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December 13, 2019

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Sent By Electronic Mail, Courier and RESS Electronic Filing

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

Attention: Christine Long
Registrar and Board Secretary

Dear Ms Long:

EB-2018-0242 – Hydro One/Peterborough Distribution Inc. Consolidation Argument-in-Chief

We are counsel to Hydro One Networks Inc. ("Hydro One") in the above-noted matter. Enclosed please find the Argument-in-Chief of Hydro One. Paper copies will be delivered to the Board via courier.

Should you have any questions, please do not hesitate to contact me.

Yours very truly,

Richard King

RK:hi

Copy (email): Joanne Richardson, *Hydro One Networks Inc.*
Service List in EB-2018-0242

ONTARIO ENERGY BOARD

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c.15, Schedule B;

AND IN THE MATTER OF an application by Hydro One Networks Inc., 1937680 Ontario Inc., Peterborough Distribution Inc., and AmalCo (defined below), under sections 86(1)(a), 86(1)(c), 78, 18, 77(5), and 74 of the *Ontario Energy Board Act, 1998*, as the case may be, for the relief necessary to effect Hydro One Networks Inc.'s purchase of the electricity distribution system assets of Peterborough Distribution Inc.

HYDRO ONE ARGUMENT-IN-CHIEF

December 13, 2019

1.0 INTRODUCTION

Hydro One Networks Inc., 1937680 Ontario Inc. (together referred to as "**Hydro One**"), AmalCo[1] and Peterborough Distribution Inc. (together referred to as "**PDI**") (collectively, the "**Applicants**") filed an application (the "**Application**") with the Ontario Energy Board ("**OEB**" or the "**Board**") on October 12, 2018 under sections 18, 74, 77, 78 and 86 of the *Ontario Energy Board Act, 1998* (the "**OEB Act**") for the relief necessary to effect Hydro One's purchase of the electricity distribution system assets of PDI.

The Application was prepared in accordance with the OEB's January 19, 2016 *Handbook to Electricity Distributor and Transmitter Consolidations* (the "**Handbook**"). The Application also adhered to the OEB's March 26, 2015 *Report on Rate-Making Associated with Distributor Consolidation* (the "**Consolidation Policy**"). This is Hydro One's Argument-in-Chief in respect of the Application. For the reasons that follow, it is Hydro One's submission that the proposed

[1] AmalCo will be formed via the amalgamation of Peterborough Distribution Inc. and Peterborough Utilities Services Inc. – the first step in the series of steps to ultimately transfer the electricity distribution system in Peterborough to Hydro One.

consolidation transaction satisfies the OEB's "no harm" test, that the relief requested is reasonable, and that the Application should therefore be approved, as filed.

As detailed in the Application and highlighted below, the proposed consolidation does not harm the price, adequacy, reliability and quality of electricity service of either distributor, or harm the attainment of the OEB's statutory objectives. The consolidation will benefit and protect ratepayers as follows:

- In Years 1 through 5 following consolidation:
  - PDI customers will not have their rates subject to an Incentive Regulation Mechanism ("**IRM**") adjustment – amounting to a benefit of $3.5 million;[2]
  - PDI customers will enjoy a 1% distribution rate reduction – amounting to a benefit of approximately $675,000[3];
- In Years 6 through 10 following consolidation:
  - Distribution rate increases for PDI customers will be less than the rate of inflation[4];
  - PDI customers will be guaranteed $1.8 million in benefits under the proposed earnings sharing mechanism ("**ESM**") (corresponding to about 13%[5] of PDI's OEB-approved base revenue requirement);
- Prior to rebasing for rates commencing in Year 11, PDI customers will have benefitted from seventeen years without a rebasing, during which extensive capital expenditures will have been made without cost to customers by both PDI and Hydro One in PDI's service territory, in particular to address numerous aging distribution stations;
- From Year 11 onwards following consolidation:

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2 Exhibit I-1-24.

3 Based on an annual cost of $135,000/year (Exhibit A-2-1, p. 5).

4 The Board's IRM methodology is calculated as inflation less productivity factor.

5 Exhibit A-1-1, p. 10.

- PDI customers will benefit from lower ongoing cost structures as a result of operational synergies – including, in particular: (a) an expected 65% savings in operations, maintenance and administration ("**OM&A**") expenses going forward; and (b) opportunities to reduce capital expenditures via Hydro One's ability to leverage its assets surrounding PDI's service area and greater purchasing power;
- Hydro One legacy customers will benefit from lower ongoing cost structures by having its shared costs allocated across a broader customer base.

The acquisition of PDI is forecast to generate a total of $9.3 million in savings[6] in Year 11. As demonstrated in the response to Exhibit I-1-48 (d), these savings will be shared by Hydro One legacy customers and PDI customers, with legacy customers seeing a $3.6 million reduction in the costs to be collected from them, and PDI customers seeing a $5.7 million reduction in the costs that would otherwise be collected from them if the transaction is not approved.

