PUBLIC INTEREST ADVOCACY CENTRE
LE CENTRE POUR LA DÉFENSE DE L'INTÉRÊT PUBLIC

April 21, 2017

VIA E-MAIL

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge St.
Toronto, ON
M4P 1E4

Dear Ms. Walli:

Re: EB-2016-0276 – Hydro One Networks Inc. MAAD Application
re Orillia Power Distribution Corporation
Final Argument of the Vulnerable Energy Consumers Coalition (VECC)

On behalf of the Vulnerable Energy Consumers Coalition please find enclosed the Final Argument of the Vulnerable Energy Consumers Coalition (VECC) with respect to the above-note proceeding.

As per Procedural Order No. 5 we have also directed a copy to the Applicant as well as their counsel via e-mail.

Yours truly,

Cynthia Khoo
Counsel for VECC

cc. Hydro One – Erin Henderson – regulatory@hydroone.com
Orillla Power – Grant Hipgrave – ghipgrave@orilliapower.ca
Orillia Power – Patrick Hurley – phurley@orilliapower.ca
Orilla Power – Gayle Jackson – gjaackson@orillia.ca
Counsel - Michael Engelberg - mengelberg@hydroone.com
Counsel - J. Mark Rodger - mrodger@blg.com

EB-2016-0276

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

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation seeking to include a rate rider in the 2016 Board-approved rate schedules of Orillia Power Distribution Corporation to give effect to a 1% reduction relative to 2016 base distribution delivery rates (exclusive of rate riders), made pursuant to section 78 of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation for leave to transfer its distribution system to Hydro One Networks Inc., made pursuant to section 86(1)(a) of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation seeking cancellation of its distribution licence, made pursuant to section 77(5) of the *Ontario Energy Board Act, 1998*.

AND IN THE MATTER OF an application made by Hydro One Networks Inc. seeking an order to amend its distribution licence, made pursuant to section 74 of the *Ontario Energy Board Act, 1998*, to serve the customers of the former Orillia Power Distribution Corporation.

VULNERABLE ENERGY CONSUMERS COALITION

FINAL ARGUMENT

April 21, 2017

1. INTRODUCTION

On September 27, 2016 Hydro One Networks Inc. filed an application[1] with the Ontario Energy Board (the "OEB" or the "Board") seeking approval to acquire all of the issued and outstanding shares of the Orillia Power Distribution Company ("OPDC") from the City of Orillia (the "City"). Specifically the Application sought the following approvals[2]:

- For Hydro One Inc. to acquire all the issued and outstanding shares of Orillia Power Distribution Corporation from the City pursuant to section 86(2)(b) of the Act.
- For OPDC to dispose of its distribution system to Hydro One Networks Inc. pursuant to section 86(1)(a) of the Act.
- For OPDC to include a rate rider in the 2016 Board-approved rate schedules of Orillia Power Distribution to give effect to a 1% reduction relative to the base distribution delivery rates (exclusive of rate riders), made pursuant to section 78 of the *Ontario Energy Board Act, 1998*[3].
- Leave for OPDC to transfer its rate order to Hydro One Networks Inc. pursuant to section 18 of the Act[4].
- If the Board grants leave for OPDC to dispose of its distribution system to Hydro One Inc., after closing and upon integration of the proposed transactions, OPDC requests, pursuant to section 77(5) of the Act, that its electricity distribution licence be cancelled. Hydro One Networks Inc. requests, pursuant to section 74 of the Act, that Hydro One's distribution licence be 7 amended such that Appendix B, Tab 1 of Schedule 1 include *The City of Orillia, County of* 8 *Simcoe as at October 31, 1991*, as described in Schedule 1 of OPDC's licence.
- Upon completion of integration, Hydro One will transfer the assets and liabilities of the electricity distribution business from OPDC to Hydro One

In addition the Application sought the following approvals and considerations:

---

[1] Subsequently Amended on October 11, 2016

[2] Exhibit A, Tab 1, Schedule 1, pages 4-5

[3] Applies only to the Residential and GS classes per Exhibit A, Tab 2, Schedule 1, Footnote 5

[4] With the exception of OPDC's specific service charges which would be amended to correspond with those currently approved for Hydro One Networks and a couple of amendments to rate rider descriptions (see Exhibit I, Tab 1, Schedule 4).

