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

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

AMPCO Final Submissions
October 7, 2016

- Enersource Hydro Mississauga Inc. (Enersource), Horizon Utilities Corporation (Horizon), PowerStream Inc. (PowerStream), (collectively the Applicants) filed an application April 18, 2016 under section 86 of the *Ontario Energy Board Act, 1998*, c. 15 (Schedule B) seeking approval of the following:

  a) Amalgamation of Enersource, Horizon, and PowerStream to form LDC Co.
  b) LDC Co. share purchase and amalgamation with Hydro One Brampton Networks Inc. (Hydro One Brampton) and continuing as LDC Co.
  c) Enersource Holdings Inc. share purchase of Enersource.
  d) Transfer of PowerStream's existing shares of Collus PowerStream Utility Services Corp to LDC Co.
  e) Transfer of Hydro One Brampton's distribution system to LDC Co.

- An application is 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.

- The Applicants estimate that the predecessor organizations will continue as LDC Co. January 1, 2017, serving over 960,000 customers. AMPCO notes LDC Co. will be the second largest utility in the Province of Ontario.

Price, Cost Effectiveness and Economic Efficiency

Issue 1. Does the proposed consolidation protect the interests of consumers with respect to price?

Issue 2. Have the applicants clearly identified the specific number of years for which they have chosen to defer the rebasing?

- In determining whether to approve this application, the Board will apply its "no harm test". The "no harm" test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB's statutory objectives, as set out in section 1 of the OEB Act. The OEB will consider whether the "no harm" test is satisfied based on an assessment of the cumulative effect of the transaction on the attainment of its statutory objectives. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

- The OEB's objectives under section 1 of the OEB Act are:
  - 1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
    - 1.1 To promote the education of consumers.

  - 2. 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.
  - 3. 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.
  - 4. To facilitate the implementation of a smart grid in Ontario.
  - 5. 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.

- To demonstrate "no harm", applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been.

- The Applicants provided a Business Case analysis for the merger (approved by shareholders) that is based on the following:
  - A ten year rebasing deferral period
  - HOBNI purchase for $607 million
  - Transition costs of $96.3 million
  - !00% of forecast synergies achieved: total net savings of $425.9 million (net of transition costs): Operating savings of $311.6 & Capital savings of $114.3
  - LDC Co. retains the savings for 10 years
  - All savings are transferred to customers at LDC Co.'s first rebasing following the merger; forecast to be year 11.
  - Forecast outcome of first rebasing after deferral period is ratepayer savings of $69.3 million (operating and capital synergies included in rates)
  - An Earning Sharing Mechanism in years six through ten. It is envisaged that any revenue sharing would be allocated equitably among all customers.[1]
  - No difference in total capital between status quo and LDC Co. except for non-poles and wires capital synergies
  - ICM in every year

- The Applicants provided a year over year distribution revenue trend analysis of the merged entity compared to the status quo that shows the relative benefit to customers as follows:

[1] B-Staff-31 (b)

  - Average decrease of $19.5 million per year or 3.3% in first 10 years
  - Average decrease of $69.3 million per year or 8% post rebasing
  - Average decrease of $ 48.6 million per year or 5.8% across forecast period (2016 to 2039

- The Applicants forecast total net synergies of $425.9 million over the ten year deferred rate rebasing period.

- The Applicants indicate the primary objective of the proposed consolidation is to realize operational and organizational efficiencies which will benefit both ratepayers and shareholders.[2]

- The Applicants submit the proposed consolidation meets the OEB's "no harm test" and that over the course of the 10-year rebasing period, customers will benefit from distribution rates that are lower than they would have been had the status quo of four independent LDCs been maintained.[3] This is based on the general notion that the Price Cap IR in effect during the rebasing deferral period (once existing rate plans expire) results in rates that will be lower over the same period than if the Applicants had remained standalone distributors and applied for consecutive Custom IR applications.[4]

- AMPCO does not oppose the proposed consolidation between Enersource, Horizon, PowerSteam and HOBNI. The consolidation appropriately identifies cost savings and operating and capital synergies. Although the merged entity has made a commitment to maintain reliability and power quality over the deferred rebasing period, AMPCO anticipates that the transaction could result in measurable improvements in these areas given the access to expanded resources and the potential for shorter power restoration times which would benefit all customers.

