BY EMAIL and RESS

Jay Shepherd
jay@shepherdrubenstein.com
Direct: 416-804-2767

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Our File No. EB-2017-0373/4

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

Attn: Kirsten Walli, Board Secretary

Dear Ms. Walli:

Re: EB-2017-0373/374 – EPCOR Acquisition of COLLUS

We are counsel for the School Energy Coalition. Pursuant to Procedural Order #1, this letter represents SEC's Final Argument in this proceeding.

Overview

EPCOR Utilities Inc ("EUI") is a substantial Alberta-based electricity and gas utility with long experience in the distribution business. It has recently acquired NRG, and has recently been granted the right to deliver natural gas to certain of the communities in the South Bruce area. We are also aware, anecdotally, that EPCOR has been an interested party or bidder with respect to a number of electricity distribution companies in the province.

SEC believes that the entry of EPCOR into the Ontario market – for gas and for electricity distribution - is by and large a positive step. The merger of Union and Enbridge reduces competition in Ontario, which reduction could be ameliorated by EPCOR's acquisitions. The dominance of Hydro One in the bidding for smaller electricity distributors may be muted with the entry of another player of similar size. Municipalities that may have believed – rightly or

wrongly – that Hydro One was "the only game in town" if they wished to sell their LDC, now may perceive a more competitive consolidation landscape.

We also note that, because of its municipal ownership, EUI may have a unique advantage in being able to acquire both gas and electricity distribution assets in Ontario without being subject to Departure Tax under the Electricity Act. The existing gas distributors would be subject to that tax. The combination of gas and electricity distribution – whether by EPCOR or by anyone else - may have long-term value to Ontario energy customers.

EUI has a good reputation in the places it does business, and SEC would not expect it to be any different here. While of course the Board must be vigilant in all utility acquisitions, and particularly with a company that has not distributed electricity in Ontario before, SEC believes that generally speaking the acquisition of COLLUS by EUI is a positive step.

SEC notes that, in responding to interrogatories, the Applicant in this proceeding has not been as forthcoming as we are used to with Ontario-based utilities. That was noticeable in 1-SEC-1 and 1-SEC-14, and in a number of other responses which were less complete than might have been helpful. While SEC did not pursue those questions through motions, given the size of the transaction, SEC believes that the Board could provide EUI with guidance on responsiveness that would assist EUI in future applications.

No Harm Test

Aside from cost structure and price (see the next section), the two key issues for most LDC acquisitions are financial viability and service to customers (reliability, service quality, etc.).

Clearly the financial viability of EUI is not in issue here, given its investment grade ratings by both S&P and DBRS [1-Staff-7(a)]. However, two facts in the evidence are worth mentioning.

First, the Applicant suggests that the premium in the transaction is $17.1 million [1-Staff-7(c)]. This is an issue because that amount is not listed in the costs and benefits analysis in 1-Staff-1(b), although other costs of the transaction are included. It also appears to be too large to be recoverable in any way, without resorting to including it in rates, given the current COLLUS income level of $601,000 [1-Staff-7(d)].

However, SEC has not been able to reconcile the stated premium with the COLLUS Financial Statements filed with the Application. It would appear to us that the premium – i.e. the amount paid above the book equity – is in the order of $2.3 million. That would appear to us to be manageable within the future income statements of COLLUS, without any impact on rates.

Second, we note that, in the most recent year, the ROE is expected to be 11.65%, or 267 basis points above the Board-approved ROE [1-SEC-2]. That means that net income is already about $140,000 per year greater than the level needed for a market rate of return. It would appear to SEC that over five years there is sufficient opportunity, between cost savings and built-in ROE, to recover the transaction costs, and the premium. Rates do not need to be impacted.

The other area of "no harm" is service to customers. The Applicant has committed "to meet or exceed current reliability standards for the next five years" [Application, p. 13]. When asked whether that should be made a condition of approval, the Applicant said that it would be "a more onerous condition than that which any other LDC within Ontario operates" [1-SEC-8].

SEC believes that, on both reliability and service quality metrics, COLLUS should maintain or improve upon its current performance, and the Board should make that a condition of approval. While the Applicant is absolutely correct that no other Ontario LDC has such a blunt obligation, EUI is new to the Ontario electricity distribution sector. SEC believes that, in making this a condition, the Board would be signalling the level of commitment and performance that it is going to expect from EUI in Ontario. Since the condition should not be difficult to meet in this case (EUI has a lot of experience), the condition would be one of affirming a principle more than anything else.

