EB-2018-0270

ONTARIO ENERGY BOARD

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 current1 Board-approved rate schedules of Orillia Power Distribution Corporation to give effect to a 1% reduction relative to their 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.

AND IN THE MATTER OF an application made by Orillia Power Distribution Corporation for leave to transfer its rate order to Hydro One Networks Inc., made pursuant to section 18 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 the Specific Service Charges in Orillia Power Distribution Corporation's transferred rate order made pursuant to section 78 of the *Ontario Energy Board Act.*

INTERROGATORIES

FROM THE

SCHOOL ENERGY COALITION

1. [Ex. A/1/1, p. 3, Ex. A, Attachment 12, Note 14, and EB-2016-0276, Ex. I/5/3] With respect to the tax implications of the proposed transaction:

a. Please confirm that, except as set forth in the subsequent sections of this interrogatory, the Applicant's response to SEC Interrogatory #3 in EB-2016-0276 remains correct.

b. Please confirm that OPDC paid a departure tax effective August 14, 2016 of $1,065,000 with respect to the deemed disposition of its assets at fair market value. Please provide the full calculation of that departure tax.

c. Please confirm that approximately $1,065,000 of the purchase price for OPDC reflects the departure tax payable by OPDC prior to acquisition by Hydro One. Please provide a reference in the agreement, or other corroboratory evidence, to support the tax component of the purchase price.

d. Please confirm that, effective August 15, 2016, OPDC acquired a deferred tax asset of $2,214,000 due to its entry into the federal income tax regime. Please provide the full calculation of that deferred tax asset, and reconcile it with the departure tax calculation.

e. Please confirm that, as a result of that fair market value bump, OPDC's federal and Ontario income taxes will be reduced by approximately $300,000 per year until the said deferred tax asset reaches zero. Please provide a schedule showing the forecast application of that deferred tax asset to tax liabilities in 2016 and any subsequent year, on a year by year basis, with all supporting calculations.

2. [Ex. A/1/1, p. 3] Please confirm that the Share Purchase Agreement filed in EB-2016-0276 and in this Application remains identical in all respects, and has not been amended, modified, supplemented, or changed in any other way.

3. [Ex. A/2/1, Table 1] SEC is concerned to understand the differences between Table 1 in the current application (the "Current Savings Table"), and EB-2016-0276, Ex. A/2/1, Table 1 (the "Previous Savings Table"). With respect to the two tables:

a. Please confirm that Year 1 in the Previous Savings Table was 2017, and Year 1 in the Current Savings Table is 2019.

b. Please confirm that the Status Quo OM&A in the Previous Savings Table was $52.6 million over ten years, and in the Current Savings Table is $60.7 million over ten years. Please explain in detail the $8.1 million increase in Status Quo OM&A.

c. Please confirm that the Hydro OM&A in the Previous Savings Table was $20.7 million over ten years, and in the Current Savings Table is $20.6 million over ten years. Please explain in detail why the Hydro One OM&A dropped while the Status Quo OM&A increased.

d. Please confirm that the Status Quo Capital in the Previous Savings Table was $31.5 million over ten years, and in the Current Savings Table is $36.6 million over ten years. Please explain in detail the $5.1 million increase in Status Quo Capital.

e. Please confirm that the Hydro Capital in the Previous Savings Table was $26.7 million over ten years, and in the Current Savings Table is $27.7 million over ten years. Please explain in detail why the Hydro One Capital increases so much less than the Status Quo Capital.

f. Please confirm that, as a result of the above changes, the Applicant is now forecasting that the ten year OM&A cost savings have increased from $31.9 million to $40.1 million, and the ten year capital cost savings have increased from $4.8 million to $8.9 million.

g. Ex. A/3/1, p. 2. Please reconcile the substantial increases in forecast savings with the drop in "guaranteed" earnings sharing from $3.4 million in EB-2016-0276 to $3.2 million in the current Application.

4. [Ex. A/2/1, p. 2] Please identify any material differences in capitalization policies between Hydro One and OPDC. For any such differences, please show the impact of those differences on Table 1, and on all other comparisons of OPDC and Hydro One costs in the Application.

5. [Ex. A/2/1, p. 3] SEC would like to better understand the impact of the comparison of OM&A per customer provided by the Applicant. Please provide the total (OM&A and capital) cost to serve each Hydro One UR customer in 2019 as set forth in the Draft Rate Order for EB-2017-0049. Please confirm that the OPDC total (OM&A and capital) cost to serve each of its residential customers in 2019 is more than the said 2019 Hydro One UR cost to serve. Please provide any supporting calculations.

