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File 94355

December 20, 2019

VIA COURIER and RESS FILING

Ms. Kirstin Walli,
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor,
P.O. Box 2319
Toronto, ON M4P 1E4

Dear Ms. Walli,

Re: EB-2018-0270 - Orillia Power Distribution Corporation

Attached please find the Submissions of the Power Workers' Union in connection with the above-noted proceedings. An electronic copy has been filed through the Board's RESS filing system, and two paper copies will follow by courier delivery.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson
RPS:pb

Encl.

Doc 3148375 v1

EB-2018-0270

Hydro One Networks Inc.
Orillia Power Distribution Corporation

Application for approval to purchase all issued and outstanding shares of Orillia Power Distribution Corporation

SUBMISSIONS OF THE POWER WORKERS' UNION (PWU)

I. INTRODUCTION

1. Hydro One Inc. ("HOI"), Hydro One Networks Inc. (together referred to as "Hydro One") and Orillia Power Distribution Corporation (Orillia Power or Orillia) (collectively, the Applicants) filed an application ("the Application") with the Ontario Energy Board ("OEB" or the "Board") on September 26, 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 HOI's purchase of all issued and outstanding shares of Orillia Power, the disposition of Orillia Power's distribution system to Hydro One Networks Inc. and the transfer by HOI of that distribution business to Hydro One Networks Inc.

a. Background: EB-2016-0276, EB-2017-0049

2. EB-2016-0276 (Hydro One and Orillia's previous MAADs application) and EB-2017-0049 (Hydro One 2018-2022 Distribution Rates Application) are relevant to the review of the current Application in two respects. First, the evidence filed by the Applicants in the current proceeding is substantially similar to Hydro One and Orillia's previous MAADs application (EB-2016-0276) that was filed on September 27, 2016. Secondly, in the Decision that that the Board issued on April 12, 2018 denying the application, it noted that its conclusions from the review of related issues in EB-2017-0049 (Hydro One's 2018-2022 Distribution rates application), a case that was concurrently before the Board, were partly the reasons for denying the application.

3. In EB-2016-0276, the Board applied the "no harm" test to the proposed consolidation primarily focusing on three main aspects of the Application that are

identified as such in the Board's January 19, 2016 *Handbook to Electricity Distributor and Transmitter Consolidations (the "Handbook")*:[1]

1) Reliability and Quality of Electricity Service

Board's Findings:

"The OEB is satisfied based on the evidence before it, that it can be reasonably expected that Orillia Power's quality and reliability of service would be maintained following a consolidation. The fact that the consolidated entity is required to report on reliability and quality of service metrics in its annual filings confirms to the OEB that any reduction in service quality would become apparent and would be addressed therefore reducing any risk of harm." [2]

2) Financial Viability

Board Findings:

"The OEB does not find that there will be an adverse impact on Hydro One's financial viability as a result of its proposals for financing the proposed acquisition transaction."[3]

3) Price, Cost Effectiveness and Economic Efficiency

Board Findings:

"The OEB's primary concern is that there is a reasonable expectation that underlying cost structures for the acquired utility are no higher than they would have been had the consolidation not occurred. Although the OEB accepts that the acquisition will lead to some savings on account of eliminating redundancies, that does not necessarily mean that Hydro One's overall cost structure to serve Orillia's customers will be no higher than Orillia's underlying cost structure would have been absent the proposed acquisition.

The experience of the three acquired utilities in Hydro One's current distribution rates case [EB-2017-0049] is informative. In the MAADs proceedings in which Hydro One acquired these utilities, Hydro One pointed to savings that would be realized through the acquisition. Although these savings may well have occurred, they do not appear to have resulted in overall cost structures (and therefore rates) for customers of the acquired utilities that are no higher than they would have been, once the deferral period ended and their rates were adjusted to account for Hydro One's overall costs to serve them. Material filed in the Hydro One current distribution rates case shows that some rate classes are expected to experience significant and material increases. While the OEB has not approved these requested rates, this panel takes notice of the proposed rate increases which Hydro One states are

[1] Handbook, page 6
[2] EB-2016-0276, OEB Decision and Order, April 12, 2018, Page 16
[3] Ibid., page 17

reflective of the costs to service the acquired customers, and are inclusive of the "savings" that Hydro One states were realized.

