EB-2018-0270

ONTARIO ENERGY BOARD

HYDRO ONE NETWORKS INC.
ORILLIA POWER DISTRIBUTION CORPORATION

APPLICATION FOR APPROVAL TO PURCHASE ALL ISSUED AND OUTSTANDING SHARES OF ORILLIA POWER DISTRIBUTION CORPORATION

EB-2018-0242

HYDRO ONE NETWORKS INC. PETERBOROUGH DISTRIBUTION INC., PETERBOROUGH UTILITIES SERVICES INC., AND 1937680 ONTARIO INC.

APPLICATION FOR APPROVAL TO AMALGAMATE PETERBOROUGH DISTRIBUTION INC. AND PETERBOROUGH UTILITIES SERVICES INC. AND SELL AMALGAMATED ELECTRICITY DISTRIBUTION SYSTEM TO HYDRO ONE NETWORKS INC

ORILLIA POWER AND PDI'S REPLY SUBMISSIONS

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I. Overview

1. Orillia Power Distribution Corporation ("Orillia Power" or "OPDC") and Peterborough Distribution Inc. ("PDI") and Peterborough Utilities Services Inc. ("PUSI") (collectively, Peterborough) respond to the submissions of the OEB staff and the interveners to the two applications that are being heard together, being:

   (a) the application filed on September 26, 2018 under section 86(2) of the *Ontario Energy Board Act*, requesting approval for Hydro One Networks Inc. ("Hydro One") to purchase all of the shares of Orillia Power (the "Transaction") (the "Orillia MAADs Application").

   (b) the application filed on October 12, 2018 under sections 86(1)(c), 86(1)(a), 78, 18, 77(5) and 74 of the *Ontario Energy Board Act*, requesting approval to amalgamate PDI and PUSI, sell the business and distribution assets to 1937680 Ontario Inc. (a Hydro One Inc. subsidiary) which would in turn dispose of the distribution system to Hydro One Inc. ("Hydro One") (the "Transaction") (the "PDI MAADS Application").

2. These submissions are structured as follows:

   (a) Re-iteration of the relevant issues that are before the Board;

   (b) The intervenor's problem with not putting direct challenges to the forecasts to the Orillia Power and Peterborough witnesses;

   (c) Specific responses to the allegations that Orillia Power and Peterborough's forecasts are unreasonable.

II. Issue before the Board

3. As referenced in our argument in chief, the Board already made findings with respect to (1) the reliability and quality of electricity service and (2) financial viability in its EB - 2016-0276 decision. Orillia Power submits that the only live issue is whether the forecasts

presented by Hydro One and Orillia Power are reasonable and whether those forecasts meet the no harm test.

4. With respect to the other factors of the no harm test, PDI submitted in its argument in chief how PDI meets those factors such as maintaining or enhancing reliability, having no adverse impact on the financial viability of Hydro One, and securing various cost savings arising from this asset sale transaction. In any event, none of the other factors of the no-harm test were challenged on cross-examination or by the interveners in their submissions.

5. Instead, the interveners, and especially SEC, are attempting to transform these MAAD Applications into a referendum on the ability of Hydro One to acquire any new Ontario distribution companies. SEC's, and to some extent CCC's, submissions are replete with ad hominin attacks on Hydro One that are exaggerated, unwarranted, colourful, and completely irrelevant to the issues before the Board.[1]

6. Orillia Power and Peterborough submit that the SEC submissions and criticisms of Hydro One are misplaced and made without context and should not be allowed to distract the Board from adjudicating of the MAAD application based on the no harm test. For example, SEC and CCC refer to Hydro One's acquisition of 89 LDCs in 1999 and 2000.[2] However, there is absolutely no evidence before this Board on the state of operations and disrepair and capital renewal requirements associated with those acquired utilities as at 1999.

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[1] For example:

SEC Submissions Paragraph 1.3.1 – "SEC has been fighting since 2013 to convince the Board that acquisitions by Hydro One of electricity distributors will result in harm to the acquired customers"

SEC Submissions Paragraph 1.3.5(a) – "Hydro One is never a Lower Cost Distributor than Anyone Else."

SEC Submissions Paragraph 1.3.8 – "SEC believes that the Board should stop listening to Hydro One's narrative and start listening to hard facts".

SEC Submissions Paragraph 1.3.8(c) – "Hydro One has consistently been one of the worst performers, which adjusts for business conditions including density".