- Hydro One is applying for approval to defer the rate rebasing of OPDC for ten years from the date of closing of the proposed transaction, consistent with the new Board policy set out in the Amended Report.
- Hydro One is applying for approval to continue to track costs to the regulatory asset accounts currently approved by the OEB for OPDC and to seek disposition of their balances at a future date.
- All OPDC rate riders will continue as per OPDC's existing rate schedules until expiry[5].
- Hydro One is applying for approval to utilize US GAAP for OPDC financial reporting.
- Hydro One is applying for approval to use an ESM to operate during the extended deferred rebasing period (i.e., years six to ten), consistent with page 16 of the Handbook[6].
- Hydro One is applying to use an Incremental Capital Module ("ICM") during the extended deferred rate rebasing period, as described on page17 of the Handbook.
- During the extended deferred rebasing period, rates of customers of OPDC will be set using the Price Cap Index adjustment mechanism.

2. VECC's INTEREST IN THE APPLICATION

VECC's interest in the Application is primarily two-fold. First, does the Application meet the "No Harm" test? In this regard, VECC supports the Board's approach whereby the focus is on "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"[7]:

> 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.

[5] See footnote #4 above
[6] Handbook to Electricity Distributor and Transmitter Consolidation, January 19, 2016
[7] Handbook, page 4

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.

Furthermore, VECC agrees that the primary focus of Board's review[8] should be with respect to the impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector (i.e., Objectives 1 and 2). In this regard, VECC's focus is on the impact of the transaction on the price and quality of service to customers. It is VECC's view that protecting customers' interests with respect to price and quality of service is consistent with, and will further, the Board's objectives as they pertain to the promotion of economic efficiency and cost effectiveness[9].

VECC's second area of interest is with respect to the rate-making aspects and implications of the Application.

3. NO HARM TEST

3.1 Price of Service to OPDC Customers

In order to demonstrate that the Application protects OPDC customers with respect to price, the Application presents a comparison of Hydro One's OM&A costs to serve customers in its high density residential rate class of $173/customer versus OPDC's cost per customer of $362[10]. The Application justifies this comparison by noting that Hydro One's urban (i.e. high density) rate class covers areas containing more than 3,000 customers with a density of at least 60 customers per kilometer and that OPDC

[8] Handbook, page 6

[9] This is because it is "customers" who, in the end, pay the costs incurred the utility and benefit/suffer from the reliability and service quality implications that result from those expenditures.

[10] Exhibit A, Tab 2, Schedule 1, pages 2-3

has 13,500 customers with a density of 58 customers per km of whom approximately 90% are residential.

The Application also notes that[11]: i) the 2016 base distribution rates will be reduced by 1% and frozen for a period of five years[12] from the closing of the transaction; ii) beginning year six through year ten base distribution rates for former OPDC customers will be set using the Price Cap Adjustment Mechanism and iii) an Earnings Sharing Mechanism will be implemented based on expected earnings in years six through ten.

In previous decisions[13] and its 2016 Handbook[14] the Board has indicated that it is the cost structures resulting from the proposed transaction and not near term rate expectations that will be determinative of whether there will be harm. As a result, VECC's consideration of the no harm test as it applies to price and OPDC's customers focuses on the cost comparison provided in the Application.

While the difference in cost structures appears significant ($173 vs. $362) VECC notes that there are several issues with the comparison:

- First, the comparison is based on forecast 2015 costs/customer counts for Hydro One versus actual costs/customer counts for OPDC. Hydro One's actual 2015 OM&A costs were 5.4% higher than forecast while its 2015 actual Urban Residential customer count was slightly less than forecast[15]. Combining these two factors would suggest that for fair comparison the Hydro One costs should be increased by 5.9%.
- Second, the Application compares Hydro One's residential cost per customer with average cost per customer for all OPDC residential and GS customers. While a significant portion[16] of OPDC's customer base is Residential, Hydro One's average cost to serve its urban GS classes is considerably higher than $173/customer[17].