The OEB recognizes that Orillia was not part of Hydro One's distribution rates filing, and that it is not certain that its customers' experiences would be the same. *Because of this uncertainty, the OEB provided Hydro One the opportunity to file further evidence on what it expects the overall cost structure to be following the deferral period and to explain the impact on Orillia's customers. Hydro One did not file further evidence. Hydro One's submissions simply restated its expectation that based on the projected Hydro One cost savings forecast for the 10 year period following the transaction, the overall cost structures to serve the Orillia area will be lower following the deferred rebasing period in comparison to the status quo. The OEB is of the view that it would have been reasonable to see a forecast of costs to service Orillia customers beyond the ten year period and an explanation of the general methodology of how costs would be allocated to Orillia ratepayers after the deferral period. Hydro One takes the position that this information is not known. The OEB recognizes that any forecast of cost structures and cost allocation 10 years out would include various assumptions and could not be expected to be 100% accurate. However, the OEB has highlighted its concern and its need to better understand the implications of how Orillia customers will be impacted by the consolidation beyond the ten year period. In the absence of information to address that OEB concern, the OEB cannot reach the conclusion that there will be no harm [Emphasis added].*[4]

4) Other Approvals (rate riders, asset transfer, amendments of licences, etc.)

Board Finding:

"As the OEB is denying Hydro One's application for the proposed share acquisition transaction, the requests set out above, which are applicable only in the event that the proposed transaction were to be approved are also denied."[5]

b. The Current Application: EB-2018-0270

4. It is apparent from the foregoing that the reason the Board denied the previous MAADs application was the Applicants' failure to file a forecast of costs to service Orillia customers beyond the ten year period and an explanation of the general methodology of how costs would be allocated to Orillia ratepayers after the deferral period. In response to the noted deficiency in the previous application, Hydro One has provided extensive evidence in the current Application:

[4] Ibid, pp 12-13
[5] Ibid, page 19

- Future Cost Structures for Orillia Power in relation to revenue requirement and explanation as to how costs would be allocated beyond the deferred rebasing period (Exhibit A, Tab 4, Schedule 1)

- Blue page updates, filed on April 26, 2019, to the following pre-filed evidence exhibits:
  - Exhibit A, Tab 1, Schedule 1
  - Exhibit A, Tab 2, Schedule 1
  - Exhibit A, Tab 3, Schedule 1 (impacted by updates to the tax calculations used in the Hydro One Earning Sharing Mechanism)
  - Exhibit A, Tab 4, Schedule 1, and Attachment 18 (the Residual Cost to Serve scenario for Year 11)

- Supplemental evidence (Exhibit A, Tab 5, Schedule 1) addressing some of the OEB concerns and conclusions in relation to EB-2017-0049.

II. SUBMISSIONS OF THE PWU

5. For the following reasons, the PWU submits that the current MAADs Application meets the no harm test set out by the Board in its previous decisions and therefore the Board should approve the transaction.

a. The Proposed Consolidation Will Benefit and Protect Ratepayers

6. The Applicants' evidence indicates that for the five years following consolidation, Orillia will not have its rates subject to an Incentive Regulation Mechanism ("IRM") adjustment. By avoiding an IRM adjustment, Orillia customers will enjoy a benefit of approximately $2.0 million.[6] Over the same period, Orillia customers will enjoy a 1% reduction in base distribution rates, and these reduced rates will be frozen over the five-year period.[7]

7. For the Years 6 through 10 following the transaction, distribution rate increases for Orillia customers will be less than the rate of inflation[8]; moreover, Orillia customers will be guaranteed $3.2 million in benefits under the proposed earning sharing mechanism

[6] EB-2018-0270, Hydro One Argument-in-Chief page 2
[7] Exhibit A, Tab 1, Schedule 1, page 3, Footnote 2
[8] EB-2018-0270, Hydro One Argument-in-Chief page 2

("ESM").[9] The implementation of a guaranteed ESM protects Orillia ratepayers from the risk of Hydro One failing to achieve the forecast level of synergies. The proposed guaranteed ESM also better protects customers of Orillia than the ESM mechanism as set out in the Board's 2015 Report wherein ESM would have been calculated on the basis of ROE over-earnings by Hydro One.

8. The ESM as set out in the Board's 2015 Report contemplates using the consolidated entity's audited financial statements. As confirmed in PWU Interrogatory # 2, Hydro One has not earned an ROE of more than 300 basis points over the OEB-approved ROE in the last over 10 years.[10] Due to the size of Orillia as compared to Hydro One, any savings resulting from this transaction would have limited impact on the overall earnings shown in Hydro One's Financial Statements.[11] Therefore, proceeding with the type of ESM that is contemplated in the Board's 2015 Report would have eliminated the guaranteed refund Hydro One is proposing and also have a less likely chance of being actualized.

9. In Exhibit A-2-1, the Applicants have provided sufficient evidence that the transfer of Orillia's distribution system to Hydro One would maintain or improve the adequacy, reliability and quality of electricity service.

b. Lower Ongoing Cost Structures from Year 11 Onwards

10. The Applicants have presented evidence that the Residual cost to serve the former customers of Orillia integrated into Hydro One is less than it would have been under Orillia's Status Quo scenario.

11. The underlying cost structures to serve the former Orillia service territory area will be reduced by approximately $6.5 million in Year 11, prior to an allocation of Shared Costs.[12] Under the proposed cost allocation method, Hydro One legacy customers will

[9] Exhibit A, Tab 1, Schedule 1, Page 5 of 11
[10] Exhibit I, Tab 4, Schedule 2, Page 1 of 1
[11] Ibid.
[12] Exhibit A, Tab 4, Schedule 1, Page 10 of 13

share $1.7 million of these savings or cost reductions, confirming that Hydro One's legacy customer classes will not subsidize the Orillia acquired classes.[13]

12. As Hydro One indicates in its Argument-in-Chief, if the proposed transaction is approved, Orillia customers will have benefitted from twenty years (from 2010-last rebasing to 2030-next rebasing) without a rebasing, during which extensive capital expenditures will have been made without cost to customers by both Orillia and Hydro One in Orillia's service territory.[14] There is evidence that confirms this benefit arising from the deferral of rebasing. As of December 2017, $20.7M capital expenditures have been added to Orillia Power's rate base since their last rate rebasing in 2010, a period of seven years (2011 to 2017).[15] Neither these capital expenditures, nor those expected to have been incurred in 2018 and 2019, are reflected in Orillia's current OEB-approved rate base, which is the basis for the rates that Orillia customers will continue to pay until Year 11. Following the completion of the transaction, Hydro One will incur additional capital expenditures to maintain service reliability and system capital requirements for the 10-year deferral period. None of these capital expenditures will be reflected in the rate base that underpins the rates the former customers of Orillia will be charged, yet customers will receive benefits from these capital expenditures.[16]

13. In Staff Interrogatory #12, Hydro One provided a forecast of revenue requirement per Orillia customer, with and without consolidation, for Years 10 and 11, i.e., 2029 and 2030.[17] In Year 10 and 11, revenue requirement per person with consolidation will be lower by $223 and $246, respectively, compared to what would be without consolidation. These savings by Orillia customers will have zero or slightly positive impact on Hydro One's legacy customers.[18] This is also true with respect to electricity bills in Years 10 and 11 with and without consolidation for both Orillia and Hydro One legacy customers.[19]

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[13] Exhibit I-1-9, part 'd'
[14] Hydro One Argument-in-Chief, page 2
[15] Exhibit A, Tab 4, Schedule 1, Page 10 of 12
[16] Ibid.
[17] Exhibit I, Tab 1, Schedule 12, Page 2 of 3
[18] Exhibit I, Tab 1, Schedule 12, Page 3 of 3
[19] Exhibit I, Tab 1, Schedule 11, Page 2 of 2

