



Ontario
Energy
Board | Commission
de l'énergie
de l'Ontario

BY EMAIL

June 28, 2019

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Walli:

**Re: North Bay (Espanola) Acquisition Inc.
Application for approval for North Bay (Espanola) Acquisition Inc. to
purchase Espanola Regional Hydro Holdings Corporation and Espanola
Regional Hydro Distribution Corporation, amalgamate them, and operate
the amalgamated company under the name of Espanola Regional Hydro
Distribution Corporation
OEB Staff Submission**

Ontario Energy Board File Number: EB-2019-0015

In accordance with the Decision on Motion and Procedural Order No. 4, please find attached the OEB Staff Submissions for the above proceeding. This document has been sent to North Bay (Espanola) Acquisition Inc. and to all other registered parties to this proceeding.

North Bay (Espanola) Acquisition Inc. is reminded that its Reply Submission is due by July 12, 2019, should it choose to file one.

Yours truly,

Original Signed By

Andrew Bishop
Project Advisor, Supply & Infrastructure



OEB Staff Submission

**Application for approval for North Bay
(Espanola) Acquisition Inc. to purchase
Espanola Regional Hydro Holdings Corporation
and Espanola Regional Hydro Distribution
Corporation, amalgamate with them, and operate
the amalgamated company under the name of
Espanola Regional Hydro Distribution
Corporation**

North Bay (Espanola) Acquisition Inc.

EB-2019-0015

June 28, 2019

1 INTRODUCTION

1.1 Overview of the Application

North Bay (Espanola) Acquisition Inc. (the Applicant), a wholly owned subsidiary of North Bay Hydro Holdings Limited (NBHHL)¹, filed an application (Application) on January 16, 2019. The Application requested leave for the Applicant to purchase Espanola Regional Hydro Holdings Corporation (ERHHC) and Espanola Regional Hydro Distribution Corporation (ERHDC), amalgamate, and operate the amalgamated company under the name of Espanola Regional Hydro Distribution Corporation (New ERHDC). Specifically, the Applicant requested that the Ontario Energy Board (OEB) approve the following:

- Approval to acquire 100% of the issued and outstanding shares of ERHHC and 100% of the special shares of ERHDC pursuant to Section 86(2)(b) of the *Ontario Energy Board Act, 1998* (Act)
- Approval to amalgamate the Applicant, ERHHC and ERHDC to create a new company operating under the name New ERHDC pursuant to Section 86(1)(c) of the Act
- Approval of the proposed rate making framework (Proposed Rate Framework) under Section 78 of the Act
 - Following completion of the proposed transaction, NBHDL and New ERHDC would continue to operate as independent utilities until 2022
 - NBHDL and New ERHDC would file separate cost of service applications prior to 2022

1.2 Application Context and Considerations

The requests sought in the Application are for what the Applicant refers to as Phase 1 of a two-phase transaction. As a result, OEB staff has considered the Application specific to the requests sought in Phase 1. The Phase 1 transaction is characterized as the application required to affect the purchase by the Applicant of ERHHC and ERHDC, and the subsequent amalgamation of the Applicant, ERHHC and ERHDC to create New ERHDC. Further, the Applicant states that following completion of the Phase 1 transaction, NBHDL's cost of service application will be filed in late 2019 or early 2020

¹ NBHHL is also the sole owner of North Bay Hydro Services Inc., North Bay Hydro Distribution Limited (NBHDL and a rate regulated entity), and North Bay Hydro Generations Limited (NBHGL and a licensed entity). NBHGL is inactive.

for rates effective May 1, 2020 and New ERHDC's cost of service application will be filed for rates effective May 1, 2021.

The Applicant noted that approvals for Phase 2 will be requested in a separate application that will be filed later – approximately in 2022 – at which time NBHDL will seek OEB approval to amalgamate NBHDL and New ERHDC. Following the implementation of Phase 2, the ultimate amalgamated company would be called North Bay Hydro Distribution Limited (New NBHDL). The Applicant highlighted in the Application that New NBHDL would commit to only defer rebasing and rate harmonization for five years after completion of the Phase 2 transaction.

A diagram outlining the Applicant's proposed two-phase transaction is provided as Appendix A of this submission.

1.3 Process to Date

The Applicant filed the Application on January 16, 2019 and requested it be heard by way of a written hearing.

The OEB issued a Notice of Hearing on February 26, 2019. School Energy Coalition (SEC) and Mr. Donald Rennick applied for, and were granted, intervenor status.

Procedural Order No. 1 noted that as part of the Application, the Applicant submitted a Notice of Proposal under Section 81 of the Act in relation to the Applicant's interest in a qualifying generation facility and its acquisition of ERHDC. Prior to the issuance of Procedural Order No. 1, the OEB issued a letter dated February 8, 2019, in which the OEB determined that it would process the Notice of Proposal separately under a different file number². On April 10, 2019, the OEB issued a letter stating that it did not intend to issue a notice of review of the proposal.

In accordance with Procedural Order No. 1, OEB staff, SEC, and Mr. Rennick filed interrogatories. The Applicant's responses to interrogatories were received by the OEB on April 29, 2019.

Following the issuance of Procedural Order No. 2, Mr. Rennick filed a Notice of Motion with the OEB on May 1, 2019 in which he requested "the Applicant provide more fulsome responses and additional explanations to the interrogatories". The OEB issued Procedural Order No. 3 in which a submission schedule for the motion was established.

² EB-2019-0085

Following submissions from both the Applicant and Mr. Rennick, the OEB issued the Decision on Motion and Procedural Order No. 4 on June 6, 2019, which denied Mr. Rennick's motion. In addition, the Decision on Motion and Procedural Order No. 4 established the schedule for the Applicant's Argument-in-Chief as well as a submission schedule. The Applicant filed its Argument-in-Chief on June 14, 2019.

2 RELEVANT REGULATORY PRINCIPLES

2.1 The “No Harm” Test

The OEB applies the “no harm” test when assessing applications for approval of utility consolidations. The “no harm” test was first established by the OEB in 2005 through its decision in an adjudicative proceeding,³ and has been used to guide OEB decision making on mergers, acquisitions, amalgamations and divestitures (MAADs) applications since then.