[11] Exhibit A, Tab 2, Schedule 1, pages 3-5 and Exhibit A, Tab 3, Schedule 2, pages 3-9
[12] With the exception of the Residential rates which will continue to be adjusted to a fully fixed charge (Exhibit A, Tab 2, Schedule 1, page 4) and the specific service charges which will be set equivalent to those approved for Hydro One Networks (Exhibit A, Tab 2, Schedule 2, page 4 and Exhibit I, Tab 1, Schedule 4)
[13] EB-2014-0213 (Woodstock), page 9; EB-2014-0244 (Haldimand), page 3; and EB-2013-0196/Eb-2013-0187/EB-2013-0198 (Norfolk), page 12
[14] Handbook, pages 6-7
[15] Exhibit I, Tab 3, Schedule 6 c)
[16] See Attachment 4
[17] Exhibit I, Tab 3, Schedule 7 c)

Indeed, if one were to weight the Hydro One per customer costs for its UR ($173); UG_e ($444) and UG_d ($4,620) classes by OPDC's 2015 customer counts for the three classes the resulting weighted average cost per customer would be $256/customer[18].

- Third, in the case of OPDC the cost per customer calculation only includes residential and GS customer count in the denominator (i.e., excludes customers in the USL, Street Lighting and Sentinel Lighting classes) whereas Hydro One's calculation is taken from its cost allocation model filed with its 2015 DRO which includes an allocation of costs to these excluded classes[19]. It is noted that in the most recent Cost Allocation provided to the Board by OPDC, only 95.2% of its OM&A costs were allocated to its Residential and GS classes. As a result, in order to fairly compare OPDC's and Hydro One's costs it would be appropriate to reduce OPDC's costs by 4.8%.

Making the above adjustments results in a comparison of $345/customer for OPDC[20] versus $271 for Hydro One[21]which still suggests that Hydro One's underling cost drivers for its urban customers are lower than those for OPDC. However, it is also noted that OPDC's current customer density is slightly less than the 60 customers / kilometer required in order to qualify for inclusion in Hydro One's urban rate classes. When asked about this, Hydro responded that: i) a large core of the Orillia service territory would meet the 60 customer per kilometer requirement and ii) at the time of integration (10 years after closing of the acquisition) it is expected that customer growth will be such that the full Orillia service territory would meet the requirement[22]. Using the OPDC customer counts, the weighted average cost for HON to serve OPDC's customer based on its R1 and standard GS costs/customer is $379/customer[23], which is more than OPDC's average cost to serve. As a result, VECC submits that, while it is reasonable to assume customer growth will result in Orillia's full service territory qualifying for urban

[18] (11.916*$173 + 1,361*$444 + $4,620*168) / 13,445
[19] Exhibit I, Tab 3, Schedule 7, a) & b)
[20] 95.2% x $362
[21] $256 x 1.059
[22] Exhibit I, Tab 3, Schedule 8 a)
[23] See Exhibit I, Tab 3, Schedule 8 c) for the costs and Attachment 4 for the customer counts.

rates at the time of "rate integration", this assumption is critical if all of OPDC's customer are to be considered as held harmless vis-à-vis price.

Overall, provided the rates charged to OPDC's former customers after the 10 year deferral period are reflective of Hydro One's costs to serve the Orillia service territory the Application should not result in any harm (vis-à-vis price) to OPDC's customers.

3.2 Price of Service to Legacy Hydro One Customers

The Application notes[24] that the rates currently charged to Hydro One's existing customers and effective until December 31, 2017 do not include any capital or OM&A costs associated with serving customers in OPDC's service area. As a result, for this period the Application will have no impact on Hydro One's legacy customers.

The Application also notes that in 2017 Hydro One intends to file a Custom Incentive Rate Application for rates effective from 2018 to 2022 and commits that the rate application will not include any costs associated with serving the OPDC customers. Similarly, the Application commits that costs to serve these customers will not be included in any Hydro One Revenue Requirements Application for its legacy customers until the deferred rebasing period has expired. Once the deferred rebasing period has expired, the Application states that existing customers are expected to derive a small price benefit as the company's fixed costs of operations will be spread over a wider customer base[25].