6. [Ex. A/2/1, p. 5] With respect to the proposal to amend the OPDC service charges:

a. Please provide a side by side table showing all of OPDC's approved service charges, and all of Hydro One's proposed service charges. If the proposal to update OPDC's service charges does not simply match each of the Hydro One service charges exactly, please provide an explanation of any exceptions.

b. Please provide a detailed estimate of the charges to OPDC customers in each of the deferred rebasing years using a) the current OPDC specific service charges, and b) the proposed Hydro One specific service charges.

7. [Ex. A/2/1, p. 8] Please confirm that, under the Board's current ten year deferred rebasing policy, Hydro One's legacy customers will subsidize the rates of OPDC customers during that period with respect to 100% of the Shared Costs to serve the OPDC customers, and after the end of the deferred rebasing period under the current Hydro One proposal Hydro One's legacy customers will continue to subsidize the rates of OPDC customers with respect to part of the Shared Costs to serve the OPDC customers

8. [Ex. A/2/1, p. 12] SEC is seeking to understand the "economies of scale" that Hydro One claims it can deliver as a result of the proposed transaction:

a. Please explain why the two largest distributors in the province (Hydro One and Toronto Hydro), and therefore the ones with the greatest economies of scale, are also two of the highest cost distributors. Please provide any studies, analyses, or other empirical evidence known to Hydro One that shows that Hydro One and/or Toronto Hydro have material economies of scale despite their high costs of service. If Hydro One is not able to provide any evidence supporting its claim, please provide reasons why the Board should assume that such economies of scale will arise.

b. Please confirm that Hydro One has acquired more than 80 smaller distributors in the province of Ontario. Please provide any studies, analyses, or other empirical evidence that shows that, on an overall basis, the cost to serve the customers of those acquired distributors today is less than the cost to serve them if they had remained independent as a result of economies of scale.

9. [Ex. A/2/1, p. 13] SEC would like to better understand the current staffing of OPDC. Table 5 in the current Application shows 34 total staff, compared to 38 in Table 4 of EB-2016-0276, Ex. A/2/1, p. 9. Further, the reductions in the interim period are one "Back Office" person, three "Trades and Technical", and zero management. Please reconcile these changes in OPDC personnel with the Affidavit of Grant Hipgrave dated August 16, 2017, filed in EB-2017-0320.

10. [Ex. A/2/1, p. 16 and A/3/1, p. 6] SEC is trying to understand the claim that OPDC long-term debt in rates is at 6.25%. Please prepare an Appendix 2-OB model showing the current debt of OPDC, and with that model calculate the weighted average cost of debt if OPDC were to rebase this year.

11. [Ex. A/3/1, p. 3] Please confirm that, under the Hydro One proposal, Hydro One would at no time calculate its actual earnings from the OPDC service territory, and would at no time share actual earnings with those customers.

12. [Ex. A/3/1, p. 1, 4, 7] With respect to the proposed ESM:

a. Please advise how Hydro One will assure the customers and the Board that the result of the guaranteed earnings sharing will be 50/50 for earnings 300 basis points above the allowed ROE of the OPDC service territory.

b. If the reason is that the earnings are forecast only, please reconcile this with the proposal to artificially increase forecast OM&A by 20% in the ESM forecast.

c. Please confirm that the OM&A increase reduces the calculated earnings sharing by $903,000.

d. Please confirm that the proposed ESM calculation assumes that the OPDC territory revenues are fully taxable, and that actual tax, after taking into account the fair market value bump, will be approximately $2 million lower, on a grossed-up basis.

e. Please provide an explanation, with all related CCA continuity schedules, of the reduction in taxes payable on Line 7 by $864,000.

13. [Ex. A/3/1, p. 4] Please provide the full "Hydro One ESM Model" in Excel format, with all formulae and assumptions intact.

14. [Ex. A/3/1, p. 7] Please expand Table 2 to show years 1 to 5 as well, with all lines populated. Please provide the result in Excel format.

15. [Ex. A/3/1] Please confirm that Hydro One plans to change the depreciation rates for OPDC rate base after the acquisition. Please confirm that, to the extent that the depreciation rates are lower than those used by OPDC, the difference each year will be credited to account 1576 and refunded to OPDC customers on rebasing. If that is not the case, please provide a detailed explanation of the proposed ratemaking treatment of the change in depreciation rates. Please quantify the reduced depreciation amount that, on current forecasts, Hydro One proposes to have taken during the deferred rebasing period than would arise at the OPDC depreciation rates.