The evidence includes two other facts that should be considered with respect to "no harm":

a) The Town has launched an investigation into the original purchase of 50% of COLLUS by Powerstream. [1-SEC-23]

b) There is a material billing problem between the Town and COLLUS relating to the Town's use of electricity. [1-SEC-24]

SEC is concerned that these material issues were not disclosed in the Application. On the other hand, having asked about them in interrogatories, and having investigated their potential impacts, SEC does not believe that either of these issues has any reasonable chance of causing harm to the customers of COLLUS.

Subject to those comments, and to our comments on price below, SEC accepts the evidence of the Applicant that the no harm test is met.

Price and Rate Order

The price-related issue in a MAADs application is whether the underlying cost structure of the utility will improve. SEC accepts the evidence of the Applicant that there are opportunities for economies of scale, both within Ontario and through shared services from Alberta, that should make COLLUS more cost effective in the future. While of course the Applicant still has to deliver on their expectation of cost efficiencies, the expectation itself seems to us to be a reasonable one.

However, in addition to the MAADs approval, the Applicant is also seeking Board approval for a 1% negative rate rider for one class of customers alone, residential [Application, p. 10]. SEC believes this is a bad precedent, and should not be allowed.

SEC is aware that negative rate adjustments have been used by Hydro One, for example, in many MAADs situations. In every case of which we are aware, the negative rate adjustment has been the same for all customers, regardless of class.

In this case, the Applicant argues [1-SEC-11] that the application of the rate reduction only to residential customers is the result of a "commercial negotiation between EPCOR and the Town". With respect, it is not the responsibility of the Town to set just and reasonable rates, and it is certainly not their prerogative to allocate the benefits of the transaction between classes of COLLUS customers.

What is being proposed is a change in rates for one class, but not others, without any evidentiary basis and without any attempt to track rates to cost causality. SEC believes this is contrary to good regulatory practice, and should not be approved by the Board. To the best of our knowledge, the Board has not in the past allowed LDCs to re-allocate costs between classes, or otherwise change rates for individual classes, without cost-based evidence supporting the change. To do so would be, in our view, a bad precedent.

The Applicant proposes to spend about $254,000 over five years [1-Staff-1(b)] to provide a 1% negative rate rider to residential customers. The typical residential customer will get a cumulative five year bill reduction of $15. What the Applicant does not appear to be willing to do is to provide the same 1% reduction to the other third of COLLUS customers, a cost to COLLUS of about another $125,000. For the local school boards, for example, the impact of that would be $7,000 over five years.

To check the context of this, SEC looked at COLLUS 2017 rates relative to the rest of the distribution sector. For each of Residential, GS<50 and GS>50, COLLUS rates are at 85-90% of the average rates for the sector, i.e. somewhat lower than average. The differences between the three classes are not material. On the other side, the 11.65% ROE of COLLUS for 2017 means that rates are about 2.6% higher than what would be necessary to give COLLUS a market ROE [$140,000 of over-earnings, grossed-up for taxes, divided by 2019 Dx revenue of $7,160,000].

In these circumstances, SEC believes that the Board should make it a condition of approval that the 1% negative rate rider apply to all customer classes. The cost to the Applicant is not material, but the value in terms of maintaining fairness between rate classes is substantial.

SEC notes that the Applicant did not seek approval of any ICM, but indicated in their Application that they planned to apply for ICM funding during the deferred rebasing period [Application p. 10]. However, questioned on this point by both OEB Staff and SEC, the Applicant now states that they have no current intention to apply for ICM funding [1-Staff-14].

As no relief was sought on this point, SEC has no recommendation for the Board. We have included the above comment only to ensure that the disjunct between Application and IRs is memorialized.

Conclusion

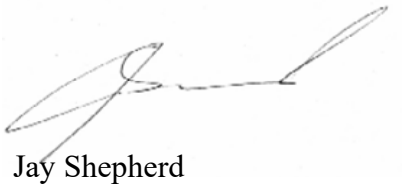
SEC submits that the Board should approve the transactions, subject to the following conditions:

a) The Applicant shall cause COLLUS to meet or exceed current COLLUS reliability and service quality levels during the deferred rebasing period, and

b) The proposed 1% negative rate rider must be expanded to include all classes of COLLUS customers.

All of which is respectfully submitted.

Yours very truly,
SHEPHERD RUBENSTEIN
PROFESSIONAL CORPORATION



Jay Shepherd

cc: Wayne McNally, SEC (email)
Interested Parties