking JTC1.1 shows an average annual increase in the number of customers over this same period of just under 1.3%.

As the Board is aware, the impact on costs of customer growth is less than 1 to 1. In fact, the Pacific Economics Group model that the Board uses for benchmarking and assigning distributors to efficiency cohorts indicates that the relationship between customer growth and costs is less than 0.5. In other words, a 1% increase in customers has, on average, an impact on costs of less than 0.5%.

Combining the inflation forecast of 2.0% with 50% of the customer growth of 1.3% yields an escalator for costs of less than 2.7%. This implies a negative productivity/stretch factor of approximately 1.3% each and every year.

Clearly these increases would not be compliant with the RRFE which requires continuous improvement and efficiency gains.

Energy Probe submits that the use of custom IR revenue requirement forecast for the status quo scenario is seriously flawed because of what the applicants believe a custom IR is. Mr. Basilio described what was in the model (Tr. Vol. 1, pages 143-144):

> *MR. BASILIO: The evidence that we put -- as I said, the* ***model generates revenue requirement****. And what we've put before the Board in evidence as the basis for demonstrating the no-harm test are two things.* ***Revenue requirement declines under the merged scenario versus the status quo.***
> *And I believe we also provided revenue, distribution revenue per customer, which I would suggest on a very broad weighted average basis, is a good proxy for the sort of rate reduction that customers should expect.*
> *We've provided statistics along those lines, again on average across all classes, 3.3 percent, in the first ten years, 5.9 percent across the forecast period, 8 percent post rebates rebasing.*
> *So that's the basis on which we filed the application and tried to demonstrate no harm.*
> *As I've articulated here, the model is a very complex thing in terms of how it builds revenue requirement. But fundamentally, conceptually it's very simple and it aligns to Board policy and the determination of that revenue requirement that you could track it through.*
> ***In a cost of service year, it starts with OM&A -- it starts with all the things that fundamentally build up to the revenue requirement: PILS, OM&A, depreciation, other income, depreciation determined off of, you know, a fixed asset continuity, rate base off of working capital and fixed assets.***
> ***And then if it's rebased annually, it's the same process. So if it's custom IR, that's the way it works****.* (emphasis added)

In discussing the model that was developed to estimate the difference between the status quo (stand alone) scenario and the merger scenario, it was clear that the custom IR methodology used by the applicants was actually a cost of service approach (Tr. Vol. 1, page 138):

> *MR. SHEPHERD: And it also allows you to do cost of service, right? Because, in fact, you did --* ***you put in cost of service numbers for the standalone.***
> *MR. BASILIO:* ***Exactly.***
> *MR. SHEPHERD: So it basically does -- it is like a rate generator? I effect, it generates rates, right?*
> *MR. BASILIO:* ***I mean, it is a distribution revenue requirement generator***.
> (emphasis added)

Clearly, the applicants have mistaken a custom IR as successive cost of service calculations. Indeed there is no talk of the use of the custom index that is referenced in Table 1 of the October, 2012 Report of the Board on the Renewed Regulatory Framework for Electricity Distributors: A Performance-Based Approach.

Table 1 in that Report also indicates that the distributor-specific trend for the plan term to be determined by the Board would be informed by: (1) the distributor's forecasts (revenue and costs, inflation, productivity); (2) the Board's inflation and productivity analyses; and (3) benchmarking to assess the reasonableness of the distributor's forecasts.

Energy Probe submits that the model that the applicants have relied on for the status quo revenues to be paid by ratepayers only takes into account the first of the three items listed above. Indeed, it is not even clear that the model takes into account any incremental efficiency improvements/stretch factor/productivity gains under the custom IR calculations. Table 1 in the Report indicates that the sharing of benefits under the custom IR model is based on a productivity factor. No such factor appears to have been used in the cost of service calculations done in the model.

The model certainly does not reflect the Board's inflation and productivity analyses or any benchmarking to assess the reasonableness of the forecasts.

The custom IR approach taken by the applicants of calculation an annual revenue requirement based on a cost of service approach has been repeatedly rejected by the Board. This was most recently illustrated in the PowerStream (EB-2015-0003) Decision where the Board indicated that PowerStream's custom IR application failed to meet the principles set out by the Board and the PowerStream approach to determining its customers' needs and establishing its future revenue requirement was not likely to result in advancing the Board's policy objectives as set out in the RRFE.

Similarly, in EB-2016-0085 (InnPower Corp.), the Board indicated that the distributor did not propose a customer index consistent with the Board's expectations for a custom IR application and that it provided neither benchmarking information nor sufficiently robust evidence to support the reasonableness of its forecasts. Energy Probe submits that the same is true with respect to the status quo forecasts made in this application.

In summary, Energy Probe submits that the Board should not and cannot rely on the status quo scenario upon which the projected savings to ratepayers are calculated over the deferred rebasing period.

Second, the assumptions related to the ICM have not been substantiated. In fact, the forecast of incremental capital and the associated impact on the revenue collected over the rebasing deferral period has changed significantly from that originally filed by the applicants.

In the response to Undertaking JTC1.13, Table 1 shows the original total net incremental eligible capital over the deferred rebasing period that was built into the revenues of the merger scenario provided in the response to Undertaking JTC1.3. As shown in JTC1.3, the total net incremental eligible capital was $414.2 million, with an associated total forecast ICM revenue of $130.6 million.

In the response to Undertaking J1.1, the applicants updated this forecast for only two items: the PowerStream decision and the use of a 10% deadband in place of the 20% deadband used in the calculation of the ICM materiality threshold. This latter change reflects the updated Board policy which reduced the deadband from 20% to 10%.

As shown in the response to part (c) of J1.1, the net incremental capital under the ICM has increased to $587.7 million and the associated total forecasted ICM revenue has increased to $168.4 million.

The increase in the total forecasted ICM revenue used in the comparison of amounts to be paid by ratepayers jumps from $130.6 million to $168.4 million. The corresponding increase in the net present value of this additional revenue, based on the same 9.3% discount rate used the applicants, is an increase from $72.3 million to $91.5 million, an increase of nearly $20 million. This reduces the net present value of the savings of $98 million calculated by the applicants to less than $80 million.

This illustrates how sensitive the IRM related revenue that is included in the merger scenario is to small changes. Of particular concern to Energy Probe is the fact that LDC Co. does not have a distribution system plan ("DSP") for the next 5 years, never mind the 10 year rebasing deferral period. Nor, apparently, will they have one until sometime in 2019 (Tr. Vol. 1, page 118). In other words, the Board is being asked to consider ratepayer savings during the rebasing deferral period that are not based on any evidence provided in this proceeding. The incremental ICM revenues and capital expenditures are only guesses at this point in time. As the witnesses explained, the forecasted capital used in their model to calculate ICM requirements was not based on the DSP's that have been seen and approved by the Board. This is because the DSP may inform the trend, but the updated forecasted capital expenditures for any year for any utility will reflect projects that are accelerated and deferred and result from new requirements.

Any change in the capital expenditure forecast will be reflected in the ICM incremental capital. This is because the materiality threshold is based on Board approved figures from the last test year and external factors such as the rate of inflation. A $1 million increase in capital expenditures would result in a $1 million increase in ICM incremental capital.

A review of the Deloitte model provided in the response to Undertaking JTC1.1 indicates that over the 10 year rebasing deferral period, the total capital expenditures for the four utilities is about $2.75 billion. Even a small variance from this amount would have a significant impact on the net present value of the estimated ratepayer savings. For example, an increase of $100 million (about 3.6% of the total) could reduce the net present value of the projected savings by close to another $20 million, on top of that already noted above.

Finally, the projected savings are totally and completely independent of the net synergies. In fact, if there were no synergies at all or even if there were negative synergies associated with the merger that would continue on beyond the rebasing deferral period, these projected savings, as calculated by the applicants would still exist.

This is because the projected savings have nothing to do with productivity or efficiency gains. They are simply the mathematical difference between two sets of hypothetical revenues to be paid by ratepayers.

Energy Probe supports the statement in January, 2016 Handbook to Electricity Distributor and Transmitter Consolidations ("Handbook") (page 7), that:

> *Consistent with recent decisions[3], the OEB will not consider temporary rate decreases proposed by applicants, and other such temporary provisions, to be*

> *demonstrative of "no harm" as they are not supported by, or reflective of the underlying cost structures of the entities involved and may not be sustainable or beneficial in the long term. In reviewing a transaction the OEB must consider the long term effect of the consolidation on customers and the financial sustainability of the sector.*
> [3] *Hydro One Inc./Norfolk Power Distribution Inc. – OEB File No. EB-2013-0196/EB-2013-0187/EB-2013-0198*
> *Hydro One Inc./Haldimand County Hydro Inc. – OEB File No. EB-2014-0244*

While the applicants are not proposing a temporary rate decrease, they are proposing other such temporary provisions, as required under the Board's merger policy as to how rates are to be set during the rebasing deferral period. These interim measures are not supported by, nor do they reflect, the underlying cost structures of the distributors involved. Neither are they sustainable in the long term. If they were, there would be no need to rebase. They are also not beneficial in the long term, as they do not reflect the actual costs incurred to service ratepayers.

c) Net Synergy Savings

The proposal put forward by the applicants has all of the net synergies flowing to the shareholders (Tr. Vol. 1, pages 26-27). These total net synergies are shown in Table 25 of Exhibit B, Tab 6, Schedule 1 and total more than $425 million over the proposed 10 year rebasing deferral period. Ratepayers get nothing except a promise that is not guaranteed that they will be seeing savings half a generation later.

In the section that follows, Energy Probe provides its submissions on why this is not an appropriate balance between ratepayers and shareholders.

v) An Appropriate Balance Between Ratepayers and Shareholders

There are no guarantees in life, or in rates. However, there is an appropriate balance between the impact on ratepayers and shareholders.

The Handbook states that while the Board has determined that allowing a longer deferred rebasing period is appropriate to incent consolidation, there must be an appropriate balance between the incentives provided to utilities and the protection provided to customers. Energy Probe agrees.

Energy Probe submits that balance in the plan proposed by the applicants is not appropriate and is tilted in favour of the shareholders.

The ratepayer savings calculated in the application rely on assumptions that are not RRFE compliant (ratepayer savings during the deferred rebasing period) and savings that cannot be guaranteed (ratepayer savings beyond the deferred rebasing period). In other words, all of the ratepayer savings are at risk.

Meanwhile, the benefits for the shareholder over the deferred rebasing period are a conservative estimate of the cost reductions that can be achieved. The shareholders could obtain even bigger benefits if the applicants determine that they do not need three head offices, or that they can rent portions of the existing head offices out because they do not require all of the space in each of them. These benefits are under the control of the distributor.

Energy Probe submits that a more equitable saving involves sharing of benefits that a more likely to occur and that this sharing should be on a timely basis. Ratepayers should not have to sit back and hope for benefits in a decade while the shareholders pocket all the savings in the first 10 years.

Energy Probe notes, with some amusement, that the submissions of the Coalition of Large Distributors ("CLD") in the Review of the Board's Policies and Processes to Facilitate Electricity Distributor Efficiency: Service Area Amendments and Rate-Making Associated with Distributor Consolidation (EB-2014-0138) dated May 5, 2014 indicates support for a sharing mechanism over a 10 year period. The CLD included Horizon, PowerStream and Enersource, along with Hydro Ottawa Limited, Toronto Hydro-Electric System Limited and Veridian Connections Inc.

In that submission, the CLD stated (page 10):

> *The CLD also recommends the implementation of a sharing mechanism over a 10-year period. Post transaction, all synergy savings are utilized to recover transaction and integration costs as a first priority. Once transaction and integration costs have been recovered, synergy savings are shared equally, on a 50-50 percentage basis between customers and shareholders, over the balance of the remaining 10 years.*

Energy Probe supports and agrees with that submission.

With respect to the earnings sharing mechanism ("ESM") proposed by the applicants, Energy Probe submits that while it is compliant with the Board policy, it is a slap in the face of ratepayers. Not only do ratepayers not share in the total net synergies of more than $425 million over the first 10 years, but they are not entitled to share in any of the overearnings under 300 basis points in years 6 through 10.

As shown in Table 1 provided in the response to part (b) of Interrogatory B-CCC-22, the total value that the shareholder could receive before any earnings sharing were to take place over the 10 rebasing deferral period is more than $400 million. This is potentially on top of the $425 million in synergies. In other words, ratepayers do not see a penny in synergy savings or over earnings until the shareholders fill their apparently very deep pockets with more than $0.8 BILLION dollars!

Energy Probe also notes that the provincial government has recently made two key decisions that reflect their view that ratepayers are paying too much for electricity and that they need a break. The provincial government will remove the provincial portion of the HST from electricity bills effective January 1, 2017 and the government has also cancelled the remaining portion of the Long Term Energy Plan that will save ratepayers billions of dollars.