Based on the above, and the full record in this proceeding, Hydro One submits that the Application satisfies the no harm test and should be approved by the OEB.

2.0 THE BOARD'S TEST FOR THE PROPOSED CONSOLIDATION

The proposed consolidation requires leave of the OEB pursuant to sections 86(1)(a) and (c) of the OEB Act. The Handbook, which provides guidance on consolidation applications, explains that in reviewing an application by a distributor for approval of a consolidation transaction the OEB will apply its "no harm" test, which is described by the OEB as follows:[7]

> The "no harm" test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB's statutory objectives, as set out in section 1 of the OEB Act. The OEB will consider 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. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

The OEB's objectives under section 1 of the OEB Act are:

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[6] Exhibit A-4-1, p. 12.

[7] Handbook, p. 4.

> 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 accommodate the connection of renewable energy generation facilities.

While the OEB's statutory objectives are broad, it has indicated that, in applying the "no harm" test to distribution consolidations, the primary focus of the review will be on the impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector.[8] The remaining statutory objectives are considered to be appropriately addressed through the OEB's existing regulatory and performance monitoring framework.

<u>Price</u>

In considering the impact of a proposed transaction on customers with respect to price, the focus for the OEB will be on the underlying cost structures of the consolidating utilities. To demonstrate that a transaction causes no harm, the Handbook states that "applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been. While the rate implications to all customers will be considered, for an acquisition, the primary consideration will be the expected impact on customers of the acquired utility."[9]

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[8] Handbook, p. 6.

[9] Handbook, p. 7.

In the Board's most recent Hydro One consolidation decision prior to this Application (EB-2016-0276; proposed share acquisition of Orillia Power), the OEB found that the transaction met all elements of the no harm test, with the exception of pricing. In light of that decision, and the Board's recent emphasis on underlying cost structures following any rebasing deferral period, Hydro One has filed detailed evidence on future cost structures (Exhibits A-4-1 and A-5-1) to explain the proposed cost allocation and rate design for PDI and Hydro One legacy customers in Year 11 and onwards. That evidence is clear that the cost to serve PDI and Hydro One legacy customers will be no higher than they otherwise would have been without the consolidation (further discussed in section 3.1 below).

Adequacy, Reliability and Quality of Electricity Service

In considering the impact of a proposed transaction on customers with respect to the adequacy, reliability and quality of electricity service, the OEB will be informed by the metrics of the consolidating entities provided through annual reporting. The OEB's expectation is that there will be continuous improvement in a distributor's ability to deliver improved reliability performance without an increase in costs, or to maintain the same level of performance at a reduced cost, and that this continuous improvement will persist following any consolidation transaction.[10] The evidence on reliability provided at Exhibit A-2-1 is clear that the transfer of PDI's distribution system to Hydro One is expected to maintain or improve the adequacy, reliability and quality of electricity service (further discussed in section 3.2 below).

Economic Efficiency and Financial Viability

In considering the extent to which a proposed transaction promotes economic efficiency and cost effectiveness in the distribution of electricity, and facilitates the maintenance of a viable electricity industry, the OEB will assess the various aspects of utility operations where the applicant expects sustained operational efficiencies, both quantitative and qualitative. Regarding financial viability, the OEB's primary concerns are the effect of the purchase price on the consolidated entity and the financing of transaction and integration costs to implement the transaction. Such transaction and

[10] Handbook, p. 7.

integration costs are not generally recoverable through rates but instead may be recovered through efficiency gains during the permitted rebasing deferral period of up to ten years.[11] The evidence provided at Exhibit A-2-1 clearly articulates that this transaction will promote economic efficiency and cost effectiveness in the electricity industry (further discussed in section 3.3 below).

3.0 THE PROPOSED CONSOLIDATION SATISFIES THE "NO HARM" TEST

The proposed transaction will cause no harm relative to the OEB's statutory objectives with respect to impacts on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector. In fact, supported by the evidence in this proceeding, relative to the status quo the proposed transaction will provide benefits and protections to ensure a positive or neutral impact on acquired and legacy customers.

3.1 Price

Integrating PDI's operations into Hydro One will lead to operational synergies and lower ongoing cost structures when compared to the status quo.