- In terms of applying the Board's "no harm test", AMPCO submits that the Applicants have applied too narrow of an interpretation of the test that essentially concludes that if the underlying cost structure of the merged entity is $1 less than it otherwise would have been, the "no harm test" has been met. In AMPCO's view the application of the "no harm test" with respect to price needs to be broader in scope and consider the incentives to ratepayers compared to the utilities shareholders to ensure an appropriate balance has been struck. Under the proposed structure of LDC Co., the $426 million in savings over the deferred rebasing period of ten years accrue to the shareholder;

---

[2] B-CCC-1

[3] B-2-1 Page 2

[4] Enersource and HOBNI will maintain Price Cap IR until the 10 year rebasing deferral period ends. Horizon will remain on Custom IR until 2019 and after that will maintain Price Cap IR. PowerStream will be on Custom IR until 2017 followed by Price Cap IR.

compared to the $195.5 million forecast benefit to customers over the same period.

- For the reasons discussed below, AMPCO submits the cumulative effect of the chosen rebasing period, conservative estimates of forecast operating and capital savings over the deferred rebasing period, and an ESM that does not properly adequately benefit customers, results in a significant imbalance between the incentives provided to the shareholders and the protection provided to customers. AMPCO submits if the Board approves the proposed consolidation of the four utilities, adjustments to the length of the deferred rebasing period and ESM are required.

- At the oral hearing, Panel Chair Mr. Quesnelle stated that "we've ruled in previous MAADs applications that the no-harm test is a holistic test and it takes in other considerations,"[5] which speaks to the need to more broadly apply the "no harm test" in reviewing this application.

Proposed Ten Year Rebasing Period

- The Applicants have chosen to defer the rebasing for LDC Co for ten years from the date of closing of the last of the proposed transactions on the basis that ten years is consistent with the Consolidation Policy and the Handbook.

- To address the issue of significant transaction costs as a barrier to consolidation, the Board lengthened the potential deferred rebasing period from five years to ten years in its 2015 Report. The Board determined that a longer rebasing period is appropriate to incent consolidation.[6] The deferred rebasing period is intended to enable distributors to fully realize anticipated efficiency gains from the transaction and retain achieved savings for a period of time to help offset the costs of the transaction.[7]

<u>Transaction Costs</u>

- As noted above under the Business Case assumptions, transaction costs are estimated at $96.3 million, comprised of $37.6 million in payroll related costs, $5.5 million in non-payroll related costs and $53.3 million in capital costs. 94% ($93.5 million) of transition costs are projected to occur in the first 3 years. Over the same time period gross synergies of $133.4 million are achieved so the break even point where cumulative savings exceed integration costs is less than three years. Year

[5] Transcript Volume 1 Page 142
[6] Report of the Board: Rate-Making Associated with Distributor Consolidation, March 26, 2015, Page 12
[7] Handbook to Electricity Distributor and Transmitter Consolidations and Filing Requirements for Consolidation Applications

one is the only year where transaction costs exceed gross synergies.[8]

- AMPCO submits that the proposed ten year rebasing period is not required to offset the costs of the transaction. This is achieved before the end of year three. The effect of a ten year rebasing period is that net savings of the consolidation are allowed to accrue to the shareholders for an extended period of time thereby tipping the balance of incentives between the shareholder and customers to the benefit of shareholders. AMPCO submits the Board should consider shortening the deferred rebasing period to less than ten years. Five years provides sufficient time for LDC Co. to achieve the savings and efficiency gains necessary to enable the recovery of the transaction costs.

- As discussed below, AMPCO submits the forecast synergies have been underestimated which means that it is likely that additional savings beyond the forecast $426 million will be generated and accrue to the shareholder over the ten year rebasing period. A ten year rebasing period without an adequate ESM is not in the best interest of customers. Also ten years is a long time for customers to wait until the savings are transferred to customers.

<u>Synergies</u>

- The ability to realize benefits to customers is dependent on the synergies created by the merger.

- The Applicant's provided evidence on where it expects to have synergy savings from Operating and Capital efficiencies resulting from the consolidation. Total gross operating savings of $354.6 million[9] and gross capital savings of $167.6 million[10] are projected over the ten year deferred rebasing period. The Applicants assess the risk of achieving the magnitude of projected synergies as low.[11]

- Gross Operating savings include the consolidation of core enterprise applications during years one to three including legacy Customer Information Systems, Enterprise Resource Planning Systems and Geographic Information systems and Outage Management Systems to a single system. Four existing Call Centres will be consolidated to two and four existing Control Rooms will be consolidated to two. For the first four years $99.6 million in gross operating savings are projected. Beginning in year five, annual gross operating savings of $42.5 million are projected. This level of annual savings is projected to continue post rebasing deferral period.

