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BY COURIER

February 15, 2018

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
Suite 2700
2300 Yonge Street
Toronto, ON M4P 1E4

Dear Ms. Walli:

EB-2016-0276 – Hydro One Networks Inc. MAAD S86 to Purchase all of the issued and outstanding shares of Orillia Power Distribution Corporation – Cost Structure Submission

In accordance with Procedural Order No. 7, issued February 5, 2018, please find attached Hydro One Networks Inc.'s Submission on the expectations of the overall cost structures following the deferred rebasing period and the effect on Orillia Power customers.

An electronic copy of this cover letter and Submission has been filed through the Ontario Energy Board's Regulatory Electronic Submission System (RESS).

Sincerely,

ORIGINAL SIGNED BY JOANNE RICHARDSON

Joanne Richardson

cc. Parties to EB-2016-0276 (electronic)

EB-2016-0276
PROCEDURAL ORDER NO. 7
SUBMISSIONS OF HYDRO ONE INC.
FEBRUARY 15, 2018

In accordance with Procedural Order No. 7 issued by the Ontario Energy Board (the “**Board**”) on February 5, 2018, Hydro One Inc. (“**Hydro One**”) provides its submissions on the expectations of the overall cost structures following the deferred rebasing period and the effect on Orillia Power Distribution Corporation (“**Orillia Power**”) customers.

PROJECTED COST SAVINGS

In **Exhibit A, Tab 2, Schedule 1, Table 1** of Hydro One’s initial Application and pre-filed Evidence (which is replicated below for convenience), the projected cost savings are outlined for Years 1 to 10 following the closing of the proposed transaction with Orillia Power.

Table 1: Projected Cost Savings - \$M

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
OM&A										
Status Quo Forecast	4.8	4.9	5.0	5.1	5.2	5.3	5.4	5.5	5.6	5.8
Hydro One Forecast	4.1	2.1	2.0	1.7	1.7	1.7	1.8	1.8	1.9	1.9
Projected Savings	0.7	2.8	2.9	3.4	3.5	3.6	3.6	3.7	3.8	3.9
Capital										
Status Quo Forecast	2.7	2.8	2.9	3.0	3.1	3.2	3.3	3.4	3.5	3.6
Hydro One Forecast	3.6	2.3	2.4	2.3	2.4	2.5	2.6	2.7	2.9	3.0
Projected Savings	(0.9)	0.5	0.5	0.7	0.7	0.7	0.7	0.7	0.6	0.6

As a result of the proposed transaction, the ongoing operating, maintenance and administration (“**OM&A**”) cost savings achieved in the initial 10-year period (a 60% reduction from status quo costs) are expected to persist *beyond* the extended deferred rebasing period. Capital expenditure requirements are also expected to be lower on an ongoing basis.

1 These savings will be achieved through an integrated operating approach and the permanent
2 elimination of costs; as a result, the Hydro One Forecast will consistently be lower *vis-à-vis*
3 the Status Quo Forecast beyond the deferred rebasing period. Hydro One can definitively
4 state that the overall cost structures to serve the Orillia area (as demonstrated in **Table 1**
5 above) will be lower following the deferred rebasing period in comparison to the status quo.

6
7 These cost savings will be achieved through *sustained* operational efficiencies in areas
8 pertaining to distribution operations, administration, and back office functions.

9
10 ***Distribution Operations***

11 The elimination of an artificial electrical boundary between Hydro One and Orillia Power
12 will allow for the realization of benefits from contiguity, resulting in a more efficient
13 distribution system as well as local operating and capital savings.

14
15 The geographic advantage of contiguity allows for economies of scale to be realized in the
16 field and at the operational level through the integration of local systems owned by Orillia
17 Power and Hydro One.

- 18 • Example: Hydro One will be able to rationalize local space needs, which will reduce
19 ongoing costs.
- 20 • Example: More efficient scheduling of operating and maintenance work and dispatch
21 crews over a larger service area will lead to lower OM&A costs; more efficient
22 utilization of work equipment (e.g., trucks and other tools), which will lead to lower
23 capital replacement requirements over time.
- 24 • Example: The elimination of the service area boundary allows for more rational and
25 efficient planning and development of the distribution system.

1 ***Administration***

2 Sustained administrative efficiencies will result due to economies of scale and the
3 elimination of redundant activities:

4 1. Financial, regulatory and law

- 5 • Example: Elimination of audited financial statements for Orillia Power,
6 elimination of Orillia Power’s submissions of rate applications and
7 preparation of a separate Distribution System Plan, resulting in both lower
8 internal and external costs.

9 2. Executive and governance

- 10 • Example: Elimination of duplicative functions performed by Orillia Power’s
11 senior management and the Board of Directors.

12
13 ***Back Office***

14 Reduction in back office and information technology costs through the elimination of
15 duplicate systems for transaction processing, such as billing, customer care, human resources
16 and financial.

- 17 • Example: Updates to customer information and billing systems relating to rate
18 changes or other new initiatives will no longer be required by Orillia Power.

19
20 All of the above are examples of areas providing persistent operating and capital savings over
21 time, which will ultimately provide long-term benefits to ratepayers relative to the status quo.