The *Handbook to Electricity Distributor and Transmitter Consolidations* (MAADs Handbook), issued by the OEB on January 19, 2016, confirmed that the OEB will continue its practice of applying the “no harm” test when adjudicating utility consolidation requests. The OEB considers whether the “no harm” test is satisfied based on an assessment of the cumulative effect of the transaction on the attainment of its statutory objectives. Those objectives include:⁴

Board objectives, electricity

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.
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

³ RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257

⁴ *Ontario Energy Board Act, 1998*, Section 1

accommodate the connection of renewable energy generation facilities. 2004, c. 23, Sched. B, s. 1; 2009, c. 12, Sched. D, s. 1; 2015, c. 29, s. 7.

If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.⁵

2.2 OEB Policy on Rate-Making Associated with Consolidations

The OEB introduced policies that provide consolidating distributors with an opportunity to offset merger-related transaction costs with any achieved savings through deferral of the rebasing of the consolidated entity.

The OEB's policies on rate-making associated with consolidations are set out in the *Report of the Board – Rate-making Associated with Distributor Consolidation*⁶, issued July 23, 2007 (the 2007 Report) and a further report⁷ issued under the same name on March 26, 2015 (the 2015 Report). The 2007 Report permitted a deferred rebasing period of five years. The 2015 Report extended the deferred rebasing period, permitting consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

Consolidating distributors are required to select a definitive timeframe for the deferred rebasing period. The OEB's expectation is that, when consolidating distributors select a deferred rebasing period, they have committed to a plan based on the circumstances of the consolidation and that, if an amendment to the selected deferred rebasing period is requested, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interests of customers.

The OEB requires consolidating entities that propose to defer rebasing beyond five years to implement an earnings sharing mechanism (ESM) for the period beyond five years to protect customers and ensure that they share in any increased benefits from consolidation during the deferred rebasing period.

⁵ MAADs Handbook, pp. 3-4

⁶ https://www.oeb.ca/documents/cases/EB-2007-0028/report_ratemaking_20070723.pdf

⁷ https://www.oeb.ca/oeb/Documents/EB-2014-0138/Board_Report_MAADs_Ratemaking_20150326.pdf

3 OEB STAFF SUBMISSIONS REGARDING THE “NO HARM” TEST

In its review of the Application, OEB staff has considered the requirements described in the MAADs Handbook and other applicable OEB policy as described herein.

3.1 Application Performance Against the “No Harm” Test

The MAADs Handbook provides guidance to applicants and stakeholders on how the OEB reviews consolidation transactions proposed under Section 86 of the Act. As noted above in Section 2.1, the MAADs Handbook confirms that the OEB applies the “no harm” test in its assessment of consolidation applications. If the proposed transaction has a positive or neutral effect on the attainment of the OEB’s statutory objectives, the OEB will approve the application. While the OEB has broad statutory objectives, in applying the “no harm” test, the OEB has primarily focused its review on the impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and the financial viability of the consolidating utilities.

Submission

OEB staff submits that the Applicant has demonstrated, through both its Application and interrogatory responses, that the proposed transaction will not adversely affect customers with respect to price or quality of service. Further, OEB staff submits that the proposed transaction will not negatively affect the cost effectiveness, economic efficiency, or financial viability of the Applicant. OEB staff therefore submits that the proposed transaction meets the “no harm” test as described in the MAADs Handbook.

The basis for this conclusion is discussed in further detail below.

3.2 Impact on Price, Economic Efficiency and Cost Effectiveness

The MAADs Handbook allows an acquiring or merging utility to elect, as part of the consolidation application, to defer rebasing for up to a maximum of ten years.⁸ This deferral period is to allow the acquiring or merging utility an opportunity to recover transaction costs, which are not normally allowed to be recovered directly from customers, through operational and capital efficiencies resulting from the transaction over a reasonable period of time. The current Application does not propose that a deferred rebasing period be established. As stated in Section 1.2 of this submission, the

⁸ MAADs Handbook, p. 12

Applicant has indicated its intent to defer rate rebasing for a period of five years following completion of the Phase 2 transaction.

The Applicant notes that following the completion of Phase 1 (i.e. the approvals sought in the current Application), there will be no impact with respect to price or underlying costs due to the continuation of the PUC Services Inc. (PUC) Services Agreement.⁹ Through the PUC Services Agreement, PUC provides a comprehensive suite of management services, customer services and IT services to support the day-to-day operations of ERHDC. ERHDC is party to the PUC Services Agreement until February 28, 2022 and the Application states that “no synergies are possible until the PUC Services Agreement expires”. However, the Applicant estimates that as a result of the Phase 1 transaction, it will incur \$450,000 in transaction costs and \$75,000 in transition costs. These costs, according to the Applicant, are not, and will not, be recovered from ratepayers. Instead, they will be funded through company residual earnings.¹⁰

Submission

OEB staff is satisfied by the Applicant’s evidence that the transaction and transition costs will be funded through residual earnings and not recovered through ratepayers. Therefore, from a price, economic efficiency, and cost effectiveness standpoint, OEB staff submits that the Phase 1 transaction will have a neutral effect on the ratepayers of ERHDC and NBHDL as there will be no synergies or savings experienced in Phase 1, nor will there be any costs to ratepayers as transaction and transition costs will be funded through residual earnings.

Although uncommon, the Applicant has not selected a deferred rebasing period following the proposed Phase 1 transaction. OEB staff notes that the absence of a deferred rebasing period is not without precedent. Previously, the OEB approved a MAADs application submitted by Algoma Power Inc. requesting approval to purchase Dubreuil Lumber Inc.¹¹ that did not include a deferred rebasing period.