- Non payroll reductions first 10 tears is ($42 million net of transition costs). Gross payroll savings over the ten year period is $306.9 million ($270 million net of transition costs). The savings result from

[8] B-6-1 Page 2
[9] B-Staff-3
[10] B-AMPCO-4 (b)
[11] B-Staff-1(b)

redundant positions largely in administration and back-office functions.[12]

- The total number of vacancies of the four parties at December 31, 2015 is 94. Approximately half of the vacancies will be mapped to the 98 forecast FTE reduction in year one. Some of the vacancies have been vacant for more than six months in anticipation of the merger. Significant savings pre-merger are generated from these vacant positions to the benefit of shareholders.[13]

- Gross Capital Savings[14] are characterized as non poles and wires stuff[15] such as the integration of IT and Asset Management Systems, supply chain discounts and rationalization and other economies of scale such as better aligned contractor management strategies to reduce contractor costs. 76 % ($127.6 million) of the savings are expected to occur between years one and five. For years 6 to 10, annual capital savings of $8 million are projected. Synergies drop in year six as most IT related synergies have been realized. After the rebasing deferral period, gross capital savings of $8 million annually will be sustained.

- The Applicants identified the above potential operating and capital synergy savings internally and the Business Case for the consolidation assumes 100% of these savings are achieved. An external third party did not assist with the identification of synergies.

- The Applicants undertook a sensitivity to synergies analysis that looked at achieved synergies of 100%, 75% and 50% and the impact on shared net income and dividends. The Applicants did not include an analysis of achieved synergies at 125% even though “greater synergies than planned are achieved”, was identified as an opportunity.[16]

- In reviewing the evidence and through discussions at the oral hearing regarding potential efficiencies that were not included in the analysis, AMPCO is of the view that the Applicants estimation of both operating and capital synergies is conservative, and the more likely scenario is that greater than 100% of achieved synergies are achieved. AMPCO believes the forecast cost savings are underestimated by the Applicants which means that savings beyond $425.9 million over the deferred rebasing period if achieved will accrue to the benefit of shareholders, creating a greater imbalance compared to customer benefits.

---

[12] B-Staff-7
[13] B-AMPCO-6
[14] B-AMPCO-4
[15] Transcript Volume #1
[16] Attachment 2 Slide 11

- Additional potential operating synergy savings were identified that are not included in the business case as follows:

  - A possible future consolidation from two call centres to one call centre[17]
  - Fleet utilization analysis not considered; potential for further fleet savings
  - Access to additional resources improves response and restoration times, potential for savings over time
  - Savings from leasing available space[18]
  - Potential for water billing savings[19]

- With respect to capital synergies, the Applicants have not included any savings from distribution system capital in the synergy savings.[20] The evidence is that the Distribution System Plans (DSP) of the four utilities will be executed as they are now and the existing level of spending proposed for each LDC post merger is unchanged. A new DSP for LDC Co. is expected in 2019 but the Applicants don't see much of a shift in where the money will be spent. In addition, LDC Co. will be applying for an ICM in each year and the Business Case for the consolidation includes this assumption. AMPCO considers this approach to be a difficult proposition to accept. AMPCO would expect that through an analysis of each of the capital planning approaches and system conditions in each of the four independent utilities, combined with Industry Best Practices, capital synergies will be found and overall capital spending will be reduced.

- As part of the Business Plan for the merger, Vanry + Associates (Vanry) (Appendix 9B) performed a review of the asset condition assessments and capital investment planning process to determine the health of the electrical distribution assets. Specifically, Vanry undertook a review of the distribution assets that are expected to require repair or replacement post merger including cable rehabilitation, pole replacement and transformer replacement programs.