The Applicants have forecast sustainable reductions to OM&A and capital expenditures of $7.8 million and $1.3 million per year respectively (based on savings achieved by Year 10).[12] This forecast is based on a comparison of PDI's status quo operations as a stand-alone distributor versus the incremental costs of operating PDI's distribution system once it is integrated within Hydro One. The resulting savings are expected to continue beyond the 10-year deferred rebasing period. The Applicants have comprehensively outlined the detailed methodology, assumptions and cost breakdowns that underpin the derivation of the relevant capital and OM&A forecasts, which provide a sound basis for comparison and analysis for the purpose of this Application.[13] Hydro One also commits to tracking the actual incremental OM&A and capital costs to serve PDI customers during the deferral period, as well as tracking the capital costs to serve PDI customers from Year 11 onwards.[14]

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[11] Handbook, pp. 8-9.

[12] Exhibit A-2-1, p. 2.

[13] For example, see Exhibit I-1-17, Attachment 2, p. 2, JT1.8, JT1.9, and JT2.11.

[14] Exhibit A-5-1, Section 3.0.

Table 1: Projected Cost Savings from Proposed Consolidation ($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	9.7	9.9	10.1	10.3	10.6	10.8	11.1	11.4	11.7	12.0
Hydro One Forecast	8.7	4.5	4.3	3.8	3.9	3.9	4.0	4.1	4.2	4.2
Projected Savings	**1.0**	**5.4**	**5.8**	**6.5**	**6.7**	**6.9**	**7.1**	**7.3**	**7.5**	**7.8**
Capital										
Status Quo Forecast	6.2	6.4	6.0	6.2	6.4	6.5	6.7	6.9	7.0	7.2
Hydro One Forecast	6.0	7.5	5.4	5.1	5.7	7.1	5.4	5.6	5.7	5.9
Projected Savings	**0.2**	**(1.1)**	**0.6**	**1.1**	**0.7**	**(0.6)**	**1.3**	**1.3**	**1.3**	**1.3**

The proposed consolidation will have no harm in terms of price impact relative to the status quo, whether assessed on the basis of the rates customers will pay or the cost to serve customers post-transaction. In response to Exhibit I-2-44, Hydro One provided the following tables that estimate by customer class Hydro One's and PDI's revenue requirements[15] (total and per-customer) for today, Year 10 (with and without consolidation), and Year 11 (with and without consolidation). The table shows that the consolidation will benefit the acquired customers by lowering PDI's revenue requirement on an aggregate and per-customer basis and have a neutral or slightly positive effect on Hydro One's legacy customers.

Table 2: PDI Revenue Requirement (Total and Per-Customer)

PDI	Today (2019)[1,2,3]	Year 10 (2029) with consolidation[2,3,4]	Year 10 (2029) without consolidation[2,3,5]	Year 11 (2030) with consolidation[6]	Year 11 (2030) without consolidation[2,3,7]
Revenue Collected					
Residential	$9,972,113	$10,778,546	$14,864,540	$11,995,089	$15,259,604
GS < 50kW	$2,654,781	$2,882,231	$3,988,616	$3,262,266	$4,096,265
GS 50-4,999 kW	$3,551,950	$3,904,773	$5,308,166	$3,844,882	$5,449,494
Other	$990,062	$1,078,764	$1,479,201	$1,447,995	$1,518,637
Total	**$17,168,906**	**$18,644,315**	**$25,640,523**	**$20,550,232**	**$26,324,000**

[15] In this context, revenue requirement refers to the revenue that would need to be collected from customers, including the cost of LV charges as appropriate.

Revenue Collected per Customer					
Residential	$300	$308	$424	$341	$433
GS < 50kW	$749	$741	$1,026	$831	$1,044
GS 50-4,999 kW	$9,567	$9,763	$13,272	$9,543	$13,525
Other	$107	$109	$150	$145	$153
Total	**$370**	**$379**	**$521**	**$415**	**$532**

[1] Total revenue collected from rates is derived by applying approved IRM increases between 2013 and 2019 to the approved revenue collected from rates in 2013.

[2] External revenues are held constant at 2013 approved values.

[3] Estimated values for revenues related to LV charges have been added to the total distribution revenue collected as described in Exhibit A-4-1, p 3.

[4] Total revenue collected from rates for Year 10 (with consolidation) is derived by holding 2019 rates revenue requirement constant for 2020-2024 and then applying IRM factor of 1.55% for 2025-2029.

[5] Total revenue collected (including external revenues) per Exhibit I, Tab 1, Schedule 10, part (d).

[6] Total revenue collected (including external revenues) from the acquired rate classes per Exhibit I, Tab 1, Schedule 49, Attachment 2 (plus $1.5M in estimated revenue collected from the "combined classes").

[7] Total revenue collected (including external revenues) per Table 2, Exhibit A, Tab 4, Schedule 1, p 4.