16. [Ex. A/4/1, p. 1] The Board in EB-2016-0276 said "*it would have been reasonable to see a forecast of costs to service Orillia customers beyond the ten year period*". Please show where in the evidence that forecast (i.e. not just the residual cost to serve, but the full cost to serve) has been provided. Please explain why Hydro One is comparing residual cost to serve, i.e. excluding certain costs to serve, with the full cost to serve in the Status Quo scenario. Please specify what conclusions, if any, Hydro One believes the Board can draw from that comparison in terms of the actual costs to serve OPDC customers in the future.

17. [Ex. A/4/1, p. 2, Attachments 18 and 20] Please provide the full calculations underlying Table 1, on a year by year basis from Year 1 to Year 11, with explanations for any figures that are not fully explained by Attachment 20. Please confirm that the status quo assumption is that revenue requirement will increase at a compound annual growth rate of 3.5% per year from 2017 to 2030. Please disaggregate the growth rate into a) increases in weighted average unit rates, and b) increases in billing determinants.

18. [Ex. A/4/1, p. 2, Attachments 18 and 20] Please confirm that, taking into account depreciation each year, OPDC currently expects to spend more than $38 million on capital (plus customer contributions) over the 13 year period 2017 to 2030, a compound annual growth rate of 3.6% per year. Please provide the Distribution System Plan or similar document of OPDC supporting that level of capital spending. If there is no DSP or multi-year plan, please provide "OPDC's 2019 Rate Base forecast" referred to in Attachment 20, with all supporting documents and all assumptions explained.

19. [Ex. A/4/1, p. 8] Please explain why Hydro One assumes that the OEB cost allocation model will not "reflect the cost to serve the acquired OPDC customers", and will have to be "adjusted" to do so. Please explain what steps would be taken to ensure that the adjustments result in just and reasonable rates, not just for OPDC customers, but for all other Hydro One customers.

20. [Ex. A/4/1, p. 9] With respect to the proposed retroactive changes to the Status Quo Forecast:

    a. Please provide examples of "unknown or unforeseen costs at that time" that would qualify for adjustment. For example, would higher than expected union wage raises require an adjustment? Or, would interest rate movements that are inconsistent with the forecast require an adjustment? Please provide sufficient examples so that the Board and parties can better understand the nature of the adjustments to be proposed.

    b. Please confirm that "unanticipated costs' and "unanticipated events" are intended to be comparable to Z factors, as the Board currently defines them. If that is not the case, please provide a fuller explanation of that proposal.

c. Please confirm that cost decreases, whether "unknown or unforeseen", or "unanticipated", would also require adjustment to the Status Quo Forecast. Please advise whether that would include better than expected savings as a result of the consolidation of OPDC into Hydro One.

21. [Ex. A/4/1, p. 11] Please explain what will happen to OPDC customers in Year 11 if the cost allocation model, after all adjustments, still shows costs to serve Hydro One customers in the OPDC service territory that are higher than the Status Quo Forecast.

22. [Ex. A/4/1, p. 12] Please advise where "an illustration of how Shared Costs could be collected from customers of the former OPDC" is found in the Application.

23. [Ex. A/5/1, p. 2 and Ex. A/4/1, Table 4] SEC is concerned with understanding the underlying drivers of the claimed ratepayer savings. With respect to Table 1 in the Update and Table 4 in the pre-filed evidence, please provide a detailed breakdown, for each year, of the components of the "ratepayer savings" of $6.5 million.

24. [A/5/1, p. 3] Please explain how, once the rates are harmonized, customers can be confident that they will continue to benefit from savings from the acquisition into the future, if the costs to serve the acquired customers are no longer being tracked.

25. [A/5/1, p. 3] The Applicants state that they are unable to "track…the costs associated with certain Hydro One resources that OPDC customers will enjoy the benefit of". Please confirm that the Applicants can track the amounts with respect to those costs that would be allocated to the OPDC customers if they were allocated on the same basis as the legacy customers.

26. [A/5/1, p. 4, 7] In the EB-2017-0049 Decision with Reasons, at p. 161/2, the Board said:

> *"As SEC argued, Hydro One's rate proposal is based on a snapshot of the existing asset base in the acquired service area. The OEB agrees and based on Hydro One's failure to demonstrate that its costs are the same or lower in its evidence,[308] finds that the proposal will result in one of the two following negative outcomes.*
>
> *a) In the absence of recalibration of the adjustment factors, an undue subsidy from Hydro One's legacy customers would be required.*
>
> *b) In the situation where the calibration of the adjustment factors is commensurate with asset renewal at Hydro One's higher costs, harm in the form of relatively higher rates to the customers of the Acquired Utilities would need to be imposed."*

Please explain how the current proposal for OPDC will not produce either

a. A situation in which legacy customers bear part of the costs fairly attributable to OPDC customers, or

b. As OPDC assets are replaced with higher cost Hydro One assets over time, and the adjustment factor is reduced, the OPDC customers will be harmed by higher longer term rates..