Paragraph 1.3.10 – "If Hydro One continues to have costs significantly higher than the LDCs they wish to acquire, the result should be that they will not be allowed to acquire those LDCs".

[2] SEC Submissions at paragraphs 1.3.8; CCC Submissions at page 7.

Furthermore, the OEB subsequently approved the distribution rates of Hydro One. Such allegations are collateral attacks on those earlier decisions.

7. Orillia Power and Peterborough have been responsive to the Board's request for evidence about the costs of serving ratepayers in the eleventh year. The main issue for this Board to determine is whether those forecasts have been reasonable. Orillia Power and Peterborough reiterate that their forecasts are reasonable and in the third section of these submissions, we reply directly to the allegations raised by the interveners to any criticisms of those forecasts.

III. Oral Evidence and Cross-Examinations

8. The interveners requested an oral hearing in this matter in order to be able to cross-examine the representatives of Hydro One and Orillia Power and Peterborough on their forecasts. One of the explicit reasons that SEC stated for the oral hearing was to assess the credibility of the representatives.

9. It is a fundamental rule of procedural fairness that if a party is going to impugn the credibility of the evidence of another party, they should put those allegations to them on the stand (rule in *Browne v Dunn*, 6 R. 67, H.L.). The purpose of the rule is to give the witness an opportunity to respond to the allegations or clarify them. This is consistent with the OEB's rules and procedures for holding Technical Conferences and Oral Hearings. For example, the explicit purpose of a Technical Conference, under Rule 25.01, is to review and clarify the evidence of a party or matters related with interrogatories.

10. In their written submissions, the interveners make a number of allegations that attempt to discredit the forecasts presented by Orillia Power and Peterborough. However, many, if not all, of the allegations or propositions that the interveners now rely upon were not put to the witnesses in order to allow them an opportunity to respond. This is not fair and not helpful to the Board. The witnesses from Orillia Power and Peterborough could have been asked probing questions and the interveners could have put these allegations and arguments to them. They did not. Representatives of Orillia Power and Peterborough were examined during the two day Technical Conference and at the two day oral hearing and the interveners did not ask them probing questions with respect to their assumptions. In

particular, SEC asked no probing questions of Orillia Power and Peterborough with respect to their forecasts. And yet, SEC now criticizes those forecasts.

IV. Responses

A. Board Staff

11. Board Staff submit that the status quo projections for PDI and Orillia Power may be high.[3] However, the numbers that Board Staff rely upon at pages 14-15 of their submissions and in particular, Table 7 that contains the Compound Annual Growth Rate ("CAGR") of the Projected Status Quo Revenue Requirements are incorrect. In particular, the end numbers that Staff rely upon include LV charges, whereas the starting point 2010 numbers do not. When comparing apples to apples, the CAGR is at industry average. It should also be noted that Board Staff in their submissions have misattributed the last rebasing year for Orillia Power and PDI. Orillia Power rebased in 2010 (not 2013) and PDI rebased in 2013.

12. Board Staff state that the CAGR for PDI is calculated based on the 2010 revenue requirement of $15.4 million and the 2030-forecasted revenue requirement of $26.3 million. For Orillia Power, Board Staff calculate the CAGR based on a 2010 revenue requirement of $7.6 million and 2030 forecasted revenue requirement of $14.5 million. The problem with these numbers is that they are not comparing apples to apples. PDI's $15.4 million as at 2010 does not include LV charges whereas the end, $26.3 million includes LV charges.[4] Similarly, Orillia Power's $7.6 million at 2010 does not include LV charges but Board Staff's 2030 revenue requirement of $14.5 million does include LV charges

13. If Board Staff were to apply the forecast submitted by PDI at 2030, which is a revenue requirement of $24.913 million[5], the rate of status quo increase is 2.9%. This is the industry average found at Table 7 of page 15 of Board Staff's submissions. As such, if the correct numbers are compared, then the forecasts are within the industry average.

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[3] OEB Staff Submissions at page 14.

[4] Exhibit A, Tab 4, Schedule 1, Page 4, Table 2

[5] Attachment 18 to Application.

14. Similarly, if Board Staff were to apply the forecast submitted by Orillia power at 2030, the revenue requirement by 2030 is 13.443 million which is a CAGR of 2.9%.[6]

15. This also impacts the analysis at page 29 of the Board Staff's submissions where they propose that the CAGR be reduced to 2.9%.