VECC notes that while Hydro One claims there will be a long term cost benefit to legacy customers, it has not calculated the benefit[26]. On the other hand, Hydro One has acknowledged that there will be incremental administrative and support services costs as a result of absorbing the OPDC service territory and has included these in its calculation of the net OM&A savings it expects as a result of the Application[27]. As a result, while there will be more customers after OPDC is integrated (for rate setting purposes), there will also be more costs and it is not immediately obvious that costs will decline for existing customers. In VECC's view it should have been fairly

[24] Exhibit A, Tab 2, Schedule 1, page 5
[25] Exhibit A, Tab 2, Schedule 1, page 5 and Exhibit I, Tab 5. Schedule 6
[26] Exhibit I, Tab 5, Schedule 6
[27] Exhibit I, Tab 3, Schedule 10 c) and Exhibit I, Tab 3, Schedule 12 a)

straightforward to compare these incremental administrative and support costs with the its current administrative and supports costs (on a per customer basis) in order to determine whether or not the Application would result in harm to existing customers vis-à-vis the recovery of administrative and support costs.

Furthermore, it is important to note that no harm to legacy customer (in terms of price) requires that costs required to service the OPDC service area be recovered from the former OPDC customers. Indeed, while ensuring there is no harm to OPDC's customers (vis-à-vis price) requires that rates charged to these customers be reflective of the cost to service them, a similar requirement exists in order to ensure there is no harm to Hydro One's legacy customers.

3.3 Adequacy, Reliability and Quality of Service

The Application claims that, based on reliability statistics for 2013-2015, Hydro One customers in the vicinity of the City of Orillia experience a level of service in terms of frequency and duration similar to the level experienced by OPDC customers. It also states that reliability may in fact improve with the combination of the pre-existing Hydro One and former OPDC resources optimized for the broader Orillia area[28].

A comparison of the three-year averages[29] of SAIDI and SAIFI for OPDC and nearby Hydro One customers indicates that:

- For SAIDI (i.e. outage duration), the OPDC average (1.423) is materially lower than that for Hydro One (2.18), whereas
- For SAIFI (i.e., frequency), the OPDC average (1.557) is materially higher than that for Hydro One (0.778).

As a result, the evidence presented is inconclusive as to whether (based on their current cost structures) Hydro One's reliability performance is better or worse than that of OPDC.

With the respect to the claim that reliability "may" in fact improve for both Hydro One and former OPDC customers, it is noted that the Application's projections of future cost

[28] Exhibit A, Tab 2, Schedule 1, page 7
[29] Calculated from Exhibit I, Tab 3, Schedule 17 a)

savings[30] call for a reductions in both the number of local direct staff positions[31] and capital expenditures. With respect to the reduction in direct staff positions, Hydro One indicates that the associated work will be picked up by other (more centralized) units in Hydro One[32]. While this may reduce costs, there is no indication/evidence that it will improve reliability. Similarly, Hydro One was specifically asked[33] how capital spending could be reduced without affecting reliability. The response[34] indicated that the integration-related capital expenditures forecast was developed based on asset information regarding OPDC's existing assets and the Company's Asset Risk Assessment process. However, there is no indication that this process will produce improved reliability (i.e., planning was such that asset risks would be reduced below those currently experienced/expected). Indeed, there is no indication that the process was applied so as to ensure a level of reliability commensurate with current levels of service performance.

As a result, it is VECC's submission there is no evidence that, based on Hydro One's spending plans, reliability for former OPDC customers will improve in the future. Furthermore, there is no conclusive evidence that current levels of reliability will be maintained for former OPDC customers. Indeed, in light of the forecast spending reductions and no concrete explanations as to how they can be effected without impacting reliability, VECC submits that Hydro One has failed to satisfy the no-harm test vis-à-vis reliability of service.

As well as the reliability of electricity service delivery, there are other aspects of service adequacy and quality that the Board has deemed to be important and required distribution utilities to report on. Exhibit I, Tab 3, Schedule 17 c) compares the Hydro One's and OPDC's performance on these various dimensions of service quality. In almost every case[35], OPDC's current performance levels equal or exceed those of Hydro One. In its response Hydro One suggests that it is inappropriate to compare

[30] Exhibit A, Tab 2, Schedule 1, page 2
[31] Exhibit A, Tab 2, Schedule 1, page 9, lines 10-15
[32] Exhibit I, Tab 3, Schedule 12 b)
[33] Exhibit I, Tab 3, Schedule 14 d)
[34] Exhibit I, Tab 1, Schedule 2 e)
[35] The one exception appears to be appointment scheduling where in 2 of the 3 years reported Hydro One's performance exceeded that of OPDC.