Table 3: Hydro One Revenue Requirement (Total and Per-Customer)

Hydro One	Today (2019)[1]	Year 10 (2029) with consolidation[2,3]	Year 10 (2029) without consolidation[2,3]	Year 11 (2030) with consolidation[4]	Year 11 (2030) without consolidation[2,3]
Revenue Collected					
Residential (UR)	$97,456,815	$121,420,723	$121,420,723	$134,691,875	$135,017,893
GS<50kW (UGe)	$23,037,678	$28,770,504	$28,770,504	$28,030,967	$28,101,853
GS>50kW (UGd)	$28,548,646	$35,752,868	$35,752,868	$31,931,011	$32,017,420
Other	$1,348,816,751	$1,685,459,484	$1,685,459,484	$1,710,108,678	$1,714,555,596
Total	**$1,497,859,890**	**$1,871,403,579**	**$1,871,403,579**	**$1,904,762,530**	**$1,909,692,763**
Revenue Collected per Customer					
Residential (UR)	$424	$469	$469	$515	$517
GS<50kW (UGe)	$1,276	$1,520	$1,520	$1,472	$1,475
GS>50kW (UGd)	$16,413	$19,665	$19,665	$17,458	$17,506
Other	$1,275	$1,504	$1,504	$1,519	$1,523
Total	**$1,146**	**$1,337**	**$1,337**	**$1,353**	**$1,356**

[1] Total revenue collected per Hydro One's Draft Rate Order in EB-2017-0049, Exhibit 1.0, filed April 5, 2019.

[2] Total revenue collected is derived using the compound annual growth in total revenue requirement between 2017 and 2022.

[3] External revenues are held constant at 2022 values per Hydro One's Draft Rate Order in EB-2017-0049, Exhibit 1.0, filed April 5, 2019.

[4] Total revenue collected for Hydro One legacy rate classes per Exhibit I, Tab 1, Schedule 49, Attachment 2 (minus $1.5M in estimated revenue collected from the "combined classes").

Hydro One provided similar tables in response to Exhibit I-2-43, comparing indicative Hydro One and PDI monthly electricity bills for today, Year 10 (with and without consolidation), and Year 11 (with and without consolidation). Again, the results show that the consolidation will benefit the acquired customers by lowering the typical electricity bills for each rate class, and having a neutral or slightly positive effect on the bills of Hydro One's legacy customers.

Table 4: Comparison of Indicative Electricity Bills for PDI

PDI	Today - 2019		Year10 - With Consolidation[1]		Year10 - Without Consolidation[2]		Year11 - With Consolidation[3]		Year11 - Without Consolidation[2]	
	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[4]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[4]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[4]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[4]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[4]
Residential (750kWh)	$23.37	$107.18	$25.85	$109.78	$36.58	$121.04	$27.16	$111.16	$37.67	$122.19
GS < 50kW (2,000kWh)	$50.96	$270.23	$56.06	$275.58	$79.74	$300.45	$61.55	$281.35	$82.14	$302.97
GS 50 to 4,999 kW (250kW)	$925.31	$28,315.37	$1,068.03	$28,476.64	$1,468.19	$28,928.82	$1,027.66	$28,431.02	$1,508.51	$28,974.38

1 Indicative distribution rates for year 10 (with consolidation) have been calculated by applying -1% to PDI's existing rates then holding them constant for 2020-2024 and then applying an IRM increase of 1.55% for 2025-2029.

2 Indicative distribution rates for year 10 and year 11 (without consolidation) have been calculated using the percentage increase in rates revenue requirement compared to 2019 (refer to Exhibit I, Tab 2, Schedule 44).

3 Indicative distribution rates for year 11 (with consolidation) per Exhibit I, Tab 1, Schedule 49, Attachment 2.

4 Commodity, Smart Metering Entity Charge, RTSR and Regulatory charges have been held constant, at values currently in effect, throughout the analysis period.

Table 5: Comparison of Indicative Electricity Bills for Hydro One

Hydro One	Today - 2019		Year10 - With Consolidation[1]		Year10 - Without Consolidation[1]		Year11 - With Consolidation[2]		Year11 - Without Consolidation[1]	
	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[3]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[3]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[3]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[3]	Base Monthly Distribution Charges ($)	Monthly Total Bill ($)[3]
Residential (UR 750kWh)	$34.26	$121.77	$43.72	$131.71	$43.72	$131.71	$41.44	$129.32	$44.87	$132.92
GS<50kW (UGe 2,000kWh)	$81.60	$306.91	$105.88	$332.41	$105.88	$332.41	$102.26	$328.61	$108.84	$335.52
GS > 50 kW (UGd 250kW)	$2,559.27	$30,087.07	$3,347.54	$30,977.82	$3,347.54	$30,977.82	$3,238.09	$30,854.14	$3,440.78	$31,083.18

[1] Indicative distribution rates for year 10 (with and without consolidation) and year 11 (without consolidation) have been calculated using the compound annual growth rate between 2018 and 2022 and then applying it to 2022 rates.