B. SEC

1. Reasonability of Forecasts

16. SEC alleges that there are "inappropriate assumptions in the forecast that estimate Hydro One's costs too low and the standalone costs too high". However, SEC does not provide any details to demonstrate which of these assumptions are actually unreasonable. SEC instead states that other interveners will raise these issues. The applicants have developed comprehensive forward-looking forecasts (both capital and O&M) that are based on well-documented assumptions and knowledge of their system requirements.

2. Performance Assessments

17. SEC's reliance on the OEB's performance assessments is misplaced for the following reasons:

(a) The performance assessments are a relatively new measure and the data sets that are used to determine the benchmarks are a work in progress.

(b) The purpose of the PEG benchmarking analysis is for the Board to inform its decision with respect to mandatory and equitable rate changes during IRM.

(c) The business conditions that the performance assessments rely upon are not relevant to a MAAD initiative or the no harm test. The Board does not rely upon these assessments in a MAAD application and it would be inappropriate for the Board to do so in any event.

[6] Attachment 18 to Application Record.

(d) Relying on density as a basis for explaining cost differences is misplaced. This argument is more fully developed below. In particular, density does not take into account the real business conditions of any electricity distribution utility, in particular, that of a small utility. It does not take into account the scale of the utility, and the real cost pressures that a small utility faces (especially with regard to matters such as regulatory and cyber security costs).

3. Using Density as a Comparator is Misplaced

18. SEC attempts to rely upon customer density to establish peer groups and then to use those peers as comparators to measure the relative economic efficiency of various LDCs and then to challenge the reasonableness of Orillia Power's and PDI's assumptions.

19. For the purpose of evaluating the individual forecasts of Orillia Power and PDI, and SEC's flawed approach, we replicate the table from paragraph 2.3.55 of SEC's submissions (excluding Hydro One) and add to it additional relevant columns from the OEB 2018 Yearbook that include customer data, OM&A per customer, sample rank and industry rank to show that SEC's reliance on density factor alone as a comparator for performance is misplaced.

LDCS that meet Hydro One Urban Metrics	Per SEC Final Argument Table 2.3.55 Density Cust/km	Residential 700 kwh	GS<50 2500 kwh	GS>50 200 kw	Per OEB 2018 Yearbook Customers	OM&A /Cust	OMA/Cust Sample Rank	Industry Rank
Brantford Power	78.24	407.04	998.40	19,996.80	39,904	270.64	5	23
E.L.K Energy Inc.	76.61	344.76	718.80	18,212.16	12,411	215.17	2	3
Essex Powerlines	65.67	371.16	948.72	14,359.56	30,012	251.70	4	14
Festival Hydro	81.87	452.52	1,228.80	21,082.44	21,369	298.92	7	31
Hydro Hawkesbury	79.24	284.28	636.48	11,532.36	5,547	210.95	1	2
Kingston Hydro	82.81	419.88	1,013.76	21,651.00	27,658	276.39	6	26
Peterborough Distribution Inc.	64.82	373.56	1,004.16	20,028.12	37,139	244.85	3	10
West Coast Huron Energy	63.43	495.24	1,078.32	16,581.48	3,869	443.58	8	56
Average	74.09	393.56	953.43	17,930.49	22,239	276.53		
ST Dev	8.08	65.37	190.93	3,546.29	13,822	73.80		
LDCs are 60-80 Density per Line Km								
ERTH Power	54.65	513.24	1,149.36	22,029.12	19,238	329.97	5	40
Hydro Ottawa Limited	58.14	442.56	1,302.48	24,227.76	335,320	260.38	4	17
London Hydro	52.42	417.72	1,080.84	21,973.80	159,039	248.01	2	12
Orangeville	56.68	421.20	1,053.84	19,141.08	12,583	255.87	3	16
Orillia Power	57.99	442.32	1,325.64	22,852.80	14,091	358.81	7	46
Oshawa PUC Networks	59.64	393.60	1,072.80	25,362.96	58,745	234.08	1	5
Renfrew Hydro	53.23	412.32	1,136.04	17,719.44	4,312	335.23	6	41
Rideau St Lawrence	55.22	408.24	1,013.16	19,036.20	5,909	379.80	8	49
Average	56.00	431.40	1,141.77	21,542.90	76,155	300.27		
Std Dev	2.54	36.96	114.93	2,688.88	116,844	56.73		

20. The additional columns demonstrate that by using density as the sole factor to compare utilities is like comparing apples with oranges:

(a) The data against which SEC asks PDI to be compared to are eight utilities and Orillia Power against another eight utilities. Of the sixteen utilities, 4 of them have an average customer size of 5,000 customers. The standard deviation of customer size is 13,822 in the PDI set and 116,844 in the Orillia Power set. This standard deviation demonstrates how density is not an appropriate comparator.

