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.

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 Peterborough Distribution Inc. ("PDI)" 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. 7, the OEB set 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. 7. 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 PDI and of Hydro One

According to Hydro One's AIC, the rates paid by former PDI 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 $675 thousand, and that no rate adjustment will save them an additional $3.5 million.[2] The estimated savings are based on a comparison between the "consolidation" and "no-consolidation" scenarios[3]. The scenarios are based on assumptions that exaggerate the costs of the no-consolidation scenario and minimize the costs of the consolidation scenario.

PDI is a low-cost utility[4] and it is hard to believe that Hydro One would be able to find large savings after consolidation[5] and the evidence confirms that. There is no evidence on the record that Hydro One can provide services or buy assets at lower cost than PDI.[6] In 2019, PDI's residential rate was 23.37 while Hydro One's was 34.26 or 47% higher.[7] PDI assumed that its rates under the no-consolidation scenario would increase by 14.4% in 2023 as a result of rebasing.[8]After 11 years with no consolidation, PDI's rates would still be lower than Hydro One's even though Hydro One is predicting that its rates will only grow at half the rate of PDI's

[1] PO No.7
[2] AIC page 2
[3] Vol. 1, pages 112 to 117
[4] Vol. 2, page 151
[5] Vol.2, pages 184-188
[6] Vol.2, page 164
[7] Vol. 2, page 56; K2.1, page 1
[8] Staff 17, Att.2; Tech. Conf. Vol.2, pages 48-50

rates. The difference in estimated rate increases between PDI and Hydro One over the 11 year period do not seem credible and appear to be exaggerated. [9]

During the same 11 year period Hydro One forecasts that PDI's revenue requirement will increase by 53% while Hydro One's will increase by only 27%. This difference is not supported by a detailed analysis. PDI does not have a distribution system plan and its forecast of capital expenditures is based on rough estimates. [10] The forecast of OM&A savings is also a rough estimate with no detail to back it up.[11] Potential future ICM projects that would reduce cost savings have not been taken into account. [12]

PDI's capitalization policy allows allocation of overheads to fixed assets. As such the difference between the Hydro One forecast capital costs and the Status Quo Peterborough capital costs in Exhibit A, Tab 2, Schedule 1, Table 1 is that the Peterborough costs include capitalization of overheads whereas in the Hydro One forecast no overhead costs are included.[13] Excluding overhead costs reduces the Hydro One forecast by $400,000.[14]

Hydro One committed that its forecast of rates with consolidation will not be higher than with no consolidation.[15] Hydro One would adjust the cost allocation model in order to keep its commitment even if costs increase.[16]

Hydro One claims that in years 6 through 10 following consolidation distribution rate increases for PDI customers will be less than the rate of inflation and that PDI customers will be guaranteed $1.8 million in benefits under the proposed earnings sharing mechanism ("ESM") (corresponding to about 13% of PDI's OEB-approved base revenue requirement).[17] The main reason why many distributors have obtained rate increases above inflation is OEB approval of

[9] Vol. 2, page 46, and J2.1
[10] Tech. Conf. Vol.2, pages 28-31
[11] Tec. Conf. Vol2, pages 36-43
[12] EP-6
[13] I-1-15a Staff 15a,
[14] Tech. Conf. Vol. 2, pages 46-47, JT2.2
[15] Vol.2, page 70
[16] Vol. 2, page 75
[17] AIC page 3

ICM applications. The commitment by Hydro One to a 1% rate reduction and the no IRM adjustment does not include ICM.[18]

Hydro One's main method of meeting the above rate commitments to PDI customers is through its cost allocation and rate design by having PDI 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[19] which resulted in large rate increases for some customers, and through the use of adjustment factors[20]. This will result in PDI customers getting a better deal than customers of other previously acquired utilities[21].

Hydro one claims that it "is expected to maintain or improve the adequacy, reliability and quality of electricity service"[22] even though Hydro One will not be able to track reliability for PDI after consolidation.[23]

After the 10-year deferral period is over, 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)."

Hydro One claims that it will meet all of the above commitments with no harm to existing Hydro One customers either during or after the 10-year deferral period.

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

[18] Vol.2, page 70 and page 165
[19] Tr. Vol.1, pages 86-92
[20] Tr. Vol.1, pages 94-107, and 122-131
[21] Tr. Vol.1, pages 143-150
[22] AIC page 5, and Vol. 2, page 3
[23] Vol.2, pages 107-108

Hydro One claims that transaction "will promote economic efficiency and cost effectiveness in the electricity industry[24]". The other aspects of the OEB's PO No. 7 requirement are not addressed in the AIC nor anywhere in evidence. Energy Probe believes that the effect of this transaction may not result in cost savings, only lower rates for PDI customers because the cost savings have not been proven. 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.

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

This PO No. 7 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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[24] AIC page 6