3.3 Impact on Service Quality and Reliability

The MAADs Handbook requires utilities to indicate the impact that the proposed transaction will have on customers with respect to reliability and quality of electricity service. The MAADs Handbook also provides that in considering the impact of a proposed transaction on the quality and reliability of electricity service, and whether the

⁹ Application, p. 24

¹⁰ Response to Interrogatories OEB Staff-1 and OEB Staff-2

¹¹ EB-2018-0271

“no harm” test has been met, the OEB will be informed by the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard.¹²

OEB staff reviewed ERHDC’s 2017 Electricity Utility Scorecard to examine reliability measures with respect to System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI) metrics. The results of this review indicate that ERHDC has been able to maintain fairly consistent reliability performance over the past five-year period. The historical reliability metrics of ERHDC are shown in Table 1.

Table 1: Historical SAIDI and SAIFI Performance for ERHDC

Description	2013	2014	2015	2016	2017
SAIDI	1.05	0.21	0.27	0.55	0.35
SAIFI	0.44	0.13	0.07	1.10	0.10

Through responses to interrogatories, the Applicant highlighted that the current ERHDC distribution system will continue to be operated from the operations centre in Espanola during Phase 1. Further, the system will continue to be operated as it is currently by ERHDC staff and managed by PUC pursuant to the PUC Services Agreement.¹³ There are no proposed reductions to ERHDC line crew or operations staff as the Securities Purchase Agreement contains a two-year guarantee on employment for employees of ERHDC following the closing date of Phase 1.¹⁴

Submission

OEB staff accepts the Applicant’s evidence that Phase 1 will have a neutral effect on the quality and reliability of electricity service for customers of ERHDC as the ERHDC distribution system will continue to be maintained by ERHDC staff – individuals who possess knowledge and understanding of the service area in which they operate. In addition, operations will continue to function out of the Espanola operations centre with management activities undertaken by PUC. There are no proposed reductions to ERHDC line crew or operations staff which will ensure that staffing levels will be adequate to address outages and maintain electricity service for customers.

Based on the evidence provided, OEB staff submits that service quality and reliability levels in the ERHDC service area are likely to be maintained. As a result, OEB staff

¹² MAADs Handbook, p. 7

¹³ Response to Interrogatory OEB Staff-11

¹⁴ Application, p. 9

submits that the proposed transaction meets the “no harm” test with respect to service quality and reliability.

3.4 Impact on Financial Viability

The OEB sets out in the MAADs Handbook that the impact of a proposed transaction on the acquiring utility’s financial viability for an acquisition, or on the financial viability of the consolidated entity in the case of a merger will be assessed. The OEB’s primary considerations in this regard are:

- The effect of the purchase price, including any premium paid above the historic (book) value of the assets involved
- The financing of incremental costs (transaction and transition costs) to implement the consolidation transaction

The Phase 1 transaction involves consideration paid in the amount of \$7.99 million (plus a purchase price adjustment) by the Applicant in exchange for 100% of the issued and outstanding common shares of ERHHC and 100% of the special shares of ERHDC. The Phase 1 transaction will be 100% financed by a newly arranged term bank loan.

The Applicant notes that, following Phase 1, it will see significant increases in its debt to equity ratios during the period up to 2022, and that its ratios tied to liquidity will decline (under the premise that the Applicant’s leverage and liquidity ratios are evaluated on a standalone basis).¹⁵ However, the Applicant expects the increase in its debt to equity ratios and decrease in liquidity will be temporary (only during Phase 1 of the proposed two-phase transaction). Following amalgamation under Phase 2, the Applicant projects that the New NBHDL will have strong liquidity and debt service ratios as well as more optimal debt to equity ratios with financial capacity for necessary borrowing.¹⁶

In the Application, the Applicant further noted that “...the purchase price will not have an adverse effect on the financial viability of [the Applicant] or New NBHDL” and “[the Applicant] has negotiated financial terms with its lender that recognize the circumstances of ERHDC and the intention to amalgamate in 2022”.¹⁷

In response to an interrogatory¹⁸, the Applicant provided supporting evidence to demonstrate that the third-party lending arrangements contain two key elements:

¹⁵ Application, p. 36

¹⁶ Application, p. 37

¹⁷ *Ibid.*

¹⁸ Response to Interrogatory OEB Staff-3

1. The requirement for the Applicant to annually comply with various standard debt covenants associated with the new term loan is being waived by the lender until the year ended December 31, 2022
2. NBHDL is acting as guarantor for the Applicant's obligation under the new term loan

The Applicant further explained that “[s]ince NBHDL is providing a guarantee for the loan, in the unlikely event that the Phase 2 Transaction is not approved by the OEB, then NBHDL would work with TD to consolidate the transitional loan with NBHDL’s other debt and [the Applicant] would likely be charged a financing charge in compliance with the Affiliate Relationship Code.”¹⁹

Submission

OEB staff is of the view that the third-party lender’s waiver of debt covenants attached to the new bank loan until such time as the year ended December 31, 2022 (after the Phase 2 transaction) supports the notion that financial viability will not be negatively impacted. Further, OEB staff notes that NBHDL’s role as guarantor in the new debt financing of the Applicant alleviates much of the financial risk of the Applicant’s proposal, given NBHDL’s current financial resources and borrowing capacity. Similarly, OEB staff is of the view that NBHDL’s guarantor role will not adversely impact NBHDL’s financial viability.

The Applicant’s evidence with respect to its financial viability has generally been provided on a consolidated basis with NBHDL. OEB staff acknowledges the relevance of this context given the expected Phase 2 amalgamation. However, OEB staff has also considered the unlikely scenario that the proposed Phase 2 transaction does not materialize. In this event, OEB staff expects that the ownership group of the Applicant would prudently monitor New ERHDC’s financial health as a standalone entity, which may include cash infusions or equity injections in order to maintain a financially viable capital structure without undue reliance on the financial position of NBHDL. The Applicant may wish to confirm its intent in this regard in its reply argument.

OEB staff has reviewed the terms of the proposed bank loan, the pro forma financial statements of the entities involved in the transaction, and the projected financial health and performance of the entities during both Phase 1 and Phase 2. OEB staff submits that the Phase 1 transaction will not adversely affect the financial viability of the Applicant and therefore meets the “no harm” test.