(b) The size variation among the utilities is considerable. The size differential multiple among the PDI data set is 9.6 times between the smallest and biggest utility and the size differential among the Orillia Power set is 77.7 times.

(c) To conclude on this point, if we used density as the sole comparator, this would mean that we would be evaluating a utility that has 335,320 customers against a utility that has 4,312 customers. Obviously, factors other than density will drive a utility's performance.

21. Orillia Power and PDI also submit that the Board should apply caution in looking at the distribution rates of other utilities when assessing whether a utility is low cost or not, for comparison purposes. Rate comparability will be impacted by the timing of individual utilities in their rate rebasing cycle, among other factors. As such, to be useful, rates must be normalized for the comparison to be correct, among other things.

4. Revenue Growth Requirements, ROE, capital rate, working capital allowance and depreciation

22. SEC takes issue with Orillia Power and PDI's revenue growth requirements and alleges that they are too high.[7] The revenue growth requirements must be assessed by taking into account that both Orillia Power and PDI have been held for sale for the past three to five years. As such, they have not been operating at full staffing capacity. The uncertainty about their future has meant staffing vacancies at the utilities and operating at a level that is not sustainable over the long term and thus this artificially increases ROE. Were the transactions not to be approved, both Orillia Power and PDI will need to ramp back up and hire to normal staffing levels and re-establish a structure that is aligned with the long-term ownership and operation of the organization.

23. Capital expenditure plans are a key component affecting rate base and thus revenue requirement. A review of Orillia's capital spending history shows that for the period 2001 - 2010 (the last rebasing period) average annual capital spending was approximately $1.4 million. For the period 2011 – 2020, OPDC's average capital spending is approximately $3.1 million. This level of investment reflects the impact of aging infrastructure, the increasing cost of replacing infrastructure (related to inflation), and the ongoing investments that will be required as other assets approach end of life. OPDC's average projected capital spending for the period 2021 - 2030 excluding the cost for the replacement

[7] SEC at para. 2.3.19 and 2.3.23.

of Orillia's service centre building is approximately $2.9 million. Given the average spending for the 2011 – 2020 period (recent history) one could conclude that if anything, OPDC's capital expenditure projections for the 2021- 2030 period might be understated, not overstated.

24. Another increase in OPDC's rate base under the status quo scenario relates to the capital cost of the service centre replacement. Given the age of OPDC's existing service centre, it has been earmarked for replacement in 2028 at a cost of $8.0 million. This capital cost is excluded from the average figures mentioned above, but has been included in Table 1 (Exhibit A, Tab 2, Schedule 1) and would certainly impact the revenue requirement while rebasing in 2030.

25. Furthermore, with respect to PDI, in the last ten years, ROE has only been achieved in one year – 2009, because of rebasing. ROE has also been impacted by externally driven cost escalation beyond management control. For example, in the last five years (from 2014 to 2018), the OEB regulatory expenses allocated to PDI have increased by 57 percent (from $98,000 in 2014 to $154,000 in 2018.

26. With respect to capital market parameters, these were correct at the time the applications were filed. These parameters are updated at least annually to reflect changes in market conditions. Recently, they have decreased to reflect the almost inverted market yield curve. However, this does not mean that the projections are incorrect. They reflect the market conditions at the time the applications were written. Furthermore, if the capital market parameters were to be adjusted for Orillia Power and PDI, these would also have to adjust in the Hydro One forecasts.

27. SEC only makes blanket assertions that the working capital allowance and depreciation rates are unreasonable but does not provide any basis or support for these assertions. The evidence of Orillia Power and PDI outlines the assumptions they used and those assumptions are compliant with OEB policies.