14. In cross examination, Hydro One's witness pointed that the proposed transaction is also expected to generate savings for Orillia customers by virtue of Hydro One's size and ability to negotiate lower prices with vendors when acquiring assets.[20]

> **MR. RICHARD STEPHENSON: Focussing first on the difference between the transaction proceeding and the status quo, with respect to these directly-allocated assets, things like transformers and poles and wires and stations, in terms of the acquisition cost for Hydro One to purchase those components, I take it there's no reason to believe Hydro One acquisition costs are going to be any higher than the PDI or OPDC costs. Fair?**
>
> **MR. FALTAOUS: Sorry, can you clarify what you mean by acquisition costs?**
>
> **MR. RICHARD STEPHENSON: Buying a transformer.**
>
> **MR. FALTAOUS: That's correct. In fact, I would actually suggest that given the size of Hydro One, we have the ability to negotiate very, very competitive prices and we can probably purchase equipment for a lower cost than PDI and OPDC.**
>
> **MR. RICHARD STEPHENSON: That was my next point. You have the ability to buy in bulk, and you have some influence over vendors that smaller purchasers do not have.**
>
> **MR. FALTAOUS: That's correct.**
>
> **MR. RICHARD STEPHENSON: Okay. And that applies to all sorts of components that are directly in-service within PDI. It is not just transformers, but it is other capital...**
>
> **MR. FALTAOUS: It's all power system equipment that would be required in order to run a distribution system. We would be able to negotiate, I would suggest, considerably favourable prices relative to smaller LDCs.**

c. The Proposed Cost Allocation Model and New Rate Classes Protect Customers Better than the Board's Standard C&A Model

15. Hydro One has provided extensive evidence on its proposed cost allocation and rate design.[21] The new rate classes and cost allocation adjustments proposed by Hydro One will ensure that cost savings from the acquisition will accrue to both Orillia Power and legacy Hydro One customers.

[20] Hearing Transcript, Day 2, page 9
[21] Exhibit A-5-1 and Appendix A; Exhibit I-1-9

16. Hydro One proposes to create three new rate classes for customers within Orillia's service territory. The net book value of distribution capital within Orillia's service territory will be directly allocated to the three new rate classes to ensure that all distribution capital costs that are attributable to Orillia is recovered from Orillia customers and distribution capital costs that are attributable to Hydro One's legacy territory is recovered from Hydro One's legacy customers. Distribution capital is directly allocated with adjustments made within the 'E2 Allocators' tab of the Board's cost allocation model.

17. This methodology assures that, while assets and costs are shared between both groups, there is no cost subsidization between Peterborough and Hydro One legacy customers. Distribution plant will continue to be recovered from the respective customer classes and the allocation of other costs that rely on distribution plant allocators appropriately delivers cost savings to both sets of customer classes. This satisfies the no harm test in the short-term because the costs recovered from both Orillia and legacy customers will be lower than without consolidation.

18. Hydro One has committed to tracking Orillia's distribution plant separately and on an ongoing basis. Actual distribution plant within Orillia will be directly allocated to the new rate classes annually within the cost allocation model by deriving updated adjustment factors. This will maintain the delineation of costs attributable to Orillia and Hydro One's legacy assets and prevent cross-subsidization.

19. Updating the direct allocation, through annual updates to the adjustment factors, is necessary because Orillia and Hydro One have materially different capital needs going forward. Orillia has not rebased since 2010[22] and its current rates are not sufficient to meet its ongoing capital needs. Orillia's revenue requirement is forecast to increase by 4.5% per year from 2019 to 2030 based on forecast capital spending and Hydro One's revenue requirement is forecast to increase by only 2.2% per year over the same period based on an assumed continuation of Hydro One's capital spending increases from 2018 to 2022.[23]

[22] Exhibit A, Tab 3, Schedule 1, page 8
[23] K2.1, page 1

20. The adjustment factors can be expected to increase over time as Orillia's distribution plant becomes a marginally larger share of Hydro One's overall distribution plant. The direct allocation of distribution plant will continue to allocate the actual net book value of Orillia and Hydro One legacy assets to the respective customer classes, even as relative costs change. Cross-subsidization would be possible without updates to the adjustment factors and updating the adjustment factors addresses this concern.