¹⁹ *Ibid.*

4 OEB STAFF SUBMISSIONS REGARDING THE PROPOSED RATE FRAMEWORK

In its review of the Applicant's Proposed Rate Framework, OEB staff has considered the requirements described in the MAADs and Rate Handbooks and other applicable OEB policy as described herein.

4.1 Proposed Rate Framework

Through both the Application and responses to interrogatories, the Applicant highlighted the unique circumstances that influenced the reasoning behind the need for a two-phased transaction and Proposed Rate Framework. Specifically, the Applicant noted ERHDC's rates and financial performance. ERHDC has not had a cost of service application before the OEB in seven years (i.e., since ERHDC's 2011 filing for approval of its 2012 rates), has not had its rates adjusted in nearly four years, has been operating under interim rates since May 1, 2016, and has not made any adjustments towards fully fixed distribution rates for residential customers.²⁰ Further, the Applicant indicated that ERHDC has not been performing well financially in recent years and expects this trend to continue if the OEB does not approve the Application.²¹

As part of the Proposed Rate Framework, the Applicant proposes that following the completion of Phase 1, NBHDL and New ERHDC be permitted to operate as independent utilities until the PUC Services Agreement expires in 2022. NBHDL proposes to file its cost of service application in late 2019 or early 2020 for rates effective May 1, 2020.

In addition to NBHDL filing a cost of service application, an additional component of the Proposed Rate Framework is a commitment from the Applicant that New ERHDC will file a cost of service application for rates effective May 1, 2021.²² The Application noted that the New ERHDC cost of service application will maintain the ongoing financial viability of the utility as well as address a number of regulatory matters, which include:

- New ERHDC to begin the transition of residential customers towards fully-fixed rates
- Ending a current Incremental Capital Module (ICM) rate rider²³, and rolling the substation properly into base rates, which will help reduce rates to the benefit of

²⁰ Application, p. 11

²¹ Application, p. 7

²² Application, p. 12

²³ In EB-2013-0127, ERHDC proposed to begin recovery of \$2,062,500, through an ICM, associated with the construction of a new municipal substation plus a required 44 kV line. In its Decision and Order, the OEB approved ICM treatment of the new municipal substation on the basis of a 2014 in-service date.

customers (the actual costs of the substation were less than what was previously forecasted)

- Filing a comprehensive five-year consolidated distribution system plan (DSP) in accordance with the OEB's requirement
- Disposing of Group 1 Deferral and Variance Accounts, which were last disposed of for December 31, 2013 balances, and Lost Revenue Adjustment Mechanism Variance Account which was last approved in 2011 for 2014 rates for pre-2012 programs until April 2012
- Updating New ERHDC's load forecast, cost allocation and rate design to reflect more current information²⁴

The Applicant noted, both in the Application and in responses to interrogatories, that a fundamental component of the Proposed Rate Framework is that the NBHDL cost of service application and the New ERHDC cost of service application be heard independently. Further, it was noted that no synergies are possible until the PUC Services Agreement expires. The Application stated that the Proposed Rate Framework is an integral, and non-severable component of the proposed two-phase transaction and that if the OEB determines that it will deny the Proposed Rate Framework, the balance of the Application must also be denied.²⁵

Following the independent rebasing of NBHDL and New ERHDC as well as the expiry of the PUC Services Agreement, NBHDL will file the Phase 2 application to amalgamate NBHDL and New ERHDC in 2022. As part of the Phase 2 application, a five-year rebasing deferral period will be proposed.

Submission

From OEB staff's review of the evidence, it appears the fundamental purpose of the Proposed Rate Framework is to allow NBHDL and New ERHDC to rebase independently prior to their formal amalgamation in the future Phase 2 application. As described by the Applicant, once the amalgamation is complete, assuming the Phase 2 application is approved, NBHDL and New ERHDC will enter into a five-year rebasing deferral period. Although the Applicant has not requested approval of Phase 2 in the Application, it is nonetheless important to consider as the requested approval of the Proposed Rate Framework has implications for both the Phase 1 and Phase 2 transactions.

OEB staff notes that there are several past cases which can be considered when making a decision on the Proposed Rate Framework.

²⁴ Application, p. 12

²⁵ Response to Interrogatory OEB Staff-9

First is the application²⁶ that was filed by Hydro One Inc. (Hydro One) on March 18, 2016 for approval to purchase Great Lakes Power Transmission Inc. (GLPT) under Section 86(2)(b) of the Act. Prior to the filing of the application from Hydro One and GLPT, GLPT filed a rate application for approval of its 2017 and 2018 revenue requirement. As part of the application, it was noted that the filing of a rate application before Hydro One's purchase of GLPT would allow Hydro One to recoup the premium paid for GLPT, approximately \$150 million, as well as the incremental transaction costs, estimated to be \$7.4 million.

Although the application between Hydro One and GLPT was between two transmitters, it was subjected to the same "no harm" test applied to distributors (i.e., the test being applied to the current Application). Therefore, OEB staff finds it reasonable to make reference to the Hydro One and GLPT proceeding as, per OEB policy, distributors and transmitters are held to the same policy objectives and requirements as outlined within the MAADs Handbook.

In the Decision and Order for the Hydro One and GLPT application, the OEB accepted the requested ten-year rebasing deferral period and customized ESM. However, the OEB denied the request of the parties that rates of GLPT be reset at the beginning of the rebasing deferral period. In its Decision and Order, the OEB noted that:

Hydro One's proposal for a resetting of rates at the beginning of the 10 year deferred rebasing period is not contemplated by the [MAADs Handbook] and the OEB does not accept it. Rate-setting policies associated with consolidation are predicated on the notion that the going-in rates are the rates intended to provide the revenues required as the starting point to achieve savings over the deferred rebasing period.²⁷

OEB staff further notes that in the Decision and Order regarding Hydro One and GLPT, the OEB highlighted that:

In response to Hydro One's argument for predictability for the business community, the OEB finds that the setting of the price a purchaser is willing to pay should reasonably assume stable rates for 10 years – it does not assume that these rates will be adjusted either up or down immediately following the purchase. The OEB is not convinced that the approval of a proposed rate-setting methodology in the deferred rebasing period provides rate or revenue certainty.