- One of Vanry's key conclusions is that certain approaches among the LDCs are sufficiently different that combining the four could lead to the potential for reductions in overall spending. There is also a distinct possibility that a merged LDC could lead to the overall capital investment program being redistributed among the respective systems in proportions that are different than the current allocations. This is due in part from different assessments of criticality and in part recognition of the current variations in system performance and failure rates among the LDCs. A merged entity would

[17] B-Staff-5
[18] Transcript Volume 3 Page 21
[19] Transcript Volume 3 Page 121
[20] Transcript Volume 3 Page 62

expect to see funding flowing to the areas of greatest value, or greatest risk potential.[21]

- In response to B-AMPCO-6(b), the Applicants provided the percentage of assets by asset type that are in very poor or poor condition. For all LDCs, underground cable had the highest percentage of assets in these categories. Other high risk assets included wood poles, vault transformers, switches, switchgear and circuit breakers. AMPCO submits it is reasonable to expect that LDC Co., in its next DSP, should evaluate the range of need among the four distribution systems and flow spending to the portions of the combined system with the greatest need and highest risks.

- AMPCO supports Vanry's analysis and submits that it is more reasonable to conclude that the range of need among the four distribution systems varies sufficiently that spending might better flow to the portions of the combined system with the greatest need compared to the status quo. AMPCO submits there are improvement opportunities regarding DSP capital spending that LDC Co. has not included in its analysis.

- Also PowerStream has a capital pole refurbishment program, where poles are refurbished instead of replaced to restore expected service life and the potential cost savings for 30 poles is estimated to be $285,000 per year, as well as a cable injection program where the cost is less than 10% of the cost of cable replacement.[22] The potential savings achieved from rolling these programs across the other three utilities are not included in the projected capital savings.

- AMPCO submits it has provided a few examples of areas where the savings have been understated relevant to what could reasonably be expected to happen.

- Although the amount of potential additional operating and capital synergies has not been quantified in evidence, the underlying point is that additional cost savings have been identified that are not included in the synergy savings over the deferred rebasing period and the more likely scenario is that more efficiencies will be achieved than projected and more savings will accrue to the benefit of the shareholder. The Applicants confirm that there may be an element of conservatism in the forecast.[23]

Incremental Capital Module (ICM)

- To encourage consolidation, the 2015 Board Report extended the availability of the ICM for consolidating distributors. During the rebasing deferral period, LDC Co may apply for rate adjustments using the Board's ICM as may be necessary and in accordance with applicable Board

[21] Appendix B Page 4
[22] Transcript Volume 3 Pages 119, 120
[23] Transcript Volume 3 Page 46

policies with respect to eligibility for, and the use of, the ICM.

- The Applicants expect to file an ICM in each year by rate zone for each rate zone under Price Cap IR during the deferred rebasing period. On this basis the aggregate ICM revenue included in the business case for years one through ten is $130 million. The Applicants identified an additional $38.54 million of incremental ICM revenue as a result of the Board's PowerStream Decision (EB-2015-0003) and the use of a 10% deadband for a total updated ICM revenue projection of $168.4 million. The total incremental capital sought through the ICM is $414.2 million, plus an additional $173.5 million of incremental capital as a result of the PowerStream Decision and the use of a 10% deadband for a total of $587.7.[24]

- The Board is not approving ICM amounts in this application and the ICM projections are not informed by a new DSP for LDC Co. Any incremental increases in the ICM projections negatively impacts the projected annual savings for customers.

Issue 3.
If the applicants have identified a deferred rebasing period greater than five years, have they identified an Earnings Sharing Mechanism (ESM), and does it follow the form set out in the OEB's 2015 Report – Rate-Making Associated with Distributor Consolidation and the OEB's 2016 Handbook to Electricity Distributor and Transmitter Consolidations?

Issue 4.
Does the ESM, as defined in the application, achieve the objective of protecting customer interests during the deferred rebasing period?

Earnings Sharing Mechanism (ESM)

- Consolidating entities that propose to defer rebasing beyond five years must implement an ESM for the period beyond five years. Earnings will be assessed each year once audited financial results are available.[25]

- The Applicants propose an Earnings Sharing Mechanism in years six to ten that is consistent with the ESM set out in the Board's 2015 Report. An ESM would be triggered if LDC Co.'s regulatory adjusted ROE is greater than 300 basis points above the allowed ROE and will be based on a 50:50 sharing of excess earnings with consumers.[26]

---

[24] JTC1.8, J1.1
[25] Report of the Board: Rate-Making Associated with Distributor Consolidation, March 26, 2015, Page 6
[26] B-T7-S2