21. Ongoing cost savings from consolidation are allocated based on allocators that are largely derived from the direct allocation of categories of distribution plant so these savings will proportionally flow to both new and legacy rate classes. Hydro One confirmed this anticipated outcome in cross-examination:[24]

> **MR. RICHARD STEPHENSON: Right. But just to be clear, and you anticipate with respect to newly-acquired directly allocated assets, those costs are going to be lower for the acquired customers by virtue of this allocation methodology as those assets are refreshed over time.**
>
> **MR. ANDRE: Sure. By virtue of being able to use the direct allocation adjustment factors to make sure that, you know, going forward, the amount of assets allocated to the acquired classes continues to reflect the actual assets being used by virtue of recalibrating those adjustment factors to take into account any new capital assets that have been added.**

22. The proposed methodology ensures that costs recovered from Orillia and Hydro One legacy customers will continue to be lower than they would be without consolidation, satisfying the no harm test in the long-run.

23. Following an exchange between Hydro One and Board Chair Spoel, the PWU confirmed with the witness that rates will converge with legacy customer classes but Hydro One expects the acquired utility will have a sustained rate advantage.[25]

> **MR. RICHARD STEPHENSON: I understood that, and I wasn't actually asking that question. I do understand that point. But I was talking strictly as arising by virtue of this -- the allocation methodology, there is a sustained advantage for the acquired customers relative to putting them into the province-wide customer classes.**
>
> **MR. ANDRE: Yes. So as I just spoke with Madam Chair, there will tend to be a**

[24] Oral Hearing Transcript, Day 2, page 12
[25] Oral Hearing Transcript, Day 2, pages 14-15

> **convergence, but, you know, yes, we continue to believe that there will be significant advantages to the acquired customers.**

24. Hydro One proposed a similar methodology in EB-2017-0049 for including acquired customers from Norfolk, Haldimand, and Woodstock in new rate classes within its cost allocation model. Though the Board "accepts that Hydro One's proposal adheres to some basic cost allocation principles that may be acceptable in a general sense"[26] the methodology was not approved because it did not reflect the decisions in the related Hydro One acquisition proceedings.[27] The proposal to integrate the acquired utilities in this manner was not approved because cost projections were overly simplistic, the methodology did not sufficiently adhere to decisions in the relevant MAADs proceedings, and Hydro One did not sufficiently demonstrate that rates would be lower.[28] The evidence in the current proceeding addresses those concerns.

25. Hydro One has provided robust evidence that includes detailed cost forecasts and indicative 2030 cost allocation models. Cost figures and assumptions are clearly defined[29] and withstood cross-examination. The quality and quantity of forecast revenue requirement and rate information addresses the Board's concern in this respect.

26. This proceeding has been more extensive than the previous MAADs proceedings for Norfolk, Haldimand, and Woodstock in the area of cost allocation for the acquired utility. Specific issues with respect to integration are addressed in current proceeding so the impact of Hydro One's proposed methodology can be appropriately considered by the Board within the context of the acquisition rather than as part of a larger rate case. The more detailed discussion of cost allocation integration will put the Board in a better position to provide more detailed directions. There is little risk that Hydro One will not follow the Board's decision in this proceeding.

27. As described earlier, Hydro One will directly allocate Orillia's distribution plant and update the direct allocation on an ongoing basis. This will provide an allocation of savings to both Orillia and Hydro One legacy rate classes and ensure that the "no harm" test is

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[26] EB-2017-0049 Decision dated March 7, 2019, page 161
[27] EB-2017-0049 Decision dated March 7, 2019, page 159
[28] EB-2017-0049 Decision dated March 7, 2019, pages 161-162
[29] EB-2017-0270, Attachment 20

satisfied in the long run. The evidence in this proceeding sufficiently demonstrates that rates would be lower for both Orillia and legacy customers with the acquisition than the status quo.

