Ontario Energy Board | Commission de l'énergie de l'Ontario

DECISION AND ORDER

EB-2018-0242

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

Application for approval to amalgamate Peterborough Distribution Inc. and Peterborough Utilities Services Inc. and to transfer the electricity distribution system to Hydro One Networks Inc.

BEFORE: Cathy Spoel
Presiding Member

Lynne Anderson
Member

Michael Janigan
Member

April 30, 2020

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1 INTRODUCTION AND SUMMARY

This is the Decision and Order (Decision) of the Ontario Energy Board (OEB) regarding an application (Application) filed by Peterborough Distribution Inc. (PDI), Peterborough Utilities Services Inc. (PUSI), Hydro One Networks Inc. (Hydro One), and 1937680 Ontario Inc. (collectively, the Applicants). The transaction proposed in the Application was for OEB approval, pursuant to section 86 of the *Ontario Energy Board Act, 1998* (OEB Act), to amalgamate PDI and PUSI, sell the amalgamated corporation to 1937680 Ontario Inc., and then allow 1937680 Ontario Inc. to dispose of its distribution system and transfer its rate orders to Hydro One (Transaction).[1] The Application also requested various related approvals under several different sections of the OEB Act.

The OEB has assessed the Application by applying the no harm test and has concluded that, subject to a number of conditions, the proposed Transaction meets this test. The OEB therefore approves the Application subject to the conditions that are described later in this Decision. The OEB also grants the various related approvals request by the Applicants, except for the ability to apply for an Incremental Capital Module (ICM). There will be no ICM available for the PDI service area during the ten year deferred rebasing period.

[1] PDI and PUSI are wholly owned subsidiaries of the City of Peterborough Holdings Inc. (CoPHI). CoPHI is a holding company that is wholly owned by the Corporation of the City of Peterborough. 1937680 Ontario Inc. is a Hydro One Inc. subsidiary.

2 APPLICATION AND PROCEEDING OVERVIEW

2.1 The Application

The Applicants requested the following orders of the OEