ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sch.B, as amended;

AND IN THE MATTER OF an Application for the relief necessary to effect the consolidation of Enersource Hydro Mississauga Inc., Horizon Utilities Corporation, PowerStream Inc. and Hydro One Brampton Networks Inc. into an entity referred to in the Application as "LDC Co", in the manner set out in the Application.

FINAL ARGUMENT OF THE SCHOOL ENERGY COALITION

October 10, 2016

JAY SHEPHERD PROFESSIONAL CORP.
2200 Yonge Street, Suite 1302
Toronto, Ontario M4S 2C6

Jay Shepherd
Mark Rubenstein

Tel: 416-483-3300
Fax: 416-483-3305
jay.shepherd@canadianenergylawyers.com
mark.rubenstein@canadianenergylawyers.com

Counsel for the School Energy Coalition

TABLE OF CONTENTS

1 GENERAL COMMENTS

1.1 *Introduction*

1.1.1 On April 18, 2016 the Applicants PowerStream Inc., Enersource Hydro Mississauga Inc, and Horizon Utilities Corporation filed an Application for the approval of the merger of the Applicants, the acquisition of and merger with Hydro One Brampton Inc, (collectively, with the three Applicants, the "Merging LDCs"), and related relief. This is the largest merger of LDCs in Ontario history, and if approved will create the second largest distribution utility in Ontario, having a combined revenue of a billion dollars a year, and an initial combined asset base in excess of two and a half billion dollars book value, and close to four billion dollars in fair market value. Almost one million customers will be affected by the proposed transactions.

1.1.2 As important as the outcomes for those customers directly affected are, and will be, the transaction is also important as the effective launch of a new series of distribution consolidation transactions under a newly-modified Board policy on consolidation, so the Board's approval, and its rationale for each aspect of that approval, will affect distribution customers across the province.

1.1.3 The Applicants' Argument-in-Chief was presented orally on September 26, 2016. This is the Final Argument of the School Energy Coalition.

1.1.4 The ratepayer groups who intervened in this proceeding have worked together throughout the hearing to avoid duplication. We have been assisted in preparing this Final Argument by that co-operation amongst parties.

1.1.5 We have not made submissions on every issue on the Issues List. In a number of cases, we have elected to focus our resources on some areas, and not develop positions on issues, including some that have material impacts. Silence on any issue should not lead to any inference of a position on that issue.

1.1.6 The numbering of Sections and Subsections in this Final Argument is not consistent with the numbering in the Issues List, as the issues that arose in the course of the proceeding and in the development of this Final Argument made a different logical structure necessary.

1.2 *Summary of Submissions*

1.2.1 The issues in this case can be divided loosely into three categories. Each invokes a different statutory jurisdiction, and each has its own legal requirements:

(a) Approval (or not) of the proposed mergers, including any conditions protecting the affected ratepayers from harm that may come to them, if any, as a result of the proposed transactions.

(b) Licensing of a new distributor.

(c) Approval of just and reasonable rates for that new distributor.

1.2.2 ***Approval of the Merger of the Merging LDCs.*** SEC is not opposed to the merger of the three Applicants, nor the acquisition of Brampton and its merger into what is currently being called LDC Co. It is always possible after the fact to look at a deal and find ways it could have been better. However, we agree with the Board's longstanding policy that it is not the Board's role to second-guess whether the proposed transactions are the best possible transactions. The Board's statutory role is to consider whether to approve the transactions proposed by the parties.

1.2.3 ***Protecting the Customers from Harm.*** There are basically two ways that the Board can protect customers from harm while approving a merger:

(a) Impose conditions that restrict the actions of the merged entity where potential harm can be identified at the outset, and conditions can prevent that harm from actually arising.

(b) Establish reporting and similar requirements that provide visibility to the Board, and transparency to ratepayers, to deal with harms that cannot be identified at the outset.

1.2.4 The Board has a policy to deal with protecting customers from harm in mergers[1]. As with any policy, individual Board panels are required to assess whether it is appropriately applied in the current case. That assessment must apply the public interest as delineated in the Board's objectives in section 1 of the Act.

1.2.5 SEC submits that, consistent with the policy, the Board can approve the proposed transactions with the conditions and reporting requirements discussed later in this Final Argument to protect ratepayers from harm:

1.2.6 ***Just and Reasonable Rates.*** The Board is exercising three jurisdictions in this proceeding. It has jurisdiction under section 86 of the Act to approve (or not) MAADs transactions. That is where the "no harm" test comes in. It has jurisdiction under section 60 of the Act to license distributors, which may also in practice invoke the "no harm" test. And, it has jurisdiction under section 78(3) to approve just and reasonable rates for the distribution of electricity.

---

[1] The Board's policy on distributor consolidation is set out in a number of policy documents and Board decisions, but is conveniently consolidated into one document, the January 19, 2016 "Handbook to Electricity Distributor and Transmitter Consolidations" (the "Handbook"). For convenience, in this Final Argument when we refer to the Board's consolidation policy, we are referring to the Handbook unless expressly stated otherwise.

1.2.7 The Handbook sets out a set of rate results and procedures that are applicable if that policy is applied to the rates of the affected distributor or distributors going forward. Again, the Board is required to determine if (or to what extent) the policy should be applied on the facts of the current case. The legal test for doing so is whether the resulting rates will be just and reasonable.

1.2.8 SEC notes that neither the Handbook, nor the updated policy document on which it is based[2], refer to just and reasonable rates, and this raises a question of whether the Board's policy has properly considered the statutory requirements in establishing the policy.

1.2.9 SEC submits that neither the Handbook, nor the policy on which it is based, can be applied unmodified to the current situation, because the resulting rates would not be just and reasonable.

1.2.10 Specifically, SEC submits that application of the policy unmodified would result in LDC Co. exacting monopoly rents from the customers, unprotected by the regulatory process. SEC believes that the Board must consider the costs and benefits of the transactions, and make a determination as to an equitable sharing of the benefits of the transactions between shareholders and customers.

1.2.11 In our submission, of the various methods the Board could use to ensure that rates for LDC Co. are just and reasonable, the simplest and most effective approach is to reduce rates for all LDC Co. customers, effective January 1, 2017, by 3.6%.

[2] "Ratemaking Associated with Distributor Consolidation", March 26, 2015 (the "Ratemaking Policy").

2 JURISDICTION

2.1 *Introduction*

2.1.1 The Applicants are seeking the following eight approvals[3]:

> *"(a) leave for Enersource Holdings Inc. to acquire all of the issued and outstanding shares of Enersource pursuant to Section 86(2)(a) of the OEB Act;*
>
> *(b) leave for Enersource, Horizon Utilities and PowerStream to amalgamate and continue as a corporation referred to as LDC Co, pursuant to Section 86(1)(c) of the OEB Act;*
>
> *(c) leave for LDC Co to acquire all of the issued and outstanding shares of HOBNI pursuant to Section 86(2)(b) of the OEB Act;*
>
> *(d) leave for HOBNI to transfer its distribution system to LDC Co pursuant to Section 86(1)(a) of the OEB Act;*
>
> *(e) leave for LDC Co and HOBNI to amalgamate 1 and continue as LDC Co, pursuant to Section 86(1)(c) of the OEB Act;*
>
> *(f) leave for Enersource, Horizon Utilities, PowerStream and HOBNI to transfer their distribution licences and rate orders to LDC Co, pursuant to Section 18 of the OEB Act;*
>
> *(g) leave for LDC Co to acquire the 50% of the shares of Collus PowerStream Utility Services Corp. currently owned by PowerStream, pursuant to Section 86(2)(a) of the OEB Act.;*
>
> *(h) the issuance of a new electricity distribution licence for LDC Co under Section 60 of the OEB Act that will come into existence on the completion of the transfers of the distribution-related assets of the former Enersource, Horizon Utilities, PowerStream and HOBNI to LDC Co, to be followed immediately by the cancellation of the distribution licences of **E**nersource, Horizon Utilities, PowerStream and HOBNI."*

2.1.2 To deal with those approvals, the Board is exercising three distinct statutory jurisdictions:

[3] As set out in Ex.B/2/1, pp.8-9, updated September 16, 2016.

(a) For the approvals listed in (a) – (e), plus (g), the Board is exercising its jurisdiction to approve changes in ownership of distribution systems under section 86 of the Act.

(b) For the approvals listed in the first part of (f), plus (h), the Board is exercising its jurisdiction to license distributors of electricity under section 60 of the Act.

(c) For the approval in the second part of (f), the Board is exercising its jurisdiction to set just and reasonable rates under section 78 of the Act.

2.1.3 The legal requirements for each of these statutory mandates are different, but they do share a common set of factors that the Board is required by law to consider. Those are the objectives set out in Section 1(1) of the Act, particularly the following[4]:

> *"1. (1) The Board, in carrying out its responsibilities under this or any other Act in relation to electricity, shall be guided by the following objectives:*
>
> > *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."*

2.1.4 In this section of our Final Argument, SEC will set out the legal requirements that apply to each of the approvals being sought by the Applicants. As will be seen in our later discussion of the specifics of the Application, it is the legal requirements that ultimately drive our submissions on the appropriate Board decision.

2.2 ***Transactional Jurisdiction***

2.2.1 The Board is given the responsibility to consider, and approve or reject, changes in the ownership of distribution systems, or of companies that own distribution systems directly or indirectly, under section 86 of the Act, as follows[5]:

> *"86. (1) No transmitter or distributor, without first obtaining from the Board an order granting leave, shall,*

---

[4] Act, s. 1(1).
[5] Act, Sections 86(1),(1.1), (2), and (6).

> > *(a) sell, lease or otherwise dispose of its transmission or distribution system as an entirety or substantially as an entirety;*
> >
> > *(b) sell, lease or otherwise dispose of that part of its transmission or distribution system that is necessary in serving the public; or*
> >
> > *(c) amalgamate with any other corporation. 2003, c. 3, s. 55 (1).*
>
> *(1.1) Subsection (1) does not apply with respect to a disposition of securities of a transmitter or distributor or of a corporation that owns securities in a transmitter or distributor. 2002, c. 1, Sched. B, s. 9 (1).*
>
> *(2) No person, without first obtaining an order from the Board granting leave, shall,*
>
> > *(a) acquire such number of voting securities of a transmitter or distributor that together with voting securities already held by such person and one or more affiliates or associates of that person, will in the aggregate exceed 10 per cent of the voting securities of the transmitter or distributor; or*
> >
> > *(b) acquire control of any corporation that holds, directly or indirectly, more than 10 per cent of the voting securities of a transmitter or distributor if such voting securities constitute a significant asset of that corporation. 1998, c. 15, Sched. B, s. 86 (2); 2015, c. 29, s. 15 (1, 2).*
>
> *(6) An application for leave under this section shall be made to the Board, which shall grant or refuse leave. 1998, c. 15, Sched. B, s. 86 (6)."*

2.2.2 As with most other jurisdictions conferred in the Act, it has two parts. First, in (1) and (2) regulated entities are prohibited from doing certain actions without approval. This by itself does not technically confer jurisdiction. A further provision, in this case (6), gives the Board the responsibility and jurisdiction to grant or refuse leave.

2.2.3 The Handbook, following a number of decisions of Board panels, confirms the "no harm" test as the test for determining whether the Board will grant or refuse leave under Section 86.

2.2.4 However, it should be noted that the "no harm" test is an interpretation by the Board of its legal responsibilities under the Act. The Act, as interpreted by the courts, is still the overriding law when it comes to exercising this jurisdiction. In this case, it appears to be settled law that the overall test is the public interest[6], and that the public interest is

---

[6] *Graywood Investments Ltd. v. Ontario Energy Board*, [2005] O.J. No. 345, at para 34; *Toronto Hydro-Electric System Limited v. Ontario Energy Board*, 2010 ONCA 284, at para 35.

to be determined in the Board's judgment, consistent with the objectives set out in Section 1 of the Act[7].

2.2.5 Thus, it is fair to treat the "no harm" test as saying, in effect, "In most situations [because this is a policy, not a rule], the objectives of the Act are served and the public interest is best achieved if the Board grants approval for transactions that meet the "no harm" test, and refuses approval for transactions that do not meet that test".

2.2.6 There are many Board cases that deal with section 86, and many or most of them talk about the "no harm" test. Further, as Vice-Chair Quesnelle noted during the hearing, the no harm test is evolving to meet the needs of the sector, and to deal with new types of transactions.

2.2.7 As a matter of policy, and unless there is reason to think that the public interest would not be served by its application in this case, the "no harm" test is the Board's test to exercise its jurisdiction under Section 86, and therefore the test to be applied to the following approvals:

(a) The proposed transfers of shares under approvals (a), (c), and (g).

(b) The proposed transfer of the Brampton distribution system under approval (d).

(c) The proposed amalgamations under approvals (b) and (e).

2.2.8 SEC notes that exercise of the jurisdiction under Section 86 does not imply licensing or rates for the resulting entities. Section 86 only speaks to ownership. This is a critical distinction that is often lost by applicants and other parties in MAADs applications.

2.2.9 By way of example, if the Applicants had applied to amalgamate their holding companies only, but maintaining the distribution companies as separate legal entities, carrying on their distribution businesses as before under common ownership, there would have been no licensing or rates aspects of this case. While it is undoubtedly more sensible to merge the distribution entities, and there are a number of tax considerations making the approach proposed in this case the optimal one, this Application could have proceeded only under section 86, without bringing in the licensing or ratemaking jurisdictions of the Board. It did not.

2.2.10 We note further that the licensing and ratemaking jurisdictions cannot be said to conferred incidentally as a result of the section 86 jurisdiction. The Act specifically deals with the licensing and ratemaking powers of the Board elsewhere. It is trite law

[7] *Toronto Hydro-Electric System Limited v. Ontario (Energy Board)*, 2010 ONCA 284 at paras. 26, 29. *Advocacy Centre for Tenants-Ontario v. Ontario (Energy Board),* [2008] O.J. No. 1970 (Div. Ct)

that if a statute confers a jurisdiction directly, it cannot be interpreted as also conferring the same jurisdiction, or an included jurisdiction, collaterally in another section[8].

2.3 *Licensing Jurisdiction*

2.3.1 The Board's jurisdiction to license electricity distributors has a similar structure to the jurisdiction with respect to ownership. There is a prohibition in section 57 of the Act against anyone distributing electricity without being licensed by the Board. There is a further prohibition against transferring a distribution licence to a successor company without the approval of the Board, in section 18(2) of the Act. There is then a power conferred on the Board to grant licences, as follows[9]:

> *"60. (1) A person may apply to the Board for the issuance or renewal of a licence authorizing one or more of the activities referred to in section 57 as specified in the application. 1998, c. 15, 70.*
>
> *70. (1) A licence under this Part may prescribe the conditions under which a person may engage in an activity set out in section 57 and a licence may also contain such other conditions as are appropriate having regard to the objectives of the Board and the purposes of the Electricity Act, 1998. 1998, c. 15, Sched. B, s. 70 (1)."*

2.3.2 Whether the Board is approving the transfer of a licence, or the granting of a new licence, it is submitted that the same legal requirements apply. That is, the Board is making a determination whether the public interest would be served by the new owners, the proposed licensee, operating the distribution systems in question. In considering the public interest, the Board has regard to the objectives of the Board in section 1.

2.3.3 The section specifically contemplates that the Board will use the licensing power to regulate the behavior of persons granted a distribution monopoly, and section 70(2) contains an extensive list of categories of conditions the Board could impose. The application of the objectives is emphasized directly in the section. Further, while section 70 does not specifically refer to the public interest, that is implied. And, if there was any doubt, that is confirmed by section 74(1)(b), dealing with amendments to licences, which directs the Board to make amendments that it determines are in the public interest, again by reference to the Board's objectives in section 1.

2.3.4 The Handbook does not deal separately with the licensing aspect of consolidation transactions. Licensing appears to be considered as part of the consideration of the

---

[8] See *ATCO Gas & Pipelines Ltd. v. Alberta (Energy & Utilities Board),* 2006 SCC 4.
[9] Act sections 60, and 70(1) et seq.

section 86 approval, which clearly it is not[10].

2.3.5 It is submitted that the Board, in licensing any person to carry on a distribution business, must apply the same principles, whether that person is seeking a new licence for unserved territory, or is seeking the licensing of a successor company where there is one or more existing licensees. Those principles, logically, revolve around (a) whether the proposed licensee will be capable of serving the customers in the proposed monopoly area, and (b) the conditions required to protect the customers and ensure the viability of the licensee.

2.3.6 Those principles, we note, cannot simply be the "no harm" test. If a person shows up at the Board saying they want to build a new distribution system in an unserved area, the Board cannot simply say "Well, we see no harm in letting you do that." Indeed, the Board has never proposed that a pure "no harm" test is applicable to the fresh granting of a distribution licence.

2.3.7 That having been said, the practical realities are quite different when entities already distributing electricity, and well known to the Board, seek to have a new combined entity licensed. In those circumstances, it is likely in almost every case that the applicants meet all tests to be licensed (because they are in fact licensed), and the only thing the Board has to look at is whether, as a result of the proposed consolidation transactions, the combined entity <u>ceases</u> to meet the tests to be licensed.

2.3.8 By way of example, the Board could conclude that the applicants in a given case had struggled to finance the proper renewal of their existing distribution systems, and in combination their ability to find necessary financing would be even worse. In such a case, the Board could require proof of a viable financing plan before licensing a merged entity. Since this would almost certainly mean that the section 86 approval would be denied, for all practical purposes the licensing jurisdiction would be exercised using the "no harm" test. It is possible to think of many examples where a particular distributor combination would be a bad idea, and the Board would decline to license the combined entity at the same time, or for the same reasons, as it declined to approve the merger.

2.3.9 Thus, while the licensing jurisdiction of the Board is significantly different from the section 86 jurisdiction, licensing in the context of a section 86 application is likely part of the same approval process and logic. In this respect, it is likely that the most important aspect of the licensing jurisdiction in the section 86 context is the express ability for the Board to regulate behavior through license conditions.

2.3.10 SEC submits that this approach – essentially the "no harm" test, but looked at through

---

[10] The Handbook in fact contains an Appendix with the relevant statutory provisions, which inexplicably fails to include either the statutory requirements for licensing, or for rate-making.

a different lens – describes the statutory requirement for consideration of the requested approvals in the first part of (f), and in (h). While these approvals are about licensing the entity, not ownership of the entity, in the context of a MAADs application they have a similar logic under the Act.

2.4 ***Rates Jurisdiction***

2.4.1 This case also invokes the Board's ratemaking jurisdiction. Like the others, that jurisdiction starts with a prohibition against persons charging for electricity distribution except in accordance with rates approved by the Board. Then, the Board is given the power to establish "just and reasonable rates". The relevant provisions are the following[11]:

> *"78. (2) No distributor shall charge for the distribution of electricity or for meeting its obligations under section 29 of the Electricity Act, 1998 except in accordance with an order of the Board, which is not bound by the terms of any contract. 2000, c. 26, Sched. D, s. 2 (7).*
>
> *(3) The Board may make orders approving or fixing just and reasonable rates for the transmitting or distributing of electricity or such other activity as may be prescribed and for the retailing of electricity in order to meet a distributor's obligations under section 29 of the Electricity Act, 1998. 2009, c. 12, Sched. D, s. 12 (1).*
>
> *(7) Upon an application for an order approving or fixing rates, the Board may, if it is not satisfied that the rates applied for are just and reasonable, fix such other rates as it finds to be just and reasonable. 1998, c. 15, Sched. B, s. 78 (7).*

2.4.2 Section 78(2) is the basic prohibition. The Act supports that with section 18(1), which prohibits the transfer of rate orders to a successor company without Board approval. Neither technically confers jurisdiction on the Board. These sections prevent utilities and others from doing things. If there were no section 78(3), perhaps they could be interpreted as implying a jurisdiction, but that is not the case here. The jurisdiction is explicit, not implied.

2.4.3 Section 78(3) then confers jurisdiction on the Board to make rate orders. It should be noted that the provision is permissive. The Board is not required to make orders. However, the requirement of "just and reasonable" is not permissive. It is mandatory. The only rate orders the Board is allowed to make are those orders that are just and reasonable. Again, if there was any doubt about that, subsection (7) makes clear that the Board can order rates other than those requested by an applicant, but only if it finds

[11] Act, sections 78(2), (3), (7)

the proposed rates to be not just and reasonable, and only if the rates the Board prefers are just and reasonable.

2.4.4 In short, the Board's ratemaking jurisdiction is clearly circumscribed. The Board can only permit/order licensees to charge just and reasonable rates. The Board is never in a position where it can make a rate order without considering whether the rates it is ordering are just and reasonable.

2.4.5 There is, of course, a substantial body of law on what constitutes "just and reasonable" for the purposes of setting rates. The basic rule is that the applicant must be allowed an opportunity to recover its reasonable costs to provide the monopoly distribution service, including its reasonable cost of capital and a reasonable rate of return on its equity capital[12]. However, it is now accepted that this does not require annual consideration of cost of service. Use of other methods, such as incentive regulation mechanisms, are also allowed if they still seek to fairly balance the interests of the utility and its ratepayers, and prevent the utility from charging monopoly rents[13].

2.4.6 It is important to note that the Board's obligation to ensure rates are just and reasonable only appears to arise at the point of making the order. If subsequent events make the rates too high or too low, those rates are still compliant with the Act. The Board may wish to use other powers to alter them[14]. However, for the period from the time the rate order is made, until the time it sees another application, or initiates a rate proceeding on its own motion, the Board can treat the rates as satisfying the Act as long as the evidence before the Board, at the time the order was made, allowed the Board to conclude that they would continue to be just and reasonable throughout the period to which they applied[15].

2.4.7 The application of Section 18(1) does not appear to have been considered by the courts. Section 18(1) says:

> *"18. (1) No authority given by the Board under this or any other Act shall be transferred or assigned without leave of the Board. 1998, c. 15, Sched. B, s. 18 (1)."*

---

[12] See for example: *Ontario (Energy Board) v. Ontario Power Generation Inc*., 2015 SCC 44, at para. 20.
[13] *Advocacy Centre for Tenants-Ontario v. Ontario (Energy Board)*, [2008] O.J. No. 7, 10, 28 1970 (Div. Ct) at para. 55.
[14] The combination of section 19(4) and 78(9) allows the Board to initiate a rate case without an application, but it is permissive. The Board does not appear to have an express obligation to monitor rates to ensure they remain just and reasonable over time. The Board's obligation is to ensure that they are just and reasonable at the time the Board makes an order. This would presumably include ensuring that and changes in the rates contemplated by the order continue to be just and reasonable based on the information known to the Board at the time the order is made.
[15] So, for example, if the Board allows rates in year 1, knowing that in years 2 through 5 a reasonable IRM mechanism will be applied, it can conclude that those rates will continue to be just and reasonable.

2.4.8 Section 18 goes on to talk about licences[16]. In the rate context, what it means is that a rate order only applies to the company for whom it was originally made. If a successor to the business, whether by acquisition of assets, or by amalgamation or other re-organization, wants to rely on the rate order, it must get a new order of the Board allowing them to do so.

2.4.9 The effect of this is that, when a successor company wants to charge rates for the distribution of electricity, it must get an order of the Board allowing it to do so (as required by section 78(2)). One way to get such an order is to get leave of the Board to transfer the rate order of one or more of the predecessor distributors[17].

2.4.10 However, whether an applicant gets a new rate order, or gets the transfer of a previous rate order, the legal requirements on the Board are clear. The Board cannot authorize a distributor to charge rates for the distribution of electricity that are not just and reasonable, and the Board is obligated to consider whether the proposed rates are just and reasonable in determining whether to issue a new rate order, or transfer existing rate orders, or both.

2.4.11 The Applicants will argue that the transfer of a rate order is an administrative act, like the transfer of a licence. Under that argument, unless there is reason to believe transferring the rate orders is a bad idea, like the licence situation, the Board can simply close its eyes and transfer the rate orders without considering whether the resulting rates are just and reasonable[18]. It is the application of the "no harm" test to rates.

2.4.12 With respect, SEC does not believe that is what the Act says. The Act is clear that no distributor can charge rates except under authority of an order of the Board. The Board can only make rate orders that are just and reasonable. A newly-created successor company has no current rates, and seeks an order allowing it to charge rates for electricity distribution. The Board is being asked to authorize the rates of the new company. No matter how the Board authorizes those rates, they are still rates, and they must be just and reasonable. The Board has broad authority in what it can consider in setting those rates, but it must reach the conclusion that they are just and reasonable, or it is legally prohibited from making the rate order.

2.4.13 This withstands the common sense test as well. The Board's central responsibility is

[16] This is supported by sections 86(6.1) and (6.2), which ensure that the normal legal results of a corporate amalgamation are void if the Board has not approved the transaction. This prevents the rate orders from flowing by operation of law to a successor.
[17] The Applicants in this proceeding say explicitly that they are proposing that the rates of the newly-licensed LDC Co. would be set for the first time by transfer of the existing rate orders from the Merging LDCs: Tr.2:60.
[18] It is at least arguable that the Handbook also assumes this theory, since the Handbook does not even refer to "just and reasonable" rates in the context of discussing rates after consolidation. Further, as noted earlier the Handbook does not include the ratemaking sections of the Act in the relevant statutory provisions in its Schedule 1.

to regulate the rates of monopolies, acting as a market proxy to ensure that utilities cannot charge monopoly rents[19]. The role is protection of the consumer in a monopoly environment. The Act delivers that responsibility through the requirement that all rates ordered by the Board must be just and reasonable.

2.4.14 There is no doubt that the Legislature could have said "Oh, but here's an exception to the just and reasonable rule. We believe so much in distributor consolidation that we don't think rates have to be just and reasonable after a consolidation." The Legislature didn't say that, and it is not reasonable to read into the Act an exception to the just and reasonable rule in this category of cases in the absence of an express exception established by the Legislature. Legislators don't make exceptions to a regulator's central responsibility by implication. They say so straight out. Which they didn't here.

2.4.15 The Applicants rely on the Handbook, and the Ratemaking Policy on which it is based, to allow them to keep existing rates, and monopoly rents, for a period of up to ten years. Their position is that they are following the policy, and the customers do not get any benefit from the consolidation (except for savings compared to an unreasonable straw man) until year 11. In the meantime, the only test applicable to any part of a consolidation is the "no harm" test.

2.4.16 There are two ways to look at this.

2.4.17 The first possibility is that the Handbook and the Ratemaking Policy are simply wrong. By not expressly considering the obligation to make rates just and reasonable, they fail to consider a key imperative in the Act, and thus cannot be correct. There is merit in this argument. The Handbook and policy appear to treat rates as being irrelevant in all consolidation transactions, except to the extent that they can be used as an incentive for distributors to consolidate. The fact that the Handbook never refers to the just and reasonable test is evidence that it is inconsistent with the requirements of the Act.

2.4.18 The one argument against this is the inclusion of the ESM. Arguably, the ESM prevents the charging of unrestricted monopoly rents by putting a soft cap on the windfall to the shareholders of the distributors. The problem with this argument, as seen in this case, is that the amount of excess profits required to make the 300 basis point ESM kick in is so high that there are no realistic circumstances in which it will apply. Thus, it protects no-one.

2.4.19 The second possibility is that the Ratemaking Policy was written with a certain type of transaction in mind, and did not contemplate the ratio of costs to benefits in a

---

[19] *Ontario (Energy Board) v. Ontario Power Generation Inc*., 2015 SCC 44 at para. 11, 120; *Toronto Hydro-Electric System Ltd. v. Ontario (Energy Board*), 2010 ONCA 284, at para. 48.

transaction such as the ones in this proceeding. That is, the policy internalizes the rule that policies are for guidance only, and where the result of application of the policy would not result in just and reasonable rates, the Board panel adjudicating the case will simply not apply it.

2.4.20 This interpretation is supported by the following wording in the Ratemaking Policy[20]:

> *"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. Distributors expressed the view that the risk for shareholders of not recovering transaction costs is a significant impediment to consolidation.*
>
> *Distributors explained 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. Distributors indicated that given 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 to four years. Therefore, 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.*
>
> *Distributors therefore 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.*
>
> *Representatives of consumers expressed the view that savings that result from a MAADs transaction should be shared equitably between the distributor's ratepayers and the distributors' shareholders. There are concerns that extending the deferral period will provide an opportunity for shareholders to retain more savings than those necessary to recover costs, which may result in a windfall for shareholders at the expanse of ratepayers. Ratepayer representatives suggested that for the rebasing to be deferred, other benefits for consumers would need to be provided, either in the form of new services or, of a certainty of savings that would continue after the rebasing."*

2.4.21 The Handbook then describes how the new ratemaking policy responds to those

[20] Ratemaking Policy, p. 5-6.

concerns, and why[21]:

> *"Incremental transaction and integration costs are not generally recoverable through rates. Distributors have indicated that these costs are significant and that recovery of these costs can be a barrier to consolidation. To address distributors' concerns, the OEB issued a report on March 26, 2015 titled "Rate-making Associated with Distributor Consolidation" (2015 Report). In this report, the OEB has provided the opportunity for distributors to defer rebasing for a period up to ten years following the closing of a consolidation transaction. <u>This 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</u>."[emphasis added]*

2.4.22 By setting out the purpose of the deferred rebasing, the Handbook ties the deferral period to the recovery of the transaction costs. In this interpretation, therefore, the Board panel assesses on each application the length of deferral period that is appropriate to recover the transaction costs and provide a reasonable incentive for the shareholders of the consolidating utilities[22].

2.4.23 It is not obvious which approach to the Handbook and Ratemaking Policy is more appropriate. On the one hand, the Handbook simply ignores the Board's ratemaking obligations under the Act, not even referring to them as being relevant statutory provisions. This would support the view that the policy is wrong and should be rejected. On the other hand, the Handbook makes clear that the deferral of rebasing is to recover transaction costs, thus guiding Board panels to make that connection in their decision.

2.4.24 SEC submits that this Board panel should follow the requirements of the Act on the rates for the Applicants after completion of the proposed transactions. Whether that means rejecting the provisions of the Handbook in general, or only their application to the transactions in this case, the result should be that the Board must engage its jurisdiction to set just and reasonable rates. It cannot, in our submission, ignore the evidence in this case that reflects whether rates going forward will be just and reasonable.

2.4.25 We note that considering whether rates are just and reasonable is not the same as engaging in a full cost of service review. In a MAADs application, there is usually extensive information on cost savings, including sources and amounts of savings. There is also usually information on transaction costs. Such evidence, while obviously

[21] Handbook, p. 8-9.
[22] While the Handbook stipulates that applicants do not have to justify their choice of deferral period, in fact there is usually, as here, evidence on the record allowing the Board to determine whether the deferral period results in just and reasonable rates. The Handbook appears to be ambiguous on this.

subject to testing and to the Board's judgment on what they will believe, can form the basis for determining rates going forward, as is the case here.

2.4.26 We also note that, to be just and reasonable, rates do not have to deliver all of the synergies to the customers. The goal of incenting distributors to consolidate may require that their shareholders get additional benefits. However, the incentive must be reasonable. An incentive policy that does not tie the size of the incentive into the amount needed to incent the behavior, does not consider reasonable sharing of consolidation benefits, and mandates no consideration of the reasonableness of rates charged to customers, cannot be said to comply with the just and reasonable standard.

2.4.27 SEC therefore submits that, if this Board panel approves these transactions, it is required as a matter of law to establish just and reasonable rates going forward, with due consideration given to reasonable incentives to the consolidating distributors, and due consideration given to a fair and equitable division of the benefits of consolidation.

2.5 ***Conclusion***

2.5.1 SEC believes that these Applicants, and applicants in past MAADs cases, have failed to distinguish between the three statutory jurisdictions that can be engaged when the Board receives a MAADs application. While the ownership and licensing jurisdictions work quite well (although for different reasons) with the "no harm" test, the Board's ratemaking jurisdiction is clear and uncompromising. The "no harm" test does not and cannot apply to that aspect of the Application. Just and reasonable is the only test that the statute allows for rates.

2.5.2 As a result, SEC submits that the Board in this proceeding should consider whether the rates to be charged to customers by LDC Co. after the proposed transactions will be just and reasonable, in light of the desire to incent distributors to consolidate, and after considering a fair division of the benefits of consolidation between customers and shareholders.

3 THE NO HARM TEST – TRANSACTIONS

3.1 *Introduction*

3.1.1 The Applicants propose a series of asset and share purchases, and then two amalgamations, to achieve the result that four separate distributors, each with separate ownership, become one distributor, with the owners of three of the four predecessor distributors as the owners of the new distributor, LDC Co., in roughly the same proportions relative to each other as they hold today.

3.1.2 Nothing appears to turn on the details of the steps proposed. The one unusual element is a fair market value bump under section 88 of the Income Tax Act, which will allow the premium paid for Brampton to be deducted by LDC Co, for tax purposes as part of the capital cost allowance or adjusted cost base of the Brampton distribution assets. This reduces the net cost of the premium by $2.8 million per year over 25 years[23], essentially by paying less PILs to the provincial government over time. One could argue that the cost to the provincial treasury is contrary to the public interest, but the technique is specifically allowed in the Income Tax Act, and presumably the government considered this tax impact in allowing the sale of Brampton for the price negotiated. SEC thus has no submissions on this aspect of the transactions.

3.1.3 The Applicants have also put the Board and parties on notice that they plan to turn LDC Co, into a partnership of some type, and provided quite detailed information[24] on the plan to do so. Ostensibly, the purpose of the partnership structure, is to allow new financiers to provide funds to the distributor in a tax-efficient manner. However, as was revealed in cross-examination, the structure is also designed for other purposes.

3.1.4 Notwithstanding the unusual nature of the partnership structure, and its effects, SEC has no comments on it at this time. We accept the evidence of the Applicants that if they propose to proceed with the partnership structure, that will be a separate application sometime in the future (i.e. after this application has been decided), and all issues will be open for debate. That is, the fact that it has been disclosed to the Board in this Application does not in any way limit the scope of the future application to approve the partnership structure.

3.1.5 On that basis, SEC submits that the Board should confirm that lack of limitation in its decision in this matter, but otherwise SEC has no submissions on the partnership structure planned.

3.1.6 SEC therefore agrees that the steps in the process, and the structure and ownership of

[23] Tr.1:167.
[24] J1.2, Schedule D and Appendix A.

LDC Co. in this Application, satisfy the "no harm" test, and satisfy the requirements of the Act with respect to the applicable parts of Section 86 and the Board's objectives, subject to our comments below.

3.2 ***The Customers of the Applicants***

3.2.1 Subject to our later comments on rates, SEC has no concerns about the customers of Powerstream, Enersource, and Horizon as customers of LDC Co. The change of ownership should, ultimately, benefit those customers.

3.2.2 We reach that conclusion in part because of the success, over the last more than a decade, that Powerstream and Horizon have had in delivering operating and capital synergies and other cost efficiencies for their customers through past consolidation transactions. In some respects, those two companies are models for how distributor consolidation can create win-win results, just as the government policy in this area expects. We expect that Enersource and Brampton will benefit from that experience.

3.2.3 We also note the evidence[25] that the shareholders of the Applicants have been active in protecting the interests of their local constituents, comprising the bulk of the customers of the three Applicants. The requirements to maintain offices and service centres in the local areas of the Applicants, and the stipulation of the organizational structure, all together with the inability of the Board of Directors to make many changes without shareholder approval, ensure some level of protection of customers in those franchise areas.

3.2.4 We are concerned that the level of shareholder involvement in decision-making may prevent the Applicants from realizing the full level of efficiencies and benefits from the transactions. However, in our view it is not for the Board to stipulate how LDCs make decisions. The Board regulates results/outcomes, and in this case there is no evidence that the potential for inefficient future decisions will in fact be realized through shareholder involvement. If and when there are results/outcomes that are contrary to the Board's objectives, then, assuming appropriate reporting and transparency, the Board will be in a position to identify them, and act accordingly.

3.3 ***The Customers of Hydro One Brampton***

3.3.1 The same conclusion cannot be reached with respect to the customers in Brampton. It is striking, when considering the evidence in this proceeding, how much the customers of the Applicants are protected in the transaction documents, and the customers of Brampton are not.

3.3.2 By way of example, LDC Co. is required to have a substantial presence in the each of

[25] J1.2 and Tr.3:31, among others.

the franchise areas of the Applicants, but is not required to have any presence at all in Brampton. The discussion of premises does not include the Brampton head office. It is presumably gone. The executives of the Applicants are going to be running LDC Co. and its affiliates. The employees of Brampton are not mentioned.

3.3.3 And, of course, Brampton customers have the lowest rates of the four LDCs, and their rates will have to increase substantially if there is a harmonization[26].

3.3.4 The Handbook provides that, where there is an acquisition, the Board focuses its attention in the "no harm" test on the customers of the acquired LDC[27]. In this case, the only acquisition is of Brampton, and it is those customers that are most likely to have less presence in their local area, and a greater rate increase through harmonization. Application of the "no harm" test necessitates consideration by the Board of how to ensure that those customers are specifically protected. This is particularly true since they won't have a municipal shareholder protecting them.

3.4 ***Protection Through Reporting***

3.4.1 ***Annual Reporting.*** SEC submits that the proposed reporting requirements are generally inadequate to ensure that the Board has sufficient information to protect the customers.

3.4.2 What the Applicants have proposed is to report essentially partially segmented information as long as the Horizon Custom IR plan remains in place, and then only consolidated reporting after that. While rates would be separate for ten years under the proposal, those rates would be on a formula basis, and so would not require separate accounting or reporting of financial results. After three years, the Applicants propose that their accounting will be fully combined. Further, the Applicants propose that their scorecard reporting will be combined at that time, and will be partially combined from the beginning.

3.4.3 The effect of these proposals is that the Board will quickly lose visibility with respect to both the costs to serve[28], and the outcomes, for the customers in each of the four franchise areas. In a normal IRM situation, where rates are decoupled from costs, the Board has annual financial and scorecard reporting that allows it to monitor whether the customers are being well-served, and whether the rates of the utility remain reasonable. Under the proposals of the Applicants, the Board will have separate rates for each of the four franchise areas, but will have no ability to monitor whether those rates continue to be reasonable, or whether the customers in those franchise areas are being well-served, either absolutely or relative to past service levels.

---

[26] Although the Applicants insist that there is no plan to have the rates converge: Tr. 2:82.
[27] Handbook, p. 7.
[28] As the Board correctly noted: Tr.2:90.

3.4.4 SEC believes that this is inappropriate. SEC proposes that, as long as the rates for different franchise areas are different, LDC Co, should be required to file full annual reporting of accounting results, and scorecard results, on a segmented basis for each of the four service territories. Not only will this allow the Board to monitor the impacts on each customer group (and thus the "no harm" test), but it will also provide valuable information at the time that harmonization is proposed. If no harmonization is proposed, then the separate accounting data will in any case be required to do a rebasing for each of the service territories separately.

3.4.5 ***Distribution System Plan***. The Applicants also propose to delay filing of a combined distribution system plan. Under the Licensing section, below, we propose that this delay be shortened.

3.5 *Conclusion*

3.5.1 SEC supports the merger of the four LDCs. However, SEC believes that more robust reporting is required to ensure that all customers of the four LDCs are protected, and that the Board will have ongoing visibility to deliver that result.

4 THE PUBLIC INTEREST TEST - LICENCES

4.1 ***Introduction***

4.1.1 SEC submits that there is no reasonable argument that licensing LDC Co. to distribute electricity would be contrary to the public interest.

4.1.2 Technically, the amended Application no longer requires a transfer of the distribution licences of the four Merging LDCs to LDC Co. The Applicants have provided a draft distribution licence for LDC Co., and the Board is in a position to approve a licence for that company. The licences of the four Merging LDCs can, in our submission, simply be cancelled when the new licence issues on the closing of the proposed transactions.

4.2 ***Licence Conditions***

4.2.1 SEC has reviewed the draft distribution licence proposed by the Applicants. With one exception, SEC has no concerns with that proposed licence.

4.2.2 In particular, SEC notes that it agrees with the proposal to phase in monthly billing as the CIS systems are harmonized. This may create a short-term disadvantage to some customers, but allows the migration to take place in a more cost-effective manner, and likely with fewer transitional problems. Overall, we think that the avoidance of additional costs, and the avoidance of transitional billing issues through a staged approach, outweigh the goal of getting to monthly billing as soon as possible.

4.2.3 Our major concern is with the delay in the Distribution System Plan. The Applicants propose to delay filing of a combined DSP until 2019. SEC believes that this represents insufficient prioritization of the DSP in the transitional period. The Board should, in our submission, require LDC Co, as a licence condition, to file a combined DSP no later than the end of calendar 2017.

4.2.4 The Distribution System Plan is, in the Board's regulatory framework, the central element of distributor planning and operational effectiveness. The Board has recognized that taking a careful and thoughtful look at the distribution system, and developing a cohesive plan both to run it, and to renew it, is the single most critical component of distributor excellence.

4.2.5 In this proceeding, the reason the Applicants give that they are unable to provide a DSP for three years is, essentially, that they have other things to do. With respect, that establishes a priority for the DSP that is lower than is appropriate. Yes, there are urgent transitional items that LDC Co. will need to address. However, it is also true to most of the efficiencies and synergies available to LDC Co., and the transitional decisions, will be optimized if they are done within the context of a well thought out DSP. By prioritizing other actions, rather than the DSP, the Applicants are putting the cart before the horse.

4.2.6 Of course, in practical terms the Applicants can't simply close the transactions, then drop everything to work on a DSP. There will be a lot to get done in the first year. Our concern, however, is that the Applicants appear to be saying that they will start work on the DSP after they have worked out their transitional arrangements. In our view, the Board should expect that the work on the DSP should be started immediately, in parallel with the transitional activities, so that the DSP work helps LDC Co. optimize the transition.

4.2.7 Further, purely from a regulatory point of view, the Board needs a DSP in order to view the annual reporting from the utility in the proper context. The Board monitors the actions of LDCs by reference to their Distribution System Plans. Lack of a DSP for LDC Co. will make Board monitoring less effective.

4.2.8 SEC therefore submits that the Board should require, as a condition of the new licence for LDC Co, that it file a DSP for the combined entity no later than December 31, 2017.

4.3 ***Reporting***

4.3.1 As noted in Section 3 above, SEC believes that more robust reporting on a segmented basis is required to ensure that the customers of the combined utility are properly protected, and that the Board is in a position to ensure that result.

5 JUST AND REASONABLE RATES

5.1 *Introduction*

5.1.1 There are four categories of evidence before the Board in this proceeding that relate to costs and rates, and therefore can provide guidance to the Board in determining just and reasonable rates after the proposed transactions:

(a) The transition costs to be incurred by the Applicants in merging the LDCs and their operations.

(b) The operating and capital efficiencies and other synergies expected as a result of the merger.

(c) The rates that customers of each utility can expect if the transactions do not proceed (referred to as the "status quo scenario").

(d) The rates that the Applicants expect will follow as a result of the transactions, and the rate proposals in the Application (referred to as the "mergeco scenario").

5.1.2 The first two categories relate to the costs and benefits of the transaction, so are at least initially from the distributor's point of view. The Ratemaking Policy and the Handbook seek to ensure that the benefits that go to the shareholder are sufficient to cover the transition costs and reduce the risk for the shareholders.

5.1.3 The second two categories deal with the rates with and without the proposed transactions, and so are at least initially from the customer's point of view. The Applicants provide this information in an effort to demonstrate that their rate proposals result in lower rates for the ratepayers, despite the deferred rebasing period.

5.1.4 We will deal with each of these components of the evidence in turn. Each has issues, and in our submission the Board will need to reach a conclusion on the reasonableness of the amounts proposed by the Applicants in each category.

5.2 *Transition Costs*

5.2.1 The Applicants state that their estimated transition costs are \$96.3 million. However, the only time the Applicants are net out of pocket on transition costs, relative to synergies, is at the end of the first year, when transition costs exceed synergies by a cumulative \$24.4 million. By the middle of year 2, synergies, even at the levels the Applicants have estimated, exceed costs, and that continues to be the case throughout[29].

5.2.2 SEC has no reason to doubt the estimates of the Applicants with respect to the amount or timing of transition costs. They have done this before, and they have no reason to provide a material over-forecast of this category of costs.

5.2.3 The result of this evidence is that the risk to the Applicants of transition costs is clearly small. This may be relevant to application of the Handbook policies to this transaction.

5.3 ***Synergies***

5.3.1 The Applicants estimate that total synergies from the proposed transactions over the first ten years are $522.2 million, or more than five times the transition costs[30]. The figure of $425.9 million, often used in the hearing, is the net of the synergies and the transition costs.

5.3.2 The synergies forecast by the Applicants have been deliberately structured to be conservative, and example of "under promise, over deliver". In fact, because the Applicants assumed that, under the "no harm" test, the actual amount of synergies was not relevant to the Board, they did not really appear to care whether the figure provided to the Board includes all synergies and benefits. This is evidence in the following exchange between counsel[31]:

> *"MR. SHEPHERD [speaking to Mr. Basilio, the witness]: Well, that's -- you know, what in fact you said at the technical conference is on page 17 of our materials. And you were asked: "It shouldn't be relevant to the Board if the actual benefits available are a lot more?" And your answer was: "I believe the no-harm test is no harm to customers and the transaction remains financially viable." and you went on to say: "So on that basis, no, I don't think that question is relevant."*
>
> *It doesn't matter whether you could get more synergies? If you want to keep them, if the shareholders wanted to keep them, if you want to spend extra money that you didn't really need to spend, that doesn't matter to the Board? Isn't that what you said?*
>
> *MR. CASS: Mr. Chair, that is indeed the position the applicants are taking. It is the no-harm test."*

5.3.3 Mr. Cass goes on to talk about the futility of trying to get the estimate of synergies right, since it doesn't matter in the end.

---

[29] B/6/1, p. 2, figure 25.
[30] Ibid.
[31] Tr.1:155.

5.3.4 In fact, throughout the cross-examinations it became clear that there are many potential synergies and savings that are not counted at all, and no attempt has been made to quantify them. By way of example only, here are some:

(a) Staff reductions of about 14% are forecast, but no savings from space reductions are forecast[32].

(b) No savings from selling any of the real estate assets, including the Brampton head office or the Mavis property[33]. A summary of the real estate assets prepared by the Applicants at SEC's request shows that there are obviously substantial assets that are excess to the new company's needs[34].

(c) Except for the bottom-up synergies, the capital plan has not been optimized in the business case model[35]. This likely leaves many more capital synergies to be achieved.

(d) The unregulated affiliates will be using substantial portions of the LDC assets, and will have to pay for that use, but no attempt has been made to estimate the impact of that increasing revenue offset.

5.3.5 These are only some of the many examples.

5.3.6 SEC submits that, on the evidence before the Board, the $522.2 million of forecast cost savings and other synergies are likely understated, although the evidence does not provide the Board with sufficient information to determine what a more reasonable forecast would be.

5.3.7 The reason this is important is that the actual out of pocket transition costs are so low, and are recovered quickly. As a result, the need to defer rebasing to allow for recovery of transition costs[36] is not actually there. The synergies will easily cover the transition costs in short order, and thereafter the shareholders will reap a benefit of at least $425.9 million, and likely hundreds of millions of dollars more.

5.3.8 Since the purpose of the Ratemaking Policy does not arise in this case, as demonstrated by the evidence, in SEC's submission the Board cannot and should not apply that policy.

---

[32] Tr.1:157-8.
[33] Tr.1:126.
[34] K3.1, p. 1 and Tr.3-1:50 or so. There appears to be about a third of their real estate that is excess to their needs, but they have no estimate of the fair market value of their real estate assets.
[35] Tr.1:132-3.
[36] As set out in the Handbook.

5.4 ***Straw Man Status Quo***

5.4.1 The Applicants say that, absent these transactions, each of the four merging LDCs would, on a standalone basis, have rates set on a cost of service basis after their current rate plans expire[37]. The effect of this is to forecast average rate increases over the next ten years of at least 2.42%[38]. Included in this forecast are, for example, increases of 16% in one year for Hydro One Brampton, and more than 8% in another year for Enersource.

5.4.2 Yet, when cross-examined on these forecasts, and the model that produced them, the Applicants did not want to talk about where the numbers came from[39]. In fact, apparently the model used to create this forecast calculated rates, but they did not use those rates. Further, they used capital spending forecasts different from those in the distribution system plans of the companies.

5.4.3 SEC submits that, based on the evidence before the Board, the Board should conclude that the status quo rate increases forecast by the Applicants are overstated. It is not reasonable to assume ten year average increases of 2.42%, substantially in excess of inflation, and the Applicants have not been able to provide support for the specific numbers they have forecast.

5.4.4 Put another way, the Applicants want the Board to accept that, without the merger, they would each fail to achieve the continuous improvement required by the RRFE for the next ten years, and the Board would simply go along with that.

5.5 ***IRM Plus Additional Capital Funding***

5.5.1 On the other side, the Applicants forecast that under the merged scenario their rates will increase by an average of about 1.74% per year for ten years, still well above assumed inflation less productivity/stretch. The reason for this is that the Applicants expect to file annual ICM applications so that, in addition to price cap increases, they have incremental rate increases to cover their normal capital spending.

5.5.2 The capital plans used for the ICM forecast are the same as for the status quo forecast, net of the savings from capital synergies[40].

5.5.3 The effect of the Applicants' plans is that, after the proposed transactions, the customers will still face increases in excess of the Board's normal price cap level, for a period of ten years. This assumes no additional capital spending plans arising during

---

[37] Tr.1:138.
[38] Tr.2:75.
[39] See, e.g. Tr.1:148 and Tr. 2:60-80..
[40] The impact of the latter is low, because the total capital synergies are $114.3 million, so the revenue requirement impact of those synergies will not be material over this period.

that period, which would of course be incremental to the current merged scenario forecast.

5.5.4 SEC also notes that the incremental capital plans do not take into account reductions in existing capital, which for the first ten years would still be reflected in rates. By way of example, a sale of Mavis or Sandalwood would reduce rate base, but the ratepayers would continue to pay depreciation and cost of capital in their rates for the sold property until year 11, and of course would not at any time – in the first ten years or otherwise - share at all in any capital gain on the property sold.

5.6 ***Claimed Customer Benefits Years 1-10***

5.6.1 The Applicants claim that, in the first ten years, the customers will benefit from the proposed transactions by a total of just over $195 million[41]. That is, despite rates increasing at an average of 1.74% per year, the Applicants say that those rates would be $195 million higher but for the merger.

5.6.2 However, when asked about those "savings", the Applicants were confused over where they come from. At first, they said they could not come out of the synergies, all if which accrue to the shareholders for the first ten years. Later, pressed on that point, they said that the customer savings do come from the synergies.

5.6.3 In fact, none of the numbers provided by the Applicants on customers benefits for the first ten years add up:

(a) The claimed net synergies are $425.9 million, before tax.

(b) The shareholders are forecast to get $259.2 million of incremental dividends over the first ten years, based on a dividend policy of 60% of net income[42]. Grossing that up, this means incremental after tax income of $432 million, and incremental pre-tax income (at the 18% assumed tax rate) of $527 million.

(c) Based on the Applicants' own estimates, the incremental dividends use up more than the total net synergies.

(d) A small amount of that will come from the increase from 50% dividends to 60% dividends for some of the non-incremental income, due to a change in dividend policy.

(e) That, however, is offset by the fact that the actual tax gross-up, according to the witnesses, is 26% rather than 18%.

---

[41] Tr.1:100.
[42] Tr.2:63.

(f) That is also offset by the fact that some of the synergies are capital in nature, and on a revenue requirement basis are a lower amount over the first ten years.

5.6.4 When all is said and done, there is no room in the Applicants' forecasts for $195 million of rate savings to the customers over the first ten years. The witnesses' first answer was correct. All of the merger savings are proposed to go to the shareholders over the first ten years.