At the same time, we have a merger application that proposes that shareholders get to keep up to $800 million in synergies and over earnings, while providing no rate relief to 1 million customers impacted by the merger. Energy Probe submits that this is ridiculous and does not follow the provincial government lead on making electricity affordable.

vi) The Deferral Period

In determining the change in policy with respect to the deferral period from a maximum of 5 years to 10 years, the Board was guided by the submissions of distributors of their key concern that the 5 year rebasing deferral period may not provide sufficient time to recover those costs through savings and efficiency gains and that shareholders would be at risk of not recovering the MAADs transaction costs.

In the EB-2014-0138 Report of the Board – Rate-Making Associated with Distributor Consolidation dated March 26, 2015 ("2015 Report"), the Board made a number of statements that summarized the focus of the distributor comments received.

Energy Probe has reviewed each of these statements and has put them into context related to this application. Each of the bullet points that follow are taken from page 5 of the 2015 Report.

- It is the view of distributors that the current policy may not provide sufficient time to achieve the savings and efficiency gains necessary to enable the recovery of transaction costs.

Based on the evidence in Figure 25 of Exhibit B, Tab 6, Schedule 1, the applicants in this proceeding are projecting that early in the third year of the consolidation, the savings and efficiency gains will cover all the transaction costs associated with the merger. As a result, there is no need for a 10 year rebasing deferral period.

- Distributors expressed the view that the risk for shareholders of not recovering transaction costs is a significant impediment to consolidation.

As noted above, the applicants expect to recover their transaction costs by the early part of the third year. By the end of the fifth year, transaction costs total $96.3 million. Over the same 5 year period, the gross synergies total $269.7. It is the submission of Energy Probe that this recovery to cost ratio of 2.8 to 1 provides a high level of confidence that the shareholders will more than recover their transaction costs by the end of the fifth year.

- Distributors explain that the transition and integration costs of a MAADs transaction, although largely incurred upfront can continue for two to four years following the completion of the transaction. Whereas efficiency gains and savings resulting from the transaction will not start to be realized until the transaction is completed and the new entity has begun to operate.

In this application, transaction costs are projected to be incurred over the first 3 years, with minor amounts incurred in the fourth and fifth year. This is consistent with the above concern expressed by distributors. However, the total synergies estimated by the applicants accrue quickly to the consolidated entity, starting at more than $30 million in the first year, growing to more than $60 million in the third year and $72.5 million in the fifth year.

- Distributors indicated that give the nature and timing of these costs and savings, annual net benefits (operational costs less transition and integration costs) are in many cases negative during the first two for our years.

As illustrated in Figure 25 in Exhibit B, Tab 6, Schedule 1, there is a much different profile in this application. Annual net benefits are negative only in the first year and by the early part of the third year, the cumulative net benefits change from negative to positive.

- 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.

As noted above, the break-even point associated with this consolidation is reached early in the third year, much quicker than that contemplated in the distributor submissions.

- Distributors there suggested that greater flexibility in terms of the rebasing time frame and the ability to retain any achieved savings for a longer deferral period will provide encouragement to those who may be interested in pursuing consolidation opportunities.

Energy Probe notes the use of the word 'encouragement' in the above statement. Energy Probe interprets this to mean that a longer rebasing time frame reduces risk to shareholders of not being able to recover their transaction costs. Energy Probe is not aware that any of the distributors believed that a longer rebasing period was necessary in order for the shareholders to retain net synergies over and above the transaction costs.

Consolidation is about providing ratepayers with savings and efficiency gains, not padding the pockets of shareholders who already earn a generous return on their equity. Doing so, in the view of Energy Probe, would not be in keeping with the Board's objectives in the RRFE. In particular, the renewed regulatory framework is a comprehensive performance-based approach to regulation that is based on the achievement of outcomes that ensure that Ontario's electricity system provides value for money for customers. Energy Probe does not see how directing all savings and efficiency gains for a 10 year period to shareholders provides any value to customers. It only provides value to shareholders.

Based on the concerns expressed by distributors for the need for up to a 10 year deferred rebasing period and a comparison of those concerns to the evidence in this proceeding, it is clear to Energy Probe that this consolidation is unique. It does not fall into the realm of consolidations that the distributors expressed concerns about.

