EB-2018-0270

ONTARIO ENERGY BOARD

IN THE MATTER OF the Ontario Energy Board Act, 1998, S.O. 3 1998, c.15, Schedule B; 4
AND IN THE MATTER OF application by Hydro One Inc., 5 Hydro One Networks Inc. and Orillia Power Distribution 6 Corporation under sections 86(2)(b), 86(1)(a), 78, 18, 77(5), and 7 74 of the Ontario Energy Board Act, 1998, as the case may be, for 8 the relief necessary to effect Hydro One Inc.'s purchase of all 9 issued and outstanding shares of Orillia Power Distribution 10 Corporation, the disposition of Orillia Power Distribution 11 Corporation's distribution system to Hydro One Networks Inc. and 12 the transfer by Hydro One Inc. of that distribution system to Hydro 13 One Networks Inc.

Argument Submission of

Energy Probe Research Foundation

December 20, 2019

Executive Summary

In order to justify a proposed consolidation or merger of utilities the proponents of consolidation have several tools that they can use to justify it if they can not do justify it through real cost savings. They can exaggerate the costs of the no-consolidation scenario. They can minimize the costs of the consolidation scenario. They can exaggerate synergy savings that consolidation would produce. And, when all that is not enough, they can use adjustment factors to produce artificially low rates for the acquired utility. Hydro One and Orillia Power Distribution Inc. ("Orillia Power") have used all these tools to justify the consolidation. They have produced rates that meet the price element of the 'no harm" test. They claim that quality of service will be maintained after consolidation. On that basis they claim to have met the "no harm" test. Energy Probe believes that it is not enough. As the OEB has stated in its procedural order it will also consider if the proposed consolidation will "*cause harm to electricity consumers or the electricity sector as a whole".* Hydro One can make the rates of Peterborough customers artificially low by allocating costs to them on a different basis than it uses for its other customers. Energy Probe believes that course of action would have adverse effects on *the economic efficiency and the viability of the electricity distribution sector* in the long run as it would lead to economic distortion in the sector. Energy Probe believes that because of the means used to justify it, this consolidation will encourage applicants to use the same inappropriate methods to justify future consolidations and mergers and the OEB should reject it.

Introduction

There is no approved issues list in this proceeding. Instead, in Procedural Order No. 9, the OEB sets out the "no harm test" as the only issue in this proceeding.

"In applying the "no harm" test, the OEB focusses its review on the impacts of the proposed transaction on price and quality of service to electricity customers, as well as its potential effect on the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector.

The OEB will only consider whether the proposed transaction is likely to cause harm to electricity consumers or the electricity sector as a whole."[1]

Accordingly, Energy Probe has structured its argument on the elements of the "no harm" test as set out by the OEB in Procedural Order No. 9. For each element of the "no harm" test the OEB in its decision should consider the impacts during and after the 10-year deferral period.

The impacts of the proposed transaction on price and quality of service to electricity customers of OPDI and of Hydro One

According to Hydro One's AIC, the rates paid by former Orillia Power customers will not be subject to an IRM rate adjustment for years 1 to 5 and that there will be a distribution rate reduction of 1%. Hydro One claims that the 1% reduction will save PDI ratepayers $405 thousand, and that no IRM rate adjustment will save them an additional $2.0 million.[2] The estimated savings are based on a comparison between the consolidation and no-consolidation scenarios.

Hydro One claims that in years 6 through 10 following consolidation, the distribution rate increases for former Orillia Power customers will be less than the rate of inflation and that the customers will be guaranteed $3.2 million in benefits under the proposed earnings sharing mechanism ("ESM") (corresponding to about 45% of Orillia Power's OEB-approved base revenue requirement).[3]

Energy Probe notes that there is no commitment to forgo ICM applications[4]. The main reason why many distributors have obtained rate increases above inflation is OEB approval of ICM applications.

[1] PO No.9
[2] AIC page 2
[3] AIC page 2
[4] Vol.2, pages 70 and 165

Hydro One's main method of meeting the above rate commitments to Orillia Power customers is through its cost allocation and rate design by having Orillia Power customers in a separate acquired rate classes rather than placing them in the existing Hydro One rate classes as was done with distributors acquired in earlier years[5], and through the use of adjustment factors[6]. This will result in Orillia Power customers getting a better deal than customers of other previously acquired utilities[7].