[2] Indicative distribution rates for year 11 (with consolidation) per Exhibit I, Tab 1, Schedule 49, Attachment 2.

[3] Commodity, Smart Metering Entity Charge, RTSR and Regulatory charges have been held constant, at values currently in effect, throughout the analysis period.

The Deferred Rebasing Period

During the rebasing deferral period, base distribution rates for PDI's service area will be reduced by 1% (for residential, general service and large use customers) and then frozen at that level for Years 1 to 5, and subsequently adjusted using the Board's Price Cap mechanism in Years 6 to 10.[16] Rate-setting during the 10-year rebasing deferral period, and future cost structures and rate plans for Year 11 onwards, are further discussed below.

16 See Exhibits A-1-1 and I-1-20.

For the first five years after the closing of the transaction, PDI's current Base Distribution Delivery Rates will be reduced by 1% for residential, general service and large use customers, and held constant.

To implement this 1% reduction, Hydro One proposes to apply a rate rider from Year 1 to 5. The cost of providing this rate rider (approximately $135,000 per year) will be recovered from synergies generated from the consolidation.[17] Hydro One's request with respect to PDI's rate riders are detailed in Exhibit A-2-1, Table 3. Additionally, PDI customers will receive rate benefits of approximately $3.5 million[18] from having these reduced rates frozen in Years 1 to 5.

For Years 6 to 10 of the deferred rebasing period, rates for the PDI service area will be set using the Price Cap adjustment mechanism, consistent with the OEB's Consolidation Policy. Starting in Year 6, Hydro One will annually apply the OEB's Price Cap Index formula, utilizing the former PDI's efficiency cohort factor of 0.45%.[19] In addition, PDI customers are guaranteed a cumulative $1.8 million in ESM benefits from Year 6 to Year 10, as discussed in Section 4 below.

Future Cost Structures

Hydro One has provided extensive evidence regarding future cost structures and rates beyond the 10-year deferral period, showing, among other things, that the residual cost to serve the PDI customers integrated into Hydro One is less than it would have been under PDI's status quo scenario.

In demonstrating "no harm", the Applicants have provided detailed forecasts of PDI's Year 11 revenue requirement under (i) a status quo scenario, where PDI continues to own and operate the distribution system, and (ii) a residual scenario, where Hydro One owns and operates the distribution system, and assuming the proposed consolidation is implemented and accounts for the synergies and efficiency gains that are anticipated during the deferral period. The Applicants have

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[17] Exhibit A-2-1, p. 5.

[18] See Footnote 2.

[19] Exhibit A-2-1, p. 7.

thoroughly outlined the methodology and assumptions that underpin the forecasts,[20] demonstrating that the approach adopted, and results derived, are reasonable and appropriate.

These forecasts indicate a residual cost of approximately $15.6 million to serve PDI's service territory in Year 11 which is $9.3 million lower than the status quo scenario cost of $24.9 million.[21] The $9.3 million in savings stems from the synergies and efficiencies realized during the 10-year deferral period, which would continue to have an ongoing mitigating effect on rates for the former PDI service area.

Following the 10-year deferral period the underlying cost structures would continue as previously illustrated in Table 1. At that time, Hydro One would begin collecting a portion of its shared costs[22] from the acquired customers so that they would pay their share of the cost of the functions, resources and assets that are carried out or held centrally by Hydro One.

For the Year 11 rebasing application, Hydro One has committed to ensuring that the total cost (including shared costs) to be collected from the former PDI customers would remain between: (i) the residual cost to serve scenario plus low voltage charges (totaling $17.0 million), and (ii) the Year 11 revenue requirement under the status quo scenario plus Year 11 low voltage charges (totaling $26.3 million).[23] This concept has been referred to by the Applicants throughout this proceeding as the "goal posts". At the low end of the goal posts ($17.0 million revenue requirement), all savings from the transaction would accrue to PDI customers, while they would

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[20] See Exhibit A-4-1 and Attachment 20; JT 1.8 and JT1.9; and Exhibit K1.2.

[21] Exhibit A-4-1, pp. 2-4.

[22] Shared costs reflect (i) shared facilities used to provide operations and maintenance services (i.e. service centres and maintenance yards), billing and IT system costs, and other miscellaneous general plant; (ii) OM&A costs associated with shared services, such as planning, finance, regulatory, human 18 resources, information technology, customer services and corporate communications; and (iii) asset and related OM&A costs associated with upstream distribution facilities used by former PDI customers (i.e. costs formerly captured under LV charges) (see Exhibit A-4-1, p. 6).