5.6.5 Where, then, does the $195 million come from? In our submission, the answer is that there is no $195 million. It simply does not exist.

5.6.6 Mr. Basilio, initially responding to this question[43], said that the source of the savings was the different rate methods used for the merged and status quo scenarios. To him, the ratepayer savings came about because of the difference between Custom IR (which they modeled as cost of service) and Price Cap IR. The assumption was that the difference in results was not based on any difference in underlying costs.

5.6.7 Inadvertently, perhaps, his answer was exactly correct. The Applicants forecast high cost of service increases for ten years in the status quo scenario. Those increases are not real. Thus, comparing those straw man rates to the rates forecast after the merger produces savings for customers, not as a result of transaction synergies, but as a result of assuming a status quo that is simply unrealistic.

5.6.8 SEC therefore submits that the Applicants are not in fact proposing any benefit to customers in the first ten years. They are proposing that all of the benefits from the transactions in the first ten years go to the shareholders.

5.7 ***Claimed Customer Benefits Years 11+***

5.7.1 The Applicants then claim that, ten years from now, there will be a rate reduction as a result of the merger, which will benefit customers to the tune of about $69 million per year[44]. The forecast rate reduction is 1.51%**.**

5.7.2 There are two problems with this proposed savings estimate.

5.7.3 First, the savings estimate depends on the same comparison to the status quo assumptions that was unreliable in the first ten years. That is, the status quo revenue requirement is assumed to start more than $42 million higher than the mergeco scenario in year 11. The increase in year 11 in the annual savings is $27 million on the Applicants' forecasts. Because of this assumption, the forecast "savings" to customers

---

[43] Tr.1:100.
[44] Tr.1:108.

in year 11 is no more useful to the Board than the first ten years.

5.7.4 Second, the year 11 savings is so far into the future that, even aside from intergenerational equity issues, it is simply not credible. The Applicants have proposed that their shareholders get their substantial benefits up front. Their customers get whatever benefits they get much later, when the circumstances will have inevitably changed and there is little likelihood, in fact, that any rate decrease will be proposed.

5.7.5 In our submission, if the Applicants were really seeking to share the benefits of the merger with their customers, they would do so from the outset. Both shareholders and customers would have the same level of risk, and uncertainty, and would benefit at the same time from the transactions.

5.8 ***Earnings Sharing Mechanism***

5.8.1 The evidence before the Board is that the proposed ESM, with a 300 basis point deadband, will not provide any protection to the ratepayers. At no time during the ten year period, when the merged company is reaping hundreds of millions of dollars of benefits from the transaction, all for the benefit of the shareholders, does the ROE come close to meeting the 300 basis point threshold.

5.8.2 Further, if the Applicants find that their synergies are greater than expected, as we believe will be the case, their ROE level is still within their control. LDC Co., which already on their own evidence of aggressive capital spending plans to spend the next ten years building rate base, could simply spend more on capital, building further rate base, so that the ROE remains within the deadband. In fact, the structure of the ESM proposed incents this behavior. This would have the further effect of having a higher rate base on rebasing, increasing the dividends to the shareholders even further after rebasing.

5.8.3 SEC therefore submits that the ESM is a red herring, and provides no protection for customers.

5.9 ***Equitable Benefit Sharing Options***

5.9.1 The essence of SEC's argument with respect to rates is that the proposals of the Applicants do not share the benefits of the transactions equitably between the customers and the shareholders. The resulting rates during the proposed ten year rebasing period are therefore not just and reasonable.

5.9.2 There would appear to be five ways for the Board to correct this, and still grant the approvals for the transactions:

(a) Reduce the rebasing deferral period, for example to five years from ten. This would deliver $173.4 million of net benefits to the shareholders (plus any additional synergies that will actually be achieved over and above the lowball estimates). This has many of the same problems as the Applicant's proposal, but with lower numbers. For example, it does not deal with the capital gains on sale of excess real estate, which would be incremental to that figure, and would all accrue to the shareholders.

(b) Amend the ESM to provide for no deadband, so that in effect the customers and the shareholders are in it together. The problem with this is that it incents the Applicants to spend on capital, building rate base as quickly as possible to avoid sharing income, and increase ROE over the long term. This is one of the reasons SEC generally opposes earning-sharing. The incentives to the distributor are not reasonably aligned with the best interests of the customer.

(c) Deny the Applicants the ability to seek ICM funding over the deferred rebasing period. This would under-compensate the customers for benefits, and would also put the Applicants at risk if they do face major unexpected capital spending during that period. Further, there is some doubt whether this Board panel would have the jurisdiction to bind future Board panels if LDC Co. were to apply for an ICM in the future.

(d) Reduce rates by an amount sufficient to share the benefits over the first ten years. A 50-50 sharing of the net benefits, for example, would mean that the ratepayers would be given rate reductions of $213 million over those ten years. This is not technically complicated. To the extent that the Applicants are able to achieve higher synergies, they would be able to retain those savings for the shareholders.

(e) Establish a benefit to customers on the basis of the incremental dividends to the shareholders. In effect, the customers would get the same dividends as the shareholders. This is technically complicated, but not difficult. The incremental dividends would have to be calculated net of the accretive impact of the Brampton purchase. The net incremental dividends would then be grossed up to a before tax equivalent, and that amount, likely around $250 million over ten years, would be credited to customers in the form of annual rate riders.

5.10 ***SEC Recommendation***

5.10.1 SEC proposes that the Board implement the fourth of the five options for sharing of benefits with customers: a pre-determined reduction in rates on the following terms:

(a) The total amount of the benefit to ratepayers would be 50% of the forecast net

synergies for the first ten years, i.e. $213 million.

(b) The adjustment would be implemented by reducing rates by the percentage that $213 million is of the total forecast LDC Co. revenue requirement over the same ten years period, i.e. $5.93 billion. That percentage is therefore 3.6%. By reducing rates by 3.6%, and continuing (but not duplicating) that reduction each year, the total savings to customers is $213 million.

(c) The reduction would apply to the rates of each customer class, in each rate zone, so that there are no cost allocation or rate design issues.

5.10.2 SEC proposes this approach because it is simple and easy to implement, and it expressly balances the interests of shareholders and customers. Further, it leaves LDC Co. free to operate its distribution business without having to consider the impacts on current rates, as would an ESM. It also allows LDC Co. to seek further savings as aggressively as they can, since they keep all of those additional savings. Finally, on the eventual rebasing, the expected rate reduction would not be expected, or would be less, because all or most of it would have already taken place.

5.10.3 SEC notes that, if the Board accepts this recommendation, there would be no need for an ESM. The Board would have the normal 300 basis point off-ramp for price cap IRM, so if after making this adjustment LDC Co. actually overearned to that extent, the Board could do a thorough review, which is likely the best option in that situation anyway.

5.10.4 SEC therefore recommends that the Board exercise its ratemaking jurisdiction in this proceeding by:

(a) Allowing the transfer of the rate orders and the ten year deferred rebasing period, all on the terms proposed by the Applicants;

(b) Rejecting the proposed ESM; and

(c) Reducing the rates of the customers of LDC Co, across the board, by 3.6% effective January 1, 2017, the expected date of the transactions, and continuing that reduction throughout the deferred rebasing period.

6 OTHER MATTERS

6.1 *Costs*

6.1.1 The School Energy Coalition hereby requests that the Board order payment of our reasonably incurred costs in connection with our participation in this proceeding. It is submitted that the School Energy Coalition has participated responsibly in all aspects of the process, in a manner designed to assist the Board as efficiently as possible.

All of which is respectfully submitted.

____

Jay Shepherd
Counsel for the School Energy Coalition