²⁶ EB-2016-0050

²⁷ EB-2016-0050, Decision and Order, p. 17

A purchaser will not know what the rates will be if they are to be reset. It is not clear why any purchaser would bid in the face of such an unknown.²⁸

As well, the OEB highlighted in the Decision and Order that it "...recognizes that the [MAADs Handbook] better defines the rate-setting framework for the deferred rebasing period for distributor consolidations. However, the deferral period is predicated on maintaining existing rates that are already in a rate order."²⁹

OEB staff notes that the OEB's Decision and Order regarding the Hydro One and GLPT application did not result in the outright denial of the application. Rather, the OEB noted that:

...a cost of service application was filed by GLPT on August 26, 2016. However, the OEB finds that GLPT can continue with its existing revenue requirement and may bring forward a separate rate application to seek approval for the elements of a specific revenue cap index framework, for the deferral period.³⁰

In conclusion, the OEB determined that the rates of GLPT could be set in accordance with the revenue cap index option during the rebasing deferral period, however, rates could not be reset prior to the purchase of GLPT and the end of the rebasing deferral period.

Another case relevant to the consideration of the Proposed Rate Framework is the deferred rebasing approach approved in the MAADs application³¹ between Alectra Utilities Corporation (Alectra Utilities)³² and Guelph Hydro Electric Systems Inc. (Guelph Hydro). As part of this application, Alectra Utilities and Guelph Hydro proposed to maintain separate rate zones – one for legacy Alectra Utilities customers in the Enersource, Horizon, PowerStream and Brampton service territories, and one for Guelph Hydro – and to rebase the Guelph Hydro rate zone and legacy Alectra Utilities customer rates separately following the ten year deferral periods prior to rates being harmonized. The structure of the rate proposal approved as part of this proceeding is as follows:

- Alectra Utilities would apply to rebase rates and establish distribution rates for its four existing rate zones (i.e., Horizon, Enersource, PowerStream and Brampton) effective from January 1, 2027

²⁸ EB-2016-0050, Decision and Order, p. 18

²⁹ *Ibid.*

³⁰ EB-2016-0050, Decision and Order, p. 19

³¹ EB-2018-0014

³² Alectra Utilities was formed on January 1, 2017 through the amalgamation of Enersource Hydro Mississauga Inc. (Enersource), Horizon Utilities Corporation (Horizon), PowerStream Inc. (PowerStream), and Hydro One Brampton Networks Inc. (Brampton).

- For the Guelph Hydro rate zone, there would be a ten-year rate rebasing deferral period, finishing at the end of 2028
- Alectra Utilities would apply to rebase rates and establish distribution rates for the Guelph Hydro rate zone effective from January 1, 2029, with distribution rates to be established through the Price Cap IR methodology thereafter
- For all five rate zones (i.e., Horizon, Enersource, PowerStream, Brampton and Guelph Hydro), Alectra Utilities would apply to rebase and establish rates for the five rate zones effective from January 1, 2032³³

The Decision and Order for the Alectra Utilities and Guelph Hydro MAADs application allowed for independent rebasings of utilities. The Applicant's Proposed Rate Framework where NBHDL and New ERHDC would each independently file cost of service applications prior to 2022 has similarities to the Alectra Utilities and Guelph Hydro MAADs application. However, one difference is that the amalgamation between Alectra Utilities and Guelph Hydro occurred during the rebasing deferral period from a prior amalgamation Alectra Utilities had undertaken.

A third case to consider with respect to the Proposed Rate Framework is the rebasing of ERTH Power Corporation (ERTH)³⁴ during its MAADs application³⁵ with West Coast Huron Energy Inc. (West Coast Huron).

In this case, ERTH filed a cost of service application³⁶ with the OEB on September 15, 2017 to change its electricity distribution rates as of May 1, 2018. A final Decision and Order for ERTH's cost of service application was issued on November 1, 2018. ERTH's MAADs application was submitted on January 23, 2018 and then revised on March 14, 2018, with the final Decision and Order being issued on December 20, 2018. Given the timing of ERTH's filing of its 2018 cost of service and MAADs applications, these proceedings were heard in relative parallel.

As it relates to the current Application, the primary takeaway from this third case is that the OEB considered ERTH's rate application without regard for the MAADs application. This is supported by findings in ERTH's cost of service application Decision on Issues List and Appeal, issued August 9, 2018, which determined that:

The setting of just and reasonable rates in [ERTH's cost of service] proceeding is not modified by considerations of what might eventuate in a future MAADs decision. The OEB finds that potential cost savings arising from the proposed

³³ EB-2018-0014, Decision and Order, pp. 10-11

³⁴ On June 19, 2018, Erie Thames Powerlines Corporation became ERTH Power Corporation.

³⁵ EB-2018-0082

³⁶ EB-2017-0038

amalgamation of [ERTH] with West Coast Huron Energy Inc., are outside the scope of [ERTH's cost of service] proceeding.³⁷

After considering the relevant past cases, context of the Application, and the “no harm” test, OEB staff supports the Applicant’s request regarding the Proposed Rate Framework.

The Applicant’s request is complicated by its two-phase structure. The Phase 1 transaction, which is the subject of the current Application, does not on its own, appear to offer any tangible benefits to ratepayers of either NBHDL or ERHDC. OEB staff supports this Application because it also appears to cause no harm, which is the OEB’s test for a MAADs application. Phase 2 of the process, assuming it is filed as described, would appear to offer benefits to both ratepayers and the shareholder. However, Phase 2 is not currently before the OEB for approval.

At its essence, the Proposed Rate Framework simply allows both NBHDL and New ERHDC to rebase prior to Phase 2. The Phase 2 transaction then proposes to amalgamate NBHDL and New ERHDC into a single utility and commence a five-year deferred rebasing period. The Proposed Rate Framework therefore would allow the new cost of service-based rates to be locked in for the five-year deferral period.