[23] As explained in Exhibit A-4-1, section 2.1.1, in addition to being charged base distribution rates that reflect PDI's revenue requirement, PDI customers also currently pay a low voltage ("LV") charge on their monthly bills, reflecting Hydro One's upstream cost to serve PDI as an embedded distribution customer. Following rate harmonization, former PDI customers would no longer pay a separate LV charge. Instead, the upstream distribution costs would be accounted for within the revenue requirement underlying the new distribution rates proposed by Hydro One for the PDI service area following harmonization. To ensure a fair comparison, the LV charges must be added to PDI's status quo revenue requirement, resulting in a total cost to serve of $26.3 million (i.e., the $24.9 million status quo revenue requirement (see footnote 21), plus $1.4 million in LV charges).

pay for their residual cost to serve so that Hydro One's legacy customers are held harmless. At the high end of the goal posts ($26.3 million revenue requirement), the revenues to be collected from PDI customers in rates would be at PDI's status quo cost to serve, meaning that all savings from the transaction would accrue to Hydro One legacy customers.[24] Any amount of revenue requirement collected from customers between these two amounts would result in a sharing of the benefits between Hydro One legacy customers and PDI customers. Through cost allocation, the annual savings of $9.3 million ($26.3M – 17.0M) from the proposed transaction will be shared by these two customer groups such that each group will have rates derived from a lower revenue requirement than would have otherwise applied in Year 11 and beyond.

The question is not whether the transaction will result in consolidation savings, but rather how those savings will be shared among PDI and Hydro One legacy customers. In this regard, Hydro One has put forward detailed evidence to explain the proposed cost allocation and rate design.[25] The evidence demonstrates that Hydro One's proposal will result in: (i) an allocation of costs to PDI customers that reflects the cost to serve them; (ii) rates that collect costs from PDI customers that are less than what they would have paid in the absence of the proposed transaction; and (iii) Hydro One legacy customers being unharmed or slightly better off than they would have been in the absence of the transaction. Specifically, the evidence provided in Exhibit I-1-48 shows that the $9.3 million in savings generated by this transaction in Year 11 will provide a $3.6 million reduction in the costs to be collected from legacy customers and a $5.7 million reduction in the costs that would otherwise be collected from the PDI customers if the transaction is not approved.

To ensure that PDI customers are charged only their costs to serve, Hydro One plans to introduce new rate classes. This option is specifically provided for by the OEB in the Handbook[26] and will allow Hydro One to allocate to those customers only the cost of fixed assets used to serve them given the customer density and distribution system configuration of PDI's specific service area. In order to ensure that these acquired customers are only charged the costs to serve them, it is critically important that those customers are appropriately allocated their specific fixed asset costs,

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[24] Exhibit A-4-1, p. 8.

[25] See Exhibit A-5-1 and Appendix A. Exhibit I-1-48 provides further details and assumptions regarding the cost allocation model being proposed for 2030 (Year 11).

[26] Handbook, p. 18.

which are a key driver of the bulk of costs within OEB's cost allocation model.[27] Since PDI customers are located within a defined service area with its own unique characteristics, and the costs of the assets are explicitly identified and separate from other Hydro One asset costs, Hydro One will know the actual gross fixed asset costs to serve certain customers and can directly allocate these costs to current PDI customers using adjustment factors.[28] To preserve continuity of the direct allocation adjustment factors, Hydro One will track the distribution gross fixed asset costs associated with serving the PDI customers, and update the adjustment factors at the time of future cost of service applications, as necessary.[29]

With respect to shared costs, Hydro One will apply the same allocation principles and allocators (e.g., number of customers, weighted number of bills) normally used in the OEB's cost allocation model[30] to ensure a consistent and fair allocation of shared costs to both Hydro One's legacy customer classes and the new PDI customer classes.

Given the alignment of Hydro One's proposals with the OEB's cost allocation and rate design principles, Hydro One is confident that its approaches to cost allocation and rate design are appropriate and will treat legacy and PDI customers equitable. This is further supported by the independent expert review by Navigant Consulting Ltd., which concluded that Hydro One's proposed cost allocation and rate design approaches are appropriate and consistent with accepted regulatory practices.[31]

3.2 Adequacy, Reliability and Quality of Electricity Service

The transfer of PDI's distribution system to Hydro One is expected to maintain or improve the adequacy, reliability and quality of electricity service. By leveraging and retaining local knowledge from existing PDI staff in combination with Hydro One's regional operations and staff, Hydro One will be in a strong position to maintain or improve reliability for the former PDI customers.

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[27] Exhibit A-5-1, p. 4.
[28] Exhibit A-5-1, p. 6.
[29] Exhibit A-5-1, p. 7.
[30] Exhibit A-5-1, pp. 7-8.
[31] Exhibit A-5-1, Appendix A.