Hydro One (largely a rural utility) with OPDC (largely an urban utility) on these metrics. However, VECC notes that even for metrics related to telephone accessibility and call abandonment (which are provided centrally by Hydro One) OPDC performance is superior. As a result, it is VECC's submission that the available evidence suggests that service quality for OPDC customers could decline as a result of the Application.

3.4 Economic Efficiency and Cost Effectiveness

The Application claims that the transaction will promote economic efficiency and cost effectiveness which will result in lowering ongoing cost structures[36]. Specifically, the Application claims the transaction will lead to OM&A savings that will increase to $3.9 M annually by year 10 and capital expenditure savings of $0.6 M per year[37].

The OM&A savings are to be achieved through:

- The elimination of 23 OPDC back office and management positions[38] the related responsibilities for which will be picked up by existing Hydro One administrative and support functions at materially lower incremental cost. It should be noted that this accounts for the majority of the reduction[39].
- The elimination of 6 direct positions[40] (i.e., staff that works directly on distribution assets) for which some of the work will be picked up by other centralized Hydro One units[41].
- The elimination of the service area boundaries (OPDC versus Hydro One) which will allow for a more optimal use of resources[42].

The Application claims that the elimination of service area boundaries will also reduce capital sending costs as will the application of Hydro One's Asset Risk Assessment process[43].

[36] Exhibit A, Tab 2, Schedule 1, page 8
[37] Exhibit A, Tab 2, Schedule 1, page 2
[38] Exhibit A, Tab 2, Schedule 1, page 9
[39] Exhibit I, Tab 1, Schedule 2 b)
[40] Exhibit A, Tab 2, Schedule 1, page 9
[41] Exhibit I, Tab 3, Schedule 12 b)
[42] Exhibit A, Tab 2, Schedule 1, page 10. lines 13-22
[43] Exhibit A, Tab 2, Schedule 1, pages 10-11.

VECC accepts that there are efficiencies to be gained through the integration of administrative and support activities formerly required for OPDC with those of Hydro One. VECC also accepts that there are likely to be capital and OM&A savings as a result of the elimination of the "artificial" boundaries between Hydro One and OPDC and the associated elimination of duplicated services. However, as discussed above in section 3.3 it is VECC's view that the Application and supporting interrogatory responses do not effectively demonstrate that the forecasted capital reductions will be attained through the use of Hydro One's Asset Risk Assessment process without affecting service reliability.

This being said, overall, VECC accepts that there are efficiencies and cost reductions to be gained from the Application.

3.5 Other Considerations

One positive aspect of the Application, in terms of adequacy and quality of service, is the expected availability of LEAP funding. It is noted that for each of the last two years (2015 & 2016) OPDC's LEAP funding has been depleted by the end of March and funds were not available during the balance of each year to assist customers. In contrast, in each year Hydro One has had sufficient funds to assist all potentially eligible customers, in part through top-ups provided by the Corporation). Furthermore, Hydro One is confident that there will be no harm to either existing Hydro One customers nor will the OPDC customers' access to LEAP funds be affected[44].

4. RATE MAKING CONSIDERATIONS

As noted in the Board's Handbook[45], the setting of rates for the "consolidated" Hydro One Networks will eventually require the filing of a separate application with the OEB under Section 78 of the OEB Act for a rebasing of its rates and typically takes place at some point in time following the OEB's approval of a consolidation. As a result, rate setting following consolidation is not addressed as part of the Application for approval of the transaction.

[44] Exhibit I, Tab 3, Schedule 4
[45] Pages 11-12

4.1 Deferred Rebasing Period

In order to encourage consolidations the Board provides consolidating entities with the opportunity to defer such rebasing for a period of up to 10-years in order to provide an opportunity to offset transaction costs with any achieved savings. However, the Handbook requires that distributors select a definitive timeframe for the deferred rebasing period but does not require evidence justifying the period select provided it meets certain minimum standards and is no greater than 10 years[46]. In the Application, Hydro One is seeking approval for a 10 year deferred rebasing period, which falls within the norms set by the Board.

4.2 Rate Setting During the Deferred Rebasing Period

The Handbook also sets out various options available for setting rates during the rebasing period, depending upon the rate setting options that employed by the time of the closing of the transaction[47]. Hydro One Networks is proposing that:

- For customers in the former OPDC territory, base distribution rates will be frozen for the first five years (following a 1% rate reduction) and then set using a Price Cap adjustment mechanism for years six through 10[48].
- For legacy Hydro One Networks customers, distribution rates will continue as currently approved until December 31, 2017. Furthermore, in 2017 a Custom IR application will be filed for rates effective from 2018-2022 which will not include any costs associated with serving the former customers of OPDC. After 2022, Hydro One will again apply to Board to set future rates for its legacy customers. While Hydro One has made no commitment as to what form this latter Application will take it has indicated that costs to serve former OPDC customers will not be included until after the deferred rebasing period has expired[49].

Hydro One has acknowledged[50] that its proposal for rate setting during the deferred rebasing period does not align with any of the six options set out by the Board in its

[46] Handbook, pages 11-12
[47] Page 15
[48] Exhibit A. Tab 2, Schedule 1, pages 3-4
[49] Exhibit A, Tab 2, Schedule 1, page 5 and Exhibit I, Tab 3, Schedule 15 c) & d)
[50] Exhibit I, Tab 3, Schedule 15 c)

Handbook. However, Hydro One also notes that the Handbook recognizes that there may be unique circumstances were alternative approaches need to be considered. In Hydro One's view the setting of rates for a large distributor that purchases a smaller utility is such a situation as is the case where a distributor is involved in multiple successive transactions to acquire other LDCs – both situations which apply in this case.

In VECC's view the rate setting proposal put forward by Hydro One for the deferred rebasing period is reasonable provided Hydro One is required to provide clear and conclusive evidence in any rate applications applicable to its legacy customers during the rebasing period that no costs associated with serving OPDC's legacy customers (including incremental costs incurred by its administrative and support functions or by centralized service such as its Utility Arborist division) are included in the rates to its legacy customers.

4.3 Earnings Sharing Mechanism (ESM)

The Handbook states[51] that "Consolidating entities that propose to defer rebasing beyond five years, must implement an ESM for the period beyond five years". The Handbook than goes on to state that "excess earnings are shared with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the consolidated entity's annual ROE" and that "earnings will be assessed each year once audited financial results are available and excess earnings beyond 300 basis points will be shared with customers annually".

In its Application[52] Hydro One has proposed an earnings sharing mechanism that covers the years six through ten and includes a 50:50 sharing of earnings above 300 basis points. In this regard Hydro One's proposal aligns with the expectations of the Board's Handbook. The proposed ESM also envisions calculating the excess earnings related to the operations of the acquired entity and sharing the excess earnings with just

[51] Page 16
[52] Exhibit A, Tab 3, Schedule 1, page 2

the former customers of OPDC. Both of these proposals are also consistent with the expectations of the Board[53].

However, Hydro One's proposal varies from the Handbook in one unique but significant aspect and that is that the calculation of the earnings to be shared is pre-calculated using the forecast OM&A and capital costs[54]. In contrast, it is clear from the wording in the Handbook regarding the use of audited results[55] that the Board's expectation is that the ESM calculation will be done based on actual results and reflect the actual savings achieved. Hydro One's primary rationale for using "forecast" savings as the basis for the ESM is that it does not intend to provide separate financial statements for acquired utilities (including OPDC) and therefore will not be a position to report on the actual earnings of the former OPDC[56]. The reason for this is the added expense (upwards of $500,000 annually) that would be incurred in maintaining separate financial records[57].

VECC notes that the forecasted over earnings are in the order of $1 M annually[58] and that, as a result, the cost of maintaining separate records would have a material effect on the ESM calculation. At the same time, as VECC has noted in the preceding section, rates to the customers in the former OPDC service area must be reflective of the cost to service the area if the no-harm test with respect to price is to be satisfied. Previous decisions by the Board[59] have required that Hydro One continue to track all costs associated with serving the acquired service area in order to ensure that future decisions regarding rates are properly informed. If Hydro One can effectively provide evidence in future rate proceedings regarding the cost to service the former OPDC service area without formal financial reporting then VECC submits it is appropriate to base the ESM on forecasted earnings. Otherwise, if full financial reporting is necessary in order to provide such evidence then, VECC submits, the ESM can and should be based on actual reported results.