The chief reason provided by the Applicant for the Proposed Rate Framework is that ERHDC’s rates have not been rebased in seven years, and that it is under some financial strain. It would not be fair, in the Applicant’s view, to lock in ERHDC’s current rates for a five-year deferral period, as these rates do not reflect the utility’s actual costs.

OEB staff is of the view that ERHDC’s historical performance, from a return on equity (ROE) perspective, has not been as ominous as the scenario characterized in the Application. However, OEB staff believes that it is important to be cognizant of ERHDC’s financial trend moving forward.

When analyzing ERHDC’s ROE, OEB staff found that ERHDC achieved an ROE in 2016 that fell within the annual ROE dead band of ± 300 basis points threshold of the OEB approved ROE of 9.12% from ERHDC’s 2012 cost of service decision. However, from 2017 to 2018³⁸, the ROE falls outside the ± 300 basis points threshold. Table 2 below illustrates OEB staff’s findings.

³⁷ EB-2017-0038, Decision on Issues List and Appeal, p. 9

³⁸ Argument-in-Chief, p. 4

Table 2: ROE Summary of ERHDC from 2016 to 2018

Year	2016	2017	2018
OEB Approved ROE (%)	9.12	9.12	9.12
Actual ROE (%)	6.29	2.45	4.12
Difference (+/-)	-2.83	-6.67	-5.00

OEB staff does recognize that there is room for improvement in ERHDC's financial metrics, and that a rate rebasing is overdue. ERHDC has been on the OEB's list of annual cost of service filers since 2015 but has not filed a cost of service application during this period. Despite this, OEB staff is not opposed to New ERHDC and NBHDL making cost of service applications prior to the Phase 2 transaction. The test established by the OEB is "no harm", and it is not clear to OEB staff that a rebasing prior to the amalgamation of the wires companies (i.e., the Phase 2 transaction) would cause any harm to ratepayers. For example, absent the Phase 1 or Phase 2 transactions, ERHDC and NBHDL would both be expected to file cost of service applications by 2022 (at the latest) in any event.

OEB staff notes that the Proposed Rate Framework can possibly address some elements of ERHDC's financial performance as the cost of service application – which will include a comprehensive five-year consolidated DSP³⁹ – can assist in ensuring that ERHDC's rates are more reflective of its current circumstances. However, OEB staff further notes that there is no guarantee that the OEB will treat the cost of service applications filed by both NBHDL and New ERHDC in an isolated context (i.e., as if they do not have a common owner). As such, there is no guarantee as to whether NBHDL and New ERHDC's rates will not be adjusted to reflect synergies in response to developments such as, but not necessarily limited to, updated evidence that may support the existence of savings due to the change in ownership. The EARTH example, in OEB staff's view, is informative, however, it must be noted that both the rate and MAADs applications were, as noted above, running in relative parallel. Whereas, in the NBHDL and New ERHDC circumstance, there will be some time that would have passed from a potential approval of the consolidation and the completion of the two independent rebasing applications. Given the difference in circumstance, in contrast to the EARTH example, future panels assigned to the New ERHDC and NBHDL cost of service applications may deem it appropriate to consider any attributable benefit resulting from the Phase 1 transaction when rendering their decisions.

The current Application is a MAADs application; it is not a rates application. Although the OEB can approve the proposed Phase 1 transaction, and it can acknowledge that

³⁹ Application, p. 3

both utilities intend to file cost of service applications prior to the Phase 2 application, it has no control at this time over the outcome of those rates applications. The rebasing applications will be filed with the OEB and will be considered on their merits by the OEB panels assigned to them.

OEB staff notes that the event of allowing for both utilities to rebase their rates prior to the Phase 2 transaction could result in overearnings for the utilities, there are mechanisms that can be put in place to remedy this. For example, following either the Phase 1 or Phase 2 transaction, the OEB could consider implementing an ESM similar to that in the amalgamation application⁴⁰ between Union Gas Limited (Union) and Enbridge Gas Distribution Inc. (Enbridge). In the Union and Enbridge amalgamation application, the OEB approved an asymmetrical ESM that shared earnings on a 50/50 basis between the amalgamated entity and its customers for all earnings in excess of 150 basis points from the OEB-approved ROE. The ESM was put in effect from year one of the deferred rebasing period, rather than beginning in year six of a ten-year deferred rebasing period, as is standard.

Implementing the above described ESM following Phase 1 may seem unnecessary given that, as a result of the PUC Services Agreement, no financial efficiencies are expected to result from the Phase 1 transaction. However, introducing the ESM at this stage, and continuing the ESM until the end of the deferred rebasing period following Phase 2, would ensure that mechanisms to protect ratepayers from any unforeseen consequences of this atypical two-phased transaction are established. OEB staff is of the view that introducing the ESM following the Phase 1 transaction would not cause harm to the Applicant or compromise its proposed transaction.

If not implemented following the Phase 1 transaction as an approval of this current proceeding, OEB staff submits that the OEB should recommend, in its Decision and Order on the Application, that a future panel should consider implementing, following the Phase 2 transaction, an ESM similar to that approved in the Union and Enbridge amalgamation application. Again, the purpose would be to protect ratepayers from any unforeseen consequences of this atypical amalgamation.

OEB staff notes that as highlighted throughout the Application and responses to interrogatories, the Applicant has stated that “[t]he Proposed Rate Framework is an integral and non-severable component of the proposed two-phase transaction and this overall Application.”⁴¹ Therefore, it appears that if the OEB denies the Proposed Rate Framework, the Application, as a whole, is essentially denied as well. This is a significant element in which the Application differs from that of the Hydro One and GLPT

⁴⁰ EB-2017-0306/EB-2017-0307

⁴¹ Application, p. 7

application. Even though the OEB denied the resetting of rates for GLPT prior to the rebasing deferral period, the parties continued with the purchase. It would be up to the Applicant to determine that if what is allowed, or denied, by the OEB would be acceptable for the parties to continue with the proposed transaction.