Hydro One expects former PDI customers' reliability to continue to reflect the urban nature of its distribution system including its load transfer capability and the fact that a large proportion of its system is underground and therefore not exposed to the elements. With the consolidation and integration of the two territories there is an opportunity to further improve the reliability for PDI customers through new tools and technologies that Hydro One currently utilizes on its distribution system.[32]

In the long term, PDI customers are expected to benefit from the operational efficiencies to be created from the consolidation. Scale efficiencies are expected in the areas of distribution system operation and maintenance, capital replacement planning, and overhead and management functions.[33] Notably, Hydro One was the first of any electric utility in Ontario to offer service guarantees. Hydro One will also augment PDI's knowledge and best practices with its size and scale to provide a level of customer service that extends beyond service levels provided by smaller utilities, such as extended call center service hours, key account managers, and automated outage notifications through text messages or emails as well as an outage app.[34]

3.3 Economic Efficiency and Financial Viability

The transaction will promote economic efficiency and cost effectiveness, leading to lower ongoing cost structures following the closing of the transaction and sustained operational efficiencies (both quantitative and qualitative).

As noted above, based on the level of savings achieved by Year 10, Hydro One projects reductions in OM&A and capital expenditures.[35] These efficiencies represent an ongoing OM&A reduction of approximately 65% of PDI's status quo forecast[36], placing downward pressure on PDI's cost structures relative to the status quo, while maintaining adequacy, reliability and quality of service. These savings are expected to continue beyond the 10-year deferred rebasing period. With the integration of PDI's staff and operations within Hydro One Distribution, Hydro One expects

[32] Exhibit I-1-28 part c).

[33] Exhibit A-2-1, Section 2.2.

[34] Transcript Vol. 2, December 3, 2019, pp. 172-173., Exhibit A-2-1 p. 17.

[35] Exhibit A-2-1, pp. 1-2.

[36] Exhibit A-3-1, p.5.

sustained operational efficiencies to be realized in distribution operations, administration, information technology and customer service, as detailed in Exhibit A-2-1, Section 2.2.

4.0 EARNING SHARING MECHANISM

Hydro One will implement an ESM for the Years 6 to 10 of the deferred rebasing period that protects customers and ensures customers share in the benefits from consolidation during that period.

Hydro One's ESM will guarantee a cumulative $1.8 million of over-earnings to be shared with former PDI customers during Years 6 to 10. The sharing of earnings solely with PDI's customers is consistent with the OEB's direction in the Handbook, which indicated that "a large distributor that acquires a small distributor may demonstrate the objective of consumer protection by proposing an ESM where excess earnings will accrue only to the benefits of the customers of the acquired distributor".[37]

Hydro One also believes that its proposed ESM better achieves the objective of protection of the acquired customers for this transaction than the ESM set out in the OEB's Consolidation Policy, which contemplates using the consolidated entity's audited financial statements. Hydro One has not earned an ROE of more than 300 basis points over allowed ROE in the last 10 years.[38] Due to the size of PDI compared to Hydro One, any savings resulting from the transaction would have limited impact on the overall earnings shown in Hydro One's financial statements.[39] As such, Hydro One proposes to calculate the excess earnings on the operations of the acquired entity as opposed to the consolidated new entity's earnings.[40]

For this calculation, Hydro One plans to use forecast OM&A and capital costs (as shown in Table 1). Hydro One proposes to record the guaranteed refund due to ratepayers in a deferral account, accruing interest as prescribed by the OEB. Hydro One is on record that PDI will be fully integrated

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[37] Handbook, p. 16.

[38] Exhibit I-6-2.

[39] The OEB recognized this concern in the 2016 Handbook, commenting that the "ESM as set out in the 2015 Report may not achieve the intended objective of customer protection for all types of consolidation proposals" and inviting applicants "to propose an ESM that better achieves the objective of protecting customer interests during the deferred rebasing period".

[40] Exhibit A-3-1, p. 3.

into its distribution business, therefore separate audited financial statements for PDI will not be available.

By committing to a pre-calculated ESM, Hydro One is guaranteeing a defined benefit to PDI customers. This approach will further incentivize Hydro One to achieve the forecast efficiency savings, and effectively transfers 100% of the risks of attaining those savings to Hydro One. Key components of the proposed ESM are detailed in Exhibit A-3-1, Table 1.[41]

5.0 SPECIFIC RELIEF REQUESTED

This transaction is unique in two ways. First, certain distribution assets used to serve PDI customers are owned by Peterborough Utilities Services Inc. ("**PUSI**"), making an amalgamation of PDI and PUSI a necessary first step to aggregate the assets in a single legal entity. Second, this transaction is the first Hydro One consolidation, since the 2007 Consolidation Policy was issued, being carried out by way of an asset purchase, which will result in a Hydro One Inc. subsidiary (1937680 Ontario Inc. ("**1937680**")) owning and operating the distribution system for a period of several months to facilitate integration. The requisite steps in the transaction to effect the ultimate acquisition of the PDI distribution assets by Hydro One are set out in Exhibit A-1-1, Section 3.0. The specific relief being requested include:

Amalgamation of PDI and PUSI

- Approval to amalgamate PDI with PUSI (the amalgamated entity to be referred to as AmalCo) pursuant to section 86(1)(c) of the OEB Act;
    - Approval to transfer PDI's distribution licence and rate orders to AmalCo, pursuant to section 18 of the OEB Act;

Interim Ownership and Operation by 1937680

- Approval for AmalCo to sell its distribution system to 1937680 pursuant to section 86(1)(a) of the OEB Act;

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41 Exhibit A-3-1, p. 7.

    - Approval to include a rate rider in PDI's current OEB-approve rate schedules to give effect to a 1% reduction relative to Base Distribution Delivery Rates applicable at the time of closing, pursuant to section 78 of the OEB Act;
    - Approval to transfer AmalCo's distribution licence and rate orders to 1937680, pursuant to section 18 of the OEB Act;

Final Transfer to Hydro One Networks Inc.

- Approval for 1937680 to dispose of its distribution system to Hydro One Networks Inc. pursuant to section 86(1)(a) of the OEB Act;
    - Approval to cancel 1937680's distribution licence pursuant to section 77(5) of the OEB Act;
    - Amend Hydro One Networks Inc.'s distribution licence, pursuant to section 74 of the OEB Act, by including The City of Peterborough, the Township of Asphodel-Norwood, the former Village of Lakefield and locations outside the Village of Lakefield to Appendix B, Tab 1 of Schedule 1;
    - Approval to transfer 1937680's rate orders to Hydro One Networks Inc. pursuant to section 18 of the OEB Act; and,
    - Update PDI's current Specific Service Charges to align with the Specific Service Charges that are, or will be, approved by the OEB for Hydro One Distribution. Amending PDI's rate schedules to reflect Hydro One's Specific Service Charges is the most reasonable and cost-effective solution. This approach simplifies and reduces the cost of billing system modifications and/or manual workarounds to accommodate different charges, reduces call centre staff training and provides for a consistent customer experience.[42]

Other Relief

Hydro One is also seeking approval to:

[42] Exhibit A-2-1, p. 6.

- Continue to track costs to the regulatory asset accounts currently approved by the OEB for PDI and to seek disposition of their balances at a future date. All PDI rate riders will continue as per PDI's existing rate schedules until expiry.

- Utilize US GAAP for financing reporting purposes with respect to PDI. PDI's financial statements are currently prepared under modified IFRS. Hydro One Distribution received OEB approval to utilize US GAAP as its approved framework for rate setting, regulatory accounting and regulatory reporting in the Decision with Reasons in EB-2011-0399 (issued on March 23, 2012). In addition, in the Hydro One Norfolk MAAD (EB-2013-0187/196/198) Decision and Order, the Board decided that using US GAAP methodology in accounting for Norfolk Power Distribution Inc. (the acquired utility) will be more efficient than continuing to use Modified IFRS. Since that Decision, the OEB has also approved the use of US GAAP for Haldimand County Hydro Inc. (EB-2014-0244) and Woodstock Hydro Services Inc. (EB-2014-0213) in their respective MAAD applications. Approval to use US GAAP for PDI will simplify any future rate integration, will avoid significant incremental costs and productivity losses by streamlining processes avoiding the need for manual workarounds, and will facilitate Hydro One Inc.'s consolidated reporting for securities filing purposes (including future U.S. Securities and Exchange Commission), thus avoiding incremental costs and/or reduced productivity.[43]

Hydro One has selected a deferred rebasing period of 10 years from the closing of the proposed transaction, consistent with the OEB's Consolidation Policy.

6.0 CONCLUSION

The proposed consolidation will cause no harm relative to the OEB's statutory objectives, including with respect to the impacts of the consolidation on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector. The proposed consolidation is also consistent with and supportive of the policies for consolidation underlying the Handbook, the Consolidation Policy and the OEB's objectives under the Renewed Regulatory Framework for Electricity. Hydro One's evidence is

[43] Exhibit A-2-1, p. 23.

clear that there are real sustained and ongoing savings achieved by this consolidation that will be incorporated into the cost structures of PDI beyond the deferred rebasing period. These savings will not only benefit PDI customers but will benefit the industry as a whole. The transaction therefore satisfies the OEB's "no harm" test and the relief requested is reasonable. On this basis, the Application should be approved as filed.

All of which is respectfully submitted this 13th day of December 2019.

HYDRO ONE NETWORKS INC.

By its Counsel, Osler, Hoskin & Harcourt LLP

Per: Richard J. King