27. [A/5/1, p. 4-6] In the EB-2017-0049 Decision with Reasons, at p. 162, the Board said:

> *"The OEB has provided clear guidance with respect to its expectations that evidence of lower cost structures relied on in acquisition proposals are expected to result in concomitant lower rates. Hydro One would be expected to apply any distinguishable cost causation analysis relied on in an acquisition application to any customers that met the identified cost causation criteria whether they are new or legacy customers. The OEB did not direct Hydro One to isolate the Acquired Utilities in its cost allocation methodology. Hydro One has not demonstrated that its proposal is equitable to all customers." [emphasis added]*

Please confirm that, under the Applicants' new proposal, Customers in towns like Brockville, Smith's Falls, Ancaster and other Hydro One service areas of a similar size and density to Orillia will also have their costs allocated using adjustment factors similar to those being applied to OPDC. If that is not confirmed, please explain how the Applicants' current proposal complies with the direction of the Board as set forth above.

28. [A/5/1, p. 6] Please confirm that all of the examples of adjustment factors cited apply to all customers with similar characteristics, and are all designed to ensure that like customers are allocated costs in a consistent manner. Please explain how the proposed adjustment factors for OPDC achieve a similar result.

29. [A/5/1, p. 7] SEC is seeking to better understand how the adjustment factors will change over time as Hydro One replaces OPDC assets. For each of the categories of assets to which the adjustment factors are proposed to apply, please provide

   a. The most recent actual unit costs to Hydro One of new assets in each of those categories, and the most recent actual unit costs to OPDC of new assets in each of those categories, and an explanation as to any material differences in unit costs.

   b. The current OPDC book value per customer, by rate class, for each of those asset categories, and the current Hydro One book value per customer, by rate class, for each of those asset categories, plus any further information (such as weighted average vintage data) that can help the Board and parties understand any material differences in book value per customer for those asset categories.

30. [A/5/1, p. 7] Please provide a run of the cost allocation model for 2018, using Board-approved costs, book value, and all other necessary assumption, to show how costs would be allocated to OPDC on a harmonized basis under the Hydro One proposal if that allocation took place in 2018. For the purposes of this sample allocation, please assume that all of the cost savings expected over the next ten years as a result of the OPDC acquisition have been realized.

31. [A/5/1, p. 7] In the EB-2017-0049 Decision with Reasons, at p. 162, the Board said:

> *"Hydro One's cost allocation evidence indicates that in the absence of adjustment factors, Hydro One's long term costs to serve the Acquired Utilities are higher than the costs of those previous utilities. This is in direct contradiction to the evidence relied on in its acquisition proposals."*

Please confirm that this statement is true with respect to OPDC as well, i.e. that absent any adjustment factors the costs normally allocated to OPDC customers would be higher than status quo costs.

32. [A/5/1, p. 7] Please provide a detailed list of the current Shared Costs of Hydro One, and provide the amount of each such Shared Cost currently allocated to each UR, UGe, UGd, R1, GSe, and GSd customers as of the most recent cost allocation by Hydro One.

33. [A/5/1, p. 8, 10, 11] Please describe in detail the principles Hydro One proposes to apply in determining the revenue to cost ratios of the rate classes to which former OPDC customers would be allocated, including any changes to those principles over time (for example, five years after harmonization, ten years after harmonization, etc.).

34. [A/5/1, p. 9] SEC is seeking to understand the purpose and import of the Navigant evaluation. Please explain the expertise that Navigant purported to apply in its evaluation that is not already the expertise of the Board itself.

35. [A/5/1, p. 10] Please explain how costs will be allocated at any time if the "Post-Consolidation Cost to Serve" OPDC customers is greater than the status quo revenue requirement for those customers. Please calculate at what percentage allocation of Shared Costs to OPDC customers will result in total cost to serve being greater than status quo.