OEB staff supports the Proposed Rate Framework, and has considered the three previous MAADs cases that have been outlined above and their relevance to the current Application. In addition, the OEB should consider recommending the implementation of an ESM to ensure that ratepayers are protected from possible overearnings as a result of NBHDL and New ERHDC rebasing independently. Further, the consideration of any attributable benefits resulting from the Phase 1 transaction should be in scope when the OEB considers the final rebasing applications of the legacy service territories.

5 OEB STAFF SUBMISSIONS REGARDING OTHER CONSIDERATIONS

5.1 Deferral Account for Accounting Policy Changes

The Applicant's proposal would ultimately result in New ERHDC and NBHDL amalgamating into one entity in 2022 following the completion of the Phase 2 transaction. Although the current Application is for approvals associated with the Phase 1 transaction, it is important to note accounting implications related to the Phase 2 transaction due to the two-phased approach the Applicant has outlined. As both entities currently report under International Financial Reporting Standards (IFRS) for external reporting purposes (and Modified IFRS for ratemaking purposes), the expectation is that the amalgamated entity will also report under IFRS following the Phase 2 transaction. The Applicant has indicated that it does not propose the use of any different accounting standards following the closing of the Phase 1 transaction as PUC will continue to provide services to the Applicant utilizing current ERHDC accounting standards.⁴²

Under IFRS, when two separate entities amalgamate, the accounting policies for the company purchased should align to the acquirer's (generally the larger entity) accounting policies. In this case, when the amalgamated entity is formed, in all likelihood, NBHDL would be deemed the acquirer and New ERHDC would be the acquired entity.

Through interrogatories, OEB staff posed questions to the Applicant about the nature, timing, and magnitude of the impact of New ERHDC's inevitable change to fully align its internal accounting policy with that of NBHDL. In its response, the Applicant indicated that it has not yet undertaken any studies of the types of transactions that may be impacted as a result of the change in policy. However, the Applicant highlighted that both NBHDL and ERHDC adhere to the recommendations of the July 2010 Kinetics Report⁴³ (Kinetics Report) for the purposes of determining estimated useful lives and the componentization of capital assets, and that both entities conform to IFRS for capitalization and overhead policies. The Applicant further submitted that it is not anticipated, at this time, that there will be material financial impacts due to New ERHDC's adoption of NBHDL's accounting policies in 2022.⁴⁴

⁴² Response to Interrogatory OEB Staff-6

⁴³ [Asset Depreciation Study for the Ontario Energy Board - July 8, 2010](#)

⁴⁴ Response to Interrogatory OEB Staff-6

Submission

OEB staff submits that, although both New ERHDC and NBHDL will report under IFRS and utilize the Kinetrics Report for certain measurements related to capital assets, this does not preclude the possibility that there are potential material differences between the rates that are underpinned by ERHDC's existing accounting policies, and those that would result if it is going to adopt NBHDL's policies. Even with both entities reporting under the same set of accounting standards, there are inherent variabilities, professional judgments, and methodologies for recording transactions that may be different between the companies, while still conforming to IFRS standards. The risk of material differences is exacerbated in this case, given that the Applicant has yet to undertake any assessments of the differences between the accounting policies of the two utilities. Examples of accounting policies include capitalization and depreciation policies, but also refer to any accounting policy underpinning rates.

In OEB staff's view, there are two alternatives to remedy the potential for a material difference between rates underpinned by one set of accounting policies versus another:

1. Option 1 to Remedy Material Difference

For ratemaking purposes, New ERHDC could be required as part of the decision on this current proceeding to adopt the accounting policies of NBHDL effective fiscal 2021 and for the purposes of its 2021 cost based application. In this case, New ERHDC would file its rebasing application for 2021 rates in accordance with the same policies as NBHDL. When the two entities amalgamate in 2022, the alignment of accounting policies would have no impact and there would be no difference in revenue requirement for New ERHDC between the two sets of policies.

OEB staff submits that this would be the most efficient option from an administrative standpoint as it would eliminate the need to track revenue requirement variances between two sets of accounting policies, and would also eliminate the need for the Applicant to establish a deferral account and request disposition of this deferral account at a later date. This remains a viable, and preferred option, given the opportunity to rebase and reset rates under a unified set of accounting policies prior to the deferred rebasing period.

2. Option 2 to Remedy Material Difference

If the OEB permits, and the Applicant elects to have New ERHDC remain on its existing accounting policies until 2022 at the earliest, and plans to rebase 2021 rates under ERHDC's existing policies, the Applicant should be ordered to establish a deferral account that captures the annual difference between New ERHDC's revenue requirement calculated using the pre-amalgamation accounting policies and the

revenue requirement calculated using NBHDL's accounting policies. These differences would be recorded annually during the deferred rebasing period.

This deferral account should be brought forward for disposition at a later date and would be subject to an OEB prudence review at that time. If the OEB determines at that time that the actual cumulative amounts recorded in the account are immaterial, it may order that the account not be disposed of and the amounts owed to or from ratepayers should be retained by the amalgamated entity's shareholders.

In the MAADs application⁴⁵ between Thunder Bay Hydro Electricity Distribution Inc. (Thunder Bay Hydro) and Kenora Hydro Electric Corporation Ltd. (Kenora Hydro), both entities stated that a complete and thorough review of their respective accounting policies had not been undertaken. The OEB ordered the Applicants to establish a deferral account in order to track the annual differences in revenue requirement arising from Kenora Hydro's transition to Thunder Bay Hydro's accounting policies.⁴⁶

OEB staff submits that, unless New ERHDC rebases in 2021 under the same accounting policies as NBHDL, the circumstances in this case are identical to those in the Thunder Bay Hydro and Kenora Hydro MAADs application. OEB staff also submits that this deferral account should be approved as part of the current Application. OEB staff has prepared a draft accounting order (Appendix B) that the Applicant may wish to comment on in its reply argument. If the OEB approves the establishment of this account, a final accounting order would accompany any approval for the Phase 1 transaction.