Energy Probe is not the only party to this proceeding that considers this consolidation to be unique. The applicants themselves agree that this is a unique transaction (Tr. Vol. 1, page 39):

> *MR. BASILIO: We think to some extent this is unchartered territory. This is a unique transaction.*

A Board policy that allows for a deferred rebasing period of up to 10 years based on general comments and concerns should not preclude a change in the deferred rebasing period when confronted with the unique circumstances and total net synergies projection that are before the Board in this application. To do so blindly would violate the very foundation of the RRFE that customers are to be provided value for their money. The

Board has to remember that each and every dollar that flows to the shareholder is a dollar out of the pocket of ratepayers and that there is no value for customers of having savings and efficiency gains go to shareholders for 10 years when the transaction costs are fully recovered early in the third year.

Energy Probe notes that in referring to transaction costs it is referring to the transition costs noted in Figure 25 of Exhibit B, Tab 6, Schedule 1. These costs do not include the premium to book value to be paid for Hydro One Brampton. As the Board is aware, these costs are not and will not be included in rate base and are not recoverable from ratepayers. For the same reason, they should not be included in the transition/transaction costs to be recovered.

vii) Energy Probe Proposals

As submitted above, Energy Probe does not believe that the applicants' proposal results in an appropriate balance between ratepayers and shareholders. Shareholders pocket all of the synergies and have an opportunity to over earn for a decade. Ratepayers receive benefits for 10 years that are marginal at best and fictitious at worst since there is no robust evidence to support the status quo revenue requirements. Then they wait for half a generation for savings that may or may not be sustainable.

Energy Probe has provided three proposals that, in its view, would more appropriately balances the outcomes between the ratepayers and the shareholders. Energy Probe submits that options (a) and (b) provided below are preferable relative to option (c). Option (c) would be the least preferred alternative, but is still significantly superior to the applicants' proposal.

a) 50/50 Sharing of Net Synergies

This proposal is identical to that of the CLD in its submissions noted earlier. LDC Co. would begin to share the net synergies as soon as they become positive. The sharing would be 50% to ratepayers and 50% to the shareholders.

The net synergies would be calculated in a manner similar to that shown in Figure 25 of Exhibit B, Tab 6, Schedule 1. The only difference would be that the amounts to be shared would not be the dollar value of the net synergies, but would be the revenue requirement impact of the net synergies. For added clarity, this would not impact on the operating net synergies, but the capital net synergies would reflect the impact on the revenue requirement of the capital savings, being the cost of debt, return on equity, PILs and depreciation.

The shareholders would be able to recover their transaction/transition costs up front before they begin sharing any of the benefits with ratepayers. This eliminates any risk for shareholders of not recovering their transaction costs.

Ratepayers are able to share in the savings almost immediately, eliminating intergenerational issues. This sharing would continue for the length of the proposed 10 year rebasing deferral period.

b) 5 Year Rebasing Deferral Period

Under this proposal, the Board would approve a 5 year rebasing deferral period rather than the 10 year period as proposed. There would be no earnings sharing during the rebasing deferral period and rebasing would take place in year 6 rather than in year 11.

This proposal has the benefit of ensuring that ratepayers obtain benefits from the merger in a reasonable amount of time (after 5 years) while still reducing any risk for shareholders of not recovering their transaction costs. If after 5 years the merged entity had not yet recovered all their transaction costs through savings and efficiency gains, they could apply to the Board to extend the deferred rebasing period until such time as the transaction costs have been recovered. Based on the forecast provided by the applicants in this proceeding, this eventuality is not likely to occur since the total net synergies are forecast to turn positive in the second year of the rebasing deferral period and transaction costs are fully recovered in the third year.

This option more closely aligns with Board's view that it is in the best interest of consumers to have consolidating entities operate as one entity as soon as possible after the MAADs transaction (page 7 of the 2015 Report). The Board Report goes on to state that the consolidated entity application would allow the Board to establish rates that reflect the efficiencies from the consolidation transaction. Energy Probe would add to this statement, indicating that this should be done in a timely manner.

As noted above in part (iv), it is the submission of Energy Probe that a 10 year rebasing deferral period is not required in this instance.

c) 50/50 Sharing in Years 6-10 with No Deadband

This proposal is identical to that of the applicants, except that the ESM would start at the allowed return on equity, rather than at the allowed return on equity plus the 300 basis point deadband. The sharing would be asymmetrical, consistent with the approach in the

Board policy, meaning that only over earnings would be shared with ratepayers. Under earnings would be to the account of the shareholders.