28. SEC cherry picks periods of time to use as a basis for comparison. For example, when reviewing CAGR, SEC states that CAGR is to increase by 3.65% for Orillia Power and

3.24% for PDI, it compares this rate of increase to the rate of increase in the period from 2005 to 2018 of 1.63%. There is no reason to use the period between 2005 and 2018. SEC has chosen that period to attempt to make the argument that the CAGR number is high. Then in at paragraph 2.3.35 SEC relies on the average CAGR as between 2010 and 2018 of 1.52 per cent. The time periods are misleading as they represent a blend of utilities some of whom have rebased, some of whom have not rebased and some who are about to rebase.

5. Tax Bump

29. SEC alleges that the Orillia Power and the PDI transaction will each result in a tax bump. This submission ignores the evidence filed at Schedule 2.5 to the PDI Asset Purchase Agreement that shows that there will not be a tax bump other than to goodwill.

30. Similarly, with respect to Orillia Power, even if there were a tax bump, this would be attributable to goodwill and would not be recoverable in distribution rates.

6. Customer Service

31. SEC alleges that Hydro One's customer service metrics demonstrate that the PDI and OPDC customers will have worse customer service if the acquisitions are allowed to proceed.[8] The Board must consider whether the customer service levels attained by PDI and Orillia Power to date are sustainable or economic in light of the IT, billing and related internal infrastructure costs to maintain those levels. Orillia Power and PDI's evidence is that they are not sustainable without an increase in costs, over time, as reflected in their forecasts. Alternatively, if there are no cost increases, customer service standards will decrease. In contrast, Hydro One has demonstrated at the hearings that it currently has IT and technology that would be of benefit to Orillia Power and PDI customers and would add value to those acquired customers. Orillia and PDI could not provide that same value to customers under the status quo without significant investment and cost that is not economical to do at their scale.

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[8] SEC at para. 1.4.2(g)

32. Furthermore, customer expectations are continuously increasing with respect to items such as real-time outage management. The cost per customer for implementing such systems is considerably higher for smaller utilities as they do not have the same economies of scale.

C. VECC

33. VECC accepts that there are efficiencies and cost reductions to be gained from the acquisition.

34. VECC focuses on PDI's rates and its ROE in 2018 for the proposition that PDI's cost structure is lower than Hydro One's. The problem with using 2018 as the comparator year is PDI's evidence is that 2018 should not be used as a basis for determining whether PDI is low cost or not. In 2018, PDI was operating at less than sustainable levels because it was being held for sale. The Board should not focus on one year in making a determination about which utility is lower or higher cost for serving a class of customers.

35. VECC submits that Hydro One and PDI used different OM&A rates of escalation (Hydro One used 2% whereas PDI used 2.5%). This should not be a problem so long as both rates of escalation are determined to be reasonable. Each rate must be reasonable in relation to each utility's own cost structures. Orillia Power and PDI have provided evidence that their project cost escalation assumptions reflect their underlying cost structures.

D. CCC

36. CCC also relies on the ROE in 2018 for PDI to argue that PDI's ROE and Hydro One's were comparable to argue that PDI's cost structure is less than Hydro One's. Again, the reliance on ROE in 2018 as an indication of a lower cost structure is misplaced. ROE is a function of approved rate base and capital. To extrapolate this to comparative distribution rates or costs of efficiency is not appropriate.

37. CCC submits at page 9 that PDI and Orillia Power's status quo revenue requirements are both overstated and relies on the CAGR of these utilities compared to the average CAGR for other utilities. As submitted above where we discuss the Staff's submissions, in fact, the PDI and Orillia Power CAGR is the average of other utilities so the revenue requirements are not overstated.

E. Kehoe

38. Mr. Kehoe challenges a number of legislative policies with respect to the restructuring of the Ontario electricity sector in 2000 and regarding the management of Hydro One. Mr. Kehoe's submissions about the Energy Competition Act and the Province of Ontario's policies with respect to Hydro One and Hydro One's debt are not relevant to this proceeding. This Board is not able to adjudicate on these issues. They are not relevant to whether the MAAD Applications should be approved.

V. Conclusion

39. Orillia Power and Peterborough submit that the Board should approve their Applications. The Applicants have discharged their burden of demonstrating that the cost structures in years 10 and 11 will be no higher than they would be under the status quo for both Orillia Power and Hydro One on the one hand and Peterborough and Hydro One on the other. As such, the evidence demonstrates that the Transactions have no adverse impact on price, adequacy, reliability and quality of electricity service of Orillia Power, Peterborough and Hydro One.

All of which is respectfully submitted, January 24, 2020.

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