- The Board notes in its Consolidations Handbook that the ESM as set out in the 2015 Report may not achieve the intended objective of customer protection for all types of consolidation proposals. There are numerous types and structures of consolidation transactions and there can be significant differences between utilities involved in a transaction. For these cases applicants are invited to propose an ESM that better achieves the objective of protecting customer interests during the deferred rebasing period.[27] This guidance is provided in the Board's handbook which outlines the process for review of an application, the information the Board expects to receive in support of an application and the approach it will take in assessing the merits of the consolidation in meeting the public interest.[28]

- The ESM is designed to protect customers and ensure that they share in any increased benefits from consolidation during the deferred rebasing period. As discussed above, AMPCO is of the view that the Applicants have understated the potential benefits and a scenario where greater than 100% of the synergies are achieved is a more likely scenario. The amount of additional savings before an ESM is triggered is substantial[29]; average beyond $40 million per year. The Applicant does not anticipate that an ESM will be triggered in years six to ten which means that customers will not see any of the synergy savings until year 11. The analysis is not showing that LDC Co. will be above 300 basis points, above the regulated return.[30]

- AMPCO submits that the Applicant's ESM proposal may meet the technical requirements of the 2015 Report but does not meet the intent of the Report or respond to the unique circumstances of this consolidation. AMPCO submits the forecast $426 million accumulated savings achieved over a potential ten year period is seen by customers as a windfall for shareholders. The design of the Applicant's ESM is such that the value of 300 basis points of ROE for LDC Co. is approximately $40 million per year that will accrue to the shareholder before the ESM is triggered[31]; over $400 million over ten years AMPCO submits the standard ESM proposed by the Applicants does not achieve the objective of consumer protection.

- If the Board approves a ten year rebasing period for LDC Co., AMPCO submits that the Board should consider requiring an ESM where savings are shared with customers earlier than year six, i.e. ideally when the transaction costs have been recovered; and the deadband of 300 basis points is removed.

[27] Handbook to Electricity Distributor and Transmitter Consolidations and Filing Requirements for Consolidation Applications Page 16
[28] Handbook to Electricity Distributor and Transmitter Consolidations and Filing Requirements for Consolidation Applications Page 1
[29] B-CCC-22
[30] Transcript Volume Page 149
[31] B-CCC-22

AMPCO submits the Applicants proposed ESM structure does not achieve the objective to protect the interests of customers.

Reliability and Quality of Electricity Service

Issue 5.
Does the proposed consolidation protect the interests of consumers with respect to adequacy, reliability, and quality of electricity service?

- In considering whether the no harm test has been met regarding the reliability and quality of electricity service, the Board will be informed by the reliability and quality metrics reported to the Board on an annual basis. The Applicant provided metrics for the years 2012 to 2015 for each of the four utilities. The Applicants have not yet determined how new reliability targets will be set and evaluated for LDC Co. and have not committed to any specific targets over the deferred rebasing period and beyond.[32]

- The Board's Handbook[33] provides guidance to applicants and stakeholders on applications. The Handbook indicates under the Board's RRFE, utilities are expected to deliver continuous improvement for both reliability and service quality performance to benefit customers. The Board noted that continuous improvement will be demonstrated by a distributor's ability to deliver improved reliability without an increase in costs, or to maintain the same level of performance at a reduced cost. The continuous improvement is expected to continue after a consolidation and will be closely monitored for the consolidated entity under the same established requirements.[34]

- The Applicant's evidence is that a larger utility will have an expanded ability to monitor, report and improve system reliability and power quality in part due to more access to resources. However, the Applicants have not made a firm commitment that reliability will improve over the deferred rebasing period as a result of the transaction. The Applicants have committed to maintaining reliability over the deferred rebasing period as a result of the transaction.

- AMPCO submits that based on the evidence, LDC Co. can reasonably be expected to maintain service quality and reliability standards. Reliability and service quality will not deteriorate as a result of the consolidation. However, given the level of proposed capital spending over ten years identified

[32] B-BOMA-6
[33] Handbook to Electricity Distributor and Transmitter Consolidations and Filing Requirements for Consolidation Applications
[34] [34] Handbook to Electricity Distributor and Transmitter Consolidations and Filing Requirements for Consolidation Applications Page 7

in this application, AMPCO submits a forecast of improved reliability over time would be a better proposition for customers to accept.