28. This method is novel because it allows savings achieved through the acquisition to be allocated to Orillia and legacy customers despite having different rates at the time of the acquisition. The method is necessary to satisfy the "no harm" test that would be otherwise unachievable for LDCs with different rates.[30]

29. Except for unusual situations in which the amalgamating utilities have very similar cost structures, a harmonized postage stamp rate is incompatible with achieving cost reductions through acquisitions. The "no harm" test could only be satisfied if both LDCs already had very similar rates, such that the acquisition savings would outweigh the revenue requirement differential. Hydro One's current rates are such that a harmonized rate would preclude it from making acquisitions. This is not a desirable outcome for two reasons.

30. Firstly, there are demonstrable savings in this proceeding that have the outcome of reducing the aggregate costs of the two utilities to the benefit of ratepayers. The reduction in aggregate costs is an absolute social benefit to the electricity system as a whole. It is also a benefit to the customers of the two utilities. It would not be reasonable to deny those savings to customers in favour of harmonized rates. Orillia and Hydro One legacy customers currently pay different rates and this would not change whether Hydro One's methodology is approved or the acquisition is denied. The only outcome is higher rates for one or both customer groups. There are rate making benefits to postage stamp rates. However, there are also dis-benefits (sometimes inequitable cross-subsidization). The Board's policy with respect to distributor amalgamations specifically recognizes that harmonized postage stamp rates are not always desirable, and permits separate rate classes to be retained.

[30] It is important to note that it does not matter whether the acquiring utility is the higher or lower cost utility. In the absence of separate rate classes and an adjustment factor, some cost shifting will always occur when costs are averaged over the amalgamated utility, post-merger. In this scenario, unless pre-existing rates were very similar, one group of customers will inevitably experience an increase in rates relative to status quo.

31. Secondly, this would dramatically reduce the number of viable merger and acquisition candidates for all LDCs across Ontario. If the only permitted amalgamations were those between utilities with pre-existing rates which are very similar to one another, the number of potential transactions would be very small. This is contrary to the recommendations of the Commission on the Reform of Ontario's Public Services, the Distribution Sector Review Panel, and Premiers Advisory Council on Government Assets, as noted in the MAADs Handbook.[31] The Handbook further states "the OEB is committed to reducing regulatory barriers to consolidation".[32] The PWU submits that requiring postage stamp rates is a regulatory barrier to achieving savings through consolidation.

32. The SEC put forward materials related to the large number of acquisitions Hydro One made in 2006, including rate and trend comparisons.[33] Those acquisitions are irrelevant to this proceeding as they are completely unrelated to the acquisition of Orillia and Hydro One's proposed methodology of integrating Orillia customers. What is relevant in this case is inter-class equity to ensure the "no harm" test is satisfied between existing customer classes and the new customer classes. The intra-class equity of Hydro One's existing rate classes is not a matter of this case. If the 2006 acquisitions were relevant to this proceeding, the Board would also have to consider the unsustainably low rates of the acquired utilities in 2005 and the capital needs of those LDCs since 2006.

33. Hydro One legacy customers will face no harm from these acquisitions and that is what is relevant to this proceeding. In fact, the SEC's suggestion that harmonizing 2006 acquired customer classes with Hydro One's existing classes caused harm to customers in those service territories supports Hydro One's new approach that does not involve harmonization in the near-term. The PWU submits that the evidence is clear that Orillia and Hydro One legacy customers will not face harm by this transaction and the Board should not consider the outcomes of different integration methodologies as evidence of the eventual impact in this acquisition.

[31] Handbook, page 1
[32] Handbook, page 1
[33] K1.3

III. CONCLUSION

34. The Applicants have put forth substantial evidence in the current Application in response to the Board's concerns identified in the EB-2016-0276 Decision that denied the previous MAADs application. The evidence is that the proposed consolidation will cause no harm to either Orillia's customers or Hydro One's legacy customers; in fact, the proposed consolidation will generate sustained and ongoing savings for Orillia customers beyond the deferred rebasing period. The Board should reject any evidence that is not relevant to the issue before the Board, i.e., whether the proposed transaction meets the "no harm" test or not. The PWU submits the proposed transaction satisfies the Board's "no harm" test and therefore should be approved.

All of which is respectfully submitted