---

[53] Exhibit A, Tab 3, Schedule 1, footnotes 4 and 5
[54] Exhibit A, Tab 3, Schedule 1, page 2, lines 16-17
[55] Handbook, page 16
[56] Exhibit A, Tab 3,Schedule 1, page 3 and Exhibit I, Tab 1, Schedule 17 a)
Exhibit A, Tab 3,Schedule 1, page 4 and [57] Exhibit I, Tab 1, Schedule 17 c)
[58] Exhibit A, Tab 3, Schedule 1, page 7
[59] EB-2014-0213 (Woodstock), page 10

In the event forecast earnings are used as the basis for the ESM then VECC does have one major reservation regarding Hydro One's proposal and this is with respect to the use of OPDC's current debt costs and currently approved ROE in the calculation. Hydro One justifies[60] the use of these values based on the fact that it is these values that underpin the current rates charged to OPDC customers.

However, it is VECC's view that, to be consistent with the spirit of the Handbook, the ESM calculation should, to extent possible, forecast what would actually be reported as the earnings and over earnings. In this regard, if prepared, the actual financial statements for OPDC would presumably reflect Hydro One's cost of debt. Indeed, the Application specifically notes[61] Hydro One's lower debt costs (currently 4.86% vs. 6.25%) as one of the benefits/cost savings from the transaction. Similarly, the calculation of over earnings would be done using Hydro One's approved ROE. It is therefore VECC's submission that the forecast earnings should be based on Hydro One's cost of debt (4.43% for 2017) and the earnings sharing based on Hydro's currently approved ROE (8.78%). Using these values Hydro One indicates that the customer refund amount would be $5.1 M as opposed to the $3.4 M proposed in the Application[62].

4.4 Incremental Capital Module

The Handbook indicates that the Incremental Capital Module is available to utilities during the deferred rebasing period to address discrete capital needs[63]. In the Application, Hydro One states[64] that it is "is applying to use an Incremental Capital Module ("ICM") during the extended deferred rate rebasing period, as described on page17 of the Handbook".

VECC acknowledges that the Incremental Capital Module is available to Hydro One to address capital needs in the former OPDC service area should the need arise and the proposal meet the prescribed eligibility criteria. However, no such need has been

[60] Exhibit I, Tab 1, Schedule 21 a)
[61] Exhibit A, Tab 2, Schedule 1, page 12
[62] Exhibit I, Tab 5, Schedule 12
[63] Page 17
[64] Exhibit A, Tab 1, Schedule 1, page 5, lines 26-27

identified in the current Application nor has a specific application for a discrete capital project (or projects) been presented. As a result, VECC submits that this particular request is premature and should not be granted by the Board at this time.

5. CONCLUSIONS

5.1 No-Harm Test

As discussed in sections 3.1 and 3.2, VECC accepts that the Application meets the no-harm test with respect to price although the benefits to OPDC customers are not as significant as claimed. However, it is VECC's submission that the no-harm test with respect to price can only be satisfied if the rates eventually charged to former OPDC customers are reflective of Hydro One's cost to serve them. To this end the Board should set out its expectation, as it has done with other MAAD applications by Hydro One[65], that future rates will be reflective of the costs to serve the OPDC service area.

With respect to reliability and quality of service, it is VECC's submission that Hydro One's evidence does not clearly demonstrate that the no-harm test will be satisfied, particularly in view of the forecast reduction in capital spending. If the OEB decides to approve the Application, then it is VECC's submission that Hydro One should be required to report reliability results for the former OPDC service area and indicate how it plans on responding to any deterioration from historical levels.

5.2 Rate Making Considerations

Hydro One's proposal with respect to the deferred rebasing period and how rates will be set during the period are reasonable subject to the following:

- Any rate application for Hydro One's legacy customers should provide evidence clearly demonstrating that no costs to service customers in the OPDC service area are included.
- The ESM should be based on actual reported results unless Hydro One can assure the Board that future rates for the customers in the former OPDC service area can be based on the cost to service the area without the use of such information.

[65] EB-2014-0244 (Haldimand), Section 3.2, page 2

- In the event that the ESM proposal is based on forecast costs (as proposed by Hydro One), the calculation of earning and excess earning should be done based on Hydro One's cost of debt and approved ROE.

6. COSTS

VECC respectfully submits that it has acted responsibly and efficiently during the course of this proceeding and requests that it be allowed to recover 100% of its reasonably incurred costs.

*****End of Document*****