According to the evidence[8], the net benefit of the merger is $6.584 million, the difference between the $14.448 million Total Cost to Serve - OPDC 9 Status Quo and the $7.864 million Total Residual Cost to Serve. The $6.584 million difference appears to be composed of three components: the less than full share of shared services costs, the difference in capitalization between USGAAP and MIFRS, and assumed savings from staff reductions.[9] Staff reductions are only 19 employees.[10] It is hard to see how a reduction on only 19 staff can result in the claimed savings. Hydro One was unable to provide an analysis of savings that would amount to approximately $6.6 million claimed.[11] There is also no evidence on the record that Hydro One can provide services or buy assets at lower cost than Orillia Power. Other methods used by Hydro One to keep Orillia rates low after consolidation is to not charge overhead costs to Orillia Power.[12] [13]

Energy Probe believes Orillia Power rates for the no-consolidation scenario are exaggerated the.[14] For the 2019 to 2030 period, Orillia Power residential rates are forecast to increase by 63% while Hydro One residential rates are forecast to increase by only 11%.[15] Over the same 11 year period, Orillia Power's revenue requirement is forecast to increase by 63% while Hydro One's is

[5] Tr. Vol.1, pages 86-92 and 122-131
[6] Tr. Vol.1, pages 94-107
[7] Tr. Vol.1, pages 143-150
[8] A-4-1-8, table 4
[9] Tech. Conf. Vol. 2, pages 56-57
[10] A-2-1, page 13
[11] Tech. Conf. Vol. 2, page 64, Staff
[12] A-3-1, page 4, EP-7
[13] Vol.2, page 164
[14] Vol. 2, page 46, and J2.1
[15] Vol. 2, pages 50-51

forecast to increase by 27%.[16] Hydro One is predicting a 4.5% compound annual growth rate for Orillia Power and only 2.2% for Hydro One.[17]

After the 10-year deferral period is over, Hydro One claims that "Orillia Power customers will benefit from lower ongoing cost structures as a result of operational synergies – including, in particular; (a) an expected 70% 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 Orillia Power'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.[18]

Hydro One claims "that the transfer of Orillia Power's distribution system to Hydro One is expected to maintain or improve the adequacy, reliability and quality of electricity service."[19] It is difficult to see how commitment could be met as Hydro One will not be able to track reliability for Orillia Power after consolidation.[20]

The potential effect of the transaction on the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector

Hydro One claims that transaction will not affect the financial viability of Hydro One because Hydro One is large and Orillia Power is small.[21] "articulates that this transaction will promote economic efficiency and cost effectiveness in the electricity industry[22]". In its pre-filed evidence Hydro One claims that "Economic efficiency is attained through sector consolidation, which ultimately eliminates redundant activities. Cost effectiveness reduces OM&A and capital expenditures and is achieved by leveraging Hydro One's economies of scale. These together

[16] Vol.2, page 53
[17] Vol.2, page 54
[18] AIC page 3
[19] Tr. Vol. 2, page 2
[20] Vol.2, pages 107-108
[21] Tr. Vol. 2, page 2
[22] AIC page 6

result in sustained operational efficiencies, both quantitative and qualitative."[23] Energy Probe believes that the effect of this transaction may not result in cost savings, only lower rates for Orillia Power customers because the cost savings have not been proven. Hydro One can make the rates of Orillia Power customers artificially low by allocating costs to them on a different basis than it uses for its other customers. Energy Probe believes that course of action would have adverse effects on the economic efficiency and the viability of the electricity distribution sector in the long run as it would lead to economic distortion in the sector.

Whether the proposed transaction is likely to cause harm to electricity consumers or the electricity sector as a whole

This PO No. 9 requirement by the OEB is not addressed in the AIC nor anywhere in evidence. Energy Probe believes that because of the means used to justify it, this consolidation will encourage future applicants to use the same inappropriate methods to justify future consolidations and mergers and the OEB should reject it.

Respectfully Submitted on behalf of Energy Probe by its consultant,

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[23] Exh. A-2-1, page 12