22
23 In addition, Orillia Power’s current debt will be retired and Hydro One will be able to
24 refinance the debt at a lower rate. Hydro One’s cost of borrowing is lower than that of a local
25 LDC, which will result in financing cost savings reflected over time in a lower debt return on
26 rate base relative to the status quo.

27
28 As a result of these cost savings, Hydro One’s costs to serve the Orillia area, while providing
29 safe, reliable and responsive customer service, will be considerably less than the costs that
30 would have been incurred by Orillia Power in the absence of the proposed transaction.

1 Furthermore, Hydro One submits that there are additional benefits and potential for cost
2 savings from economies of scale through a higher level analysis of the electricity industry as
3 a whole. The electricity sector is a dynamic and rapidly-changing industry, a fact which is
4 currently affecting and will continue to affect all utilities. Such disruptive changes in the
5 electricity industry are likely to be more challenging and proportionately costlier for smaller
6 LDCs and their customers than for a larger distributor. Hydro One is positioned with its
7 economies of scale, network of resources, and industry experience to navigate current and
8 future industry change in innovative areas such as electric vehicle infrastructure, distributed
9 generation, smart grid technology, and energy storage.

10
11 Hydro One's evidence is that the incremental OM&A costs to serve Orillia Power customers
12 will be 60% lower than they otherwise would have been under the status quo. Capital costs
13 and debt costs are also expected to be lower than the status quo. Hydro One believes that the
14 long-term benefits of the proposed transaction will be even greater because of the high
15 probability that Orillia Power may be faced with even larger economic hurdles in the future,
16 where potentially high-cost investments may be required to address changing industry needs
17 and these costs will need to be recovered over a smaller customer base.

18
19 In addition, overall costs to serve Hydro One's customers as a result of the proposed
20 transaction will be less than in its absence. Future rate applications will determine how all
21 costs will be allocated to the appropriate customers, including a share of costs for Orillia
22 Power customers with respect to common assets and common corporate costs.

23
24 COST ALLOCATION RELATING TO ORILLIA POWER'S CUSTOMERS

25 Hydro One expects to file a rate application at the end of the deferred rebasing period
26 consistent with Board policies and rate-making principles in effect at the time (e.g. fair,
27 practical, clear, rate stability and effective cost recovery of revenue requirement), which are
28 expected to reflect changes to the electricity industry, government policy and Board policy
29 that may have evolved over the next ten years.

1 At this time, in order to satisfy the Board Handbook’s direction that future rates for Orillia
2 Power customers be reflective of Hydro One’s cost to serve those customers, Hydro One
3 expects that it would migrate Orillia Power residential and general service customers to
4 either the new Urban Acquired rate classes that Hydro One has proposed in its current
5 distribution application¹, or to new classes specifically created to accommodate Orillia
6 Power’s customers. In any case, Hydro One will prepare its application with proposed rates
7 for Orillia Power’s customers in accordance with Chapter 2 of the Board’s Filing
8 Requirements for Electricity Distribution Rate Applications in effect at the time, including a
9 harmonization plan as required in Section 2.8.13.2, as noted below:

10
11 *Section 2.8.13.2 - Rate Harmonization Mitigation Issues*

12
13 *Distributors which have merged or amalgamated service areas, and which have not*
14 *yet fully harmonized the rates between or among the affected distribution service*
15 *areas, must file a rate harmonization plan. The plan must include a detailed*
16 *explanation and justification for the implementation plan, and an impact analysis. In*
17 *the event that the combined impact of the cost of service based rate increases and*
18 *harmonization effects result in total bill increases for any customer class exceeding*
19 *10%, the distributor must include a discussion of proposed measures to mitigate any*
20 *such increases in its mitigation plan discussed in section 2.8.13 above, or provide a*
21 *justification as to why a mitigation plan is not required.*

22
23 Hydro One will ensure that future rates for acquired customers are reflective of the cost-to-
24 serve Orillia Power customers by following a process that adjusts its Board-approved Cost
25 Allocation Model (“CAM”) as necessary to ensure that the costs allocated to Orillia Power
26 customers reflect their cost-to-serve, while recognizing that the Board will ultimately
27 approve Hydro One’s cost allocation and rate harmonization plan for Orillia Power
28 customers. Any changes affecting Orillia Power customers will involve an open, fair,
29 transparent and robust process where the Board will continue to exercise its jurisdiction and
30 supervisory role as the ultimate decision-maker.

¹ EB-2017-0049, currently under review by the Board

1 CONCLUSION

2 Based on the foregoing, Hydro One submits that it is abundantly clear that the costs to serve
3 the Orillia area will be lower versus the status quo, absent the proposed transaction.
4 Furthermore, at the time of rebasing, Hydro One will adhere to the cost allocation and rate
5 design principles in place at such time in the future, ensuring that the costs allocated to
6 Orillia Power customers fairly and accurately reflect the new lower cost structure to serve all
7 customers.

8

9 In the interim, Orillia Power customers will benefit from the deferred rebasing period, which
10 will provide rate certainty for a period of 10 years, a five-year 1% reduction in base
11 distribution rates, Year 6 to 10 rates adjusted only by inflation less productivity, and a
12 guaranteed \$3.4 million earnings sharing mechanism refund.

13

14 In conclusion, Hydro One submits that the proposed transaction meets the Board's "no harm"
15 test and respectfully requests that the Board approve the Orillia MAAD Application.