⁴⁵ EB-2018-0124 and EB-2018-0233

⁴⁶ EB-2018-0124 and EB-2018-0233, Decision and Order, pp. 12-13

6 CONCLUSION

The Applicants have requested the OEB's approval for:

- Approval to acquire 100% of the issued and outstanding shares of ERHHC and 100% of the special shares of ERHDC pursuant to Section 86(2)(b) of the Act
- Approval to amalgamate the Applicant, ERHHC and ERHDC to create a new company operating under the name New ERHDC pursuant to Section 86(1)(c) of the Act
- Approval of the Proposed Rate Framework under Section 78 of the Act
 - Following completion of the proposed transaction, NBHDL and New ERHDC would continue to operate as independent utilities until 2022
 - NBHDL and New ERHDC would file separate cost of service applications prior to 2022

OEB staff submits that the Phase 1 transaction meets the “no harm” test as described in the MAADs Handbook and that OEB staff does not oppose the Proposed Rate Framework, subject to the conditions discussed in this submission.

All of which is respectfully submitted.

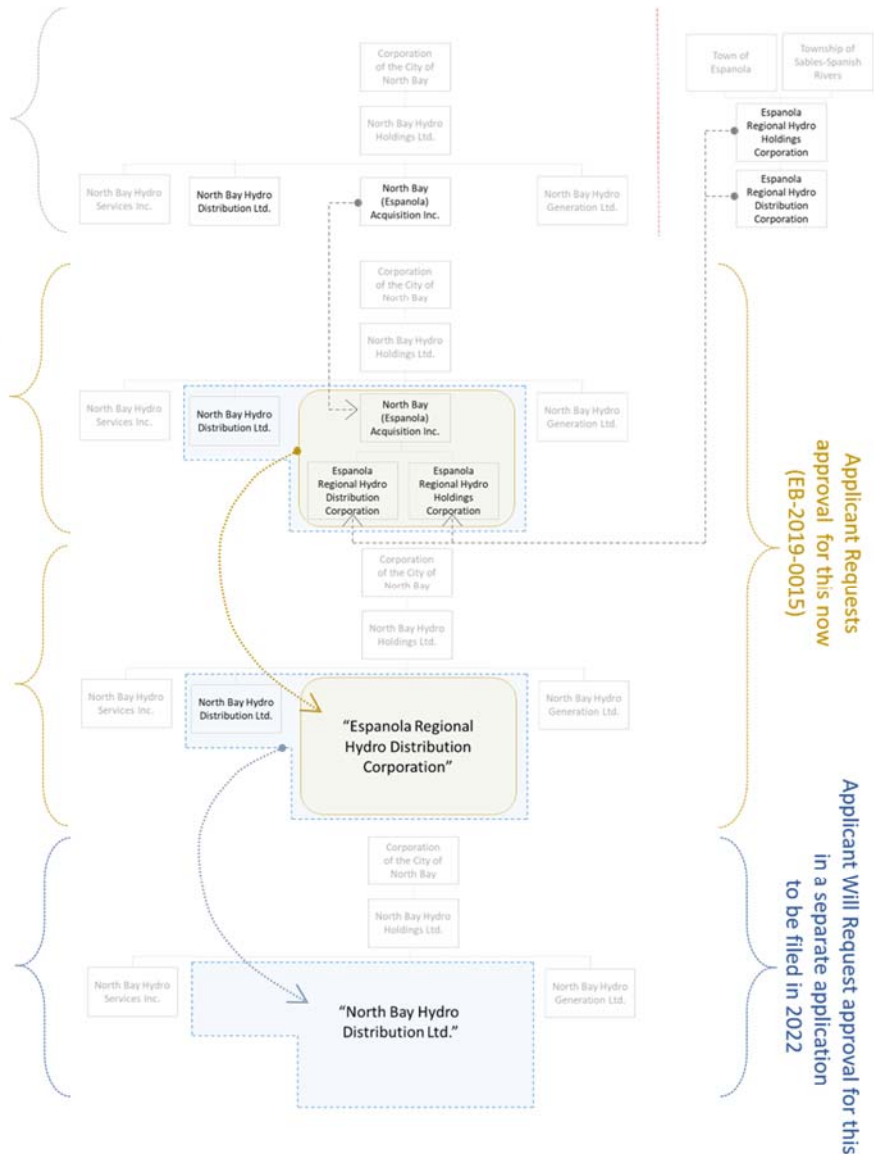
Appendix A

Right Now:
North Bay Acquisition Inc., the Espanola distributor and the Espanola holding company are separate companies, not affiliated with one another.

Phase 1:
North Bay Acquisition Inc. purchases the Espanola distributor and Espanola holding company

Phase 1, continued:
North Bay Acquisition Inc., the Espanola distributor and the Espanola holding company amalgamate. The "Amalco" is called the Espanola Regional Hydro Distribution Corp. It operates as a separate business from the North Bay distributor.

Phase 2:
The North Bay distributor and the Amalco created in Phase 1 amalgamate and operate as one company. The New company is called North Bay Hydro Distribution Ltd.



Appendix B

North Bay (Espanola) Acquisition Inc.

DRAFT ACCOUNTING ORDER

Changes in Accounting Policies Between Rebasing Years

North Bay (Espanola) Acquisition Inc. will establish the following new 1508 sub-account:

1508 – Changes in Accounting Policies

On an annual basis, the revenue requirement for New ERHDC will be calculated in two different ways:

- i. Applying the accounting policies underpinning New ERHDC's distribution rates prior to the amalgamation between New ERHDC and NBHDL, and
- ii. Applying the revised accounting policies of New ERHDC after the requirement to adopt those of NBHDL

The revenue requirement impacts shall be calculated on an as-spent basis, meaning that actual results, rather than amounts previously forecast, shall be applied in these calculations.

New ERHDC will compare the difference between the two revenue requirement calculations above. If the result of subtracting amount (i) from amount (ii) is positive (revenue requirement increases after the change in accounting policies), the following entries will be made:

Dr. 1508 Changes in Accounting Policies
Cr. 4310 Regulatory Credit

If the result of subtracting amount (i) from amount (ii) is negative (revenue requirement decreases after the change in accounting policies), the following entries will be made:

Dr. 4305 Regulatory Debit
Cr. 1508 Changes in Accounting Policies

Carrying charges will apply to the balance in the account.