36. [A/5/1, App. A] SEC is seeking to better understand the report of Navigant. In its EB-2017-0049 Decision with Reasons, at p. 161-2, the Board said:

> *"The OEB denies Hydro One's rates proposals with respect to the Acquired Utilities for the following reasons.*
>
> *1) Hydro One's proposal contains simplistically derived and questionable estimates of revenue requirement comparisons to demonstrate adherence to the no harm requirement. The OEB accepts VECC's submission that given the wide range of past rate adjustments, the rebasing rate increase for any utility can vary widely from the 6.3% average.*
>
> *2) Hydro One's proposal is based on a cost allocation approach that recognizes the existing assets of the Acquired Utilities as being distinguishable and at a lower cost than its legacy assets by using adjustment factors. It intends to revisit this approach and proposes to recalibrate the adjustment factors over time as assets are renewed in the acquired service areas. The new assets will be included in Hydro One's existing asset pool at a higher cost and result in a lowering of the adjustment factors over time.*
>
> *OEB staff submitted that Hydro One's proposal is reasonable because the adjustment factors are, in effect, performing a direct allocation of assets and depreciation to the Acquired Utilities. OEB staff accepted that where costs associated with specific rate classes are known, direct allocation is appropriate. OEB staff submitted that Hydro One's proposal to use the adjustment factors for capital and the allocation of OM&A costs based on the cost allocation model is a reasonable proxy for reflecting the cost to serve.*

The OEB accepts that Hydro One's proposal adheres to some basic cost allocation principles that may be acceptable in a general sense. However, it is not acceptable to ignore the basis on which the approvals for acquiring the utilities were granted.

As SEC argued, Hydro One's rate proposal is based on a snapshot of the existing asset base in the acquired service area. The OEB agrees and based on Hydro One's failure to demonstrate that its costs are the same or lower in its evidence,[308] finds that the proposal will result in one of the two following negative outcomes.

a) In the absence of recalibration of the adjustment factors, an undue subsidy from Hydro One's legacy customers would be required.

b) In the situation where the calibration of the adjustment factors is commensurate with asset renewal at Hydro One's higher costs, harm in the form of relatively higher rates to the customers of the Acquired Utilities would need to be imposed.

3) Hydro One argued that its proposal adheres to previous OEB determinations with respect to treating the Acquired Utilities as separate rate classes and that its proposal to do so is in response to OEB direction. The OEB does not accept Hydro One's contention. The OEB has provided clear guidance with respect to its expectations that evidence of lower cost structures relied on in acquisition proposals are expected to result in concomitant lower rates. Hydro One would be expected to apply any distinguishable cost causation analysis relied on in an acquisition application to any customers that met the identified cost causation criteria whether they are new or legacy customers. The OEB did not direct Hydro One to isolate the Acquired Utilities in its cost allocation methodology. Hydro One has not demonstrated that its proposal is equitable to all customers.

4) Hydro One's cost allocation evidence indicates that in the absence of adjustment factors, Hydro One's long term costs to serve the Acquired Utilities are higher than the costs of those previous utilities. This is in direct contradiction to the evidence relied on in its acquisition proposals."

With respect to each of the reasons of the Board set forth above, please provide Navigant's expert opinion explaining how the current Hydro One proposal complies with the Board's conclusions and expectations.

37. [Ex. A/5/1] Please provide a table for OPDC similar to that provided in EB-2018-0242, Ex. I/1/1(a), but including the application of the new Ex/ A/5/1.

38. [Ex. A/5/1] Please provide two tables for OPDC similar to those provided in EB-2018-0242, Ex. I/1/3(a), but including the application of the new Ex/ A/5/1. Please provide details of each adjustment factor applied to the Year 11 figures and the dollar impact of those adjustment factors.

39. [Ex. A, Attachment 5] Please provide details of any material adjustments to the purchase price or other terms of the Share Purchase Agreement, either in accordance with its terms or otherwise, as a result of the delay in closing if the transaction is approved in 2019.

40. [Ex. A, Attachment 12] With respect to the OPDC Financial Statements:

a. Please provide the 2018 audited financial statements of OPDC.

b. Page 3, 20. Please provide a detailed explanation for the 8.1% increase in Net PP&E in 2017, and the 18.6% increase in Net PP&E in 2016.

c. Page 24, 27. Please provide a full continuity statement for OEB Account 1576 from 2015 to date, and explain any additions to the account of more than $100,000 in any year.

d. Page 37. For each of the categories of operating expenses in Note 21, please identify the amount, if any, paid to Hydro One or any of its affiliates, and provide details of those payments.

41. [Ex. A, Attachment 16] With respect to the Hydro One Distribution Financial Statements, please provide the same statements for the year ended December 31, 2018.

Respectfully submitted on behalf of the School Energy Coalition this May 28, 2019.

Jay Shepherd
Counsel for the School Energy Coalition