The applicant has indicated that it has followed the Board policy with respect to the required ESM for the period beyond 5 years. However, as noted in the Handbook (page 16), the Board is aware that there are numerous types and structures of consolidation transactions, and there can be significant differences between utilities involved in a transaction and that the ESM as set out in the 2015 Report, and as adopted by the applicants in this proceeding, may not achieve the intended objective of consumer protection for all types of consolidation proposals.

The Board noted in the 2015 Report (page 7) that the 50:50 sharing above 300 basis points in years 6 through 10 of the deferred rebasing period provides for the shareholders to continue to recover transaction costs while ensuring customers of the consolidated entity will benefit from the efficiencies and savings the new distributor has achieved. As noted earlier in this submission, shareholders fully recover their transaction costs in this application by the third year.

As noted above in part (vi), this transaction is unique. It is the submission of Energy Probe that if the Board accepts a 10 year rebasing deferral account despite the evidence that the total net synergies turn positive in the second year and transaction costs are fully recovered in the third year, then a more equitable ESM is required for years 6 through 10. Allowing the merged entity to pocket all of the potential savings that have been identified – and those that have not yet been identified – is not fair to ratepayers. Adjusting the ESM as proposed by Energy Probe represents a fairer and more appropriate balance between the ratepayers and the shareholders.

viii) Reporting and Accountability

The applicants have proposed that LDC Co. track its operations in four separate rate zones, subject to any amendments as determined by the Board, until the end of the third year following the completion of the consolidation of the four predecessor distributors. The end of the third year is expected to be December 31, 2019.

The applicants have also proposed to report to the Board on electricity service quality requirements and other reportable financial metrics as set out in the Board's reporting and record keeping requirements ("RRR") separately for each of the four rate zones for the three period.

The applicants also propose that LDC Co. may, at its option, report to the Board under the RRR on a consolidated basis, instead of separately for the four rate zones after the end of the third year following completion of the consolidation.

Energy Probe supports the tracking of the LDC Co. operations by rate zone through to the end of the third year following the completion of the consolidation. Energy Probe notes that this would be required for the Horizon rate zone in order to comply with provisions in the Settlement Proposal that was accepted by the Board.

Similarly, Energy Probe submits that the RRR reporting by rate zone for the first three years following completion of the consolidation is appropriate. This will enable comparisons to be made with historical figures for each of the predecessor distributors that make up the rate zones. This may be required to ensure that one rate zone is not receiving improved services at the expense of another one receiving services that have declined in value.

However, Energy Probe submits that with respect to both the operations and RRR reporting, LDC Co. should be required to report on a consolidated basis in addition to each of the four rate zones. This information will be crucial to the analysis of productivity and efficiency gains and value for money during the rebasing deferral period. In the absence of the consolidated information, the Board and other interested parties would have no basis to compare the results in the fourth or subsequent year following consolidation to see if improvements are being realized.

Energy Probe disagrees with respect to the final proposal to report to the Board under the RRR after the end of the third year following completion of the consolidation on a consolidated basis, at the option of LDC Co.

As noted above, Energy Probe believes that the consolidated reporting should begin in the first year, as is required for any distributor in the province. This would mean that there would be no option to move to a consolidated basis at the end of the third year, since that reporting would already be in place.

The option to stop reporting separately for the four rate zones should be at the Board's option, not the option of LDC Co. The RRR reporting in the first three years following the completion of the consolidation may identify problems or issues in one or more the rate zones that correspond to a predecessor distributor. The Board may want to ensure that these problems or issues are resolved before allows LDC Co. to stop reporting by rate zone. In other words, the Board should have the option to extend the filing by rate zone until it is satisfied that the information is no longer required at the rate zone level.

C - COSTS

Energy Probe requests that it be awarded 100% of its reasonably incurred costs. Energy Probe worked with other intervenors in this proceeding to ensure complete coverage of the issues with a minimum of duplication. As an example, Energy Probe did not do any cross-examination in this proceeding with respect to the operations panel (Panel 2). This was because Energy Probe was aware that other intervenors were going to more than adequately cover the issues covered by this panel.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

October 7, 2016

Randy Aiken
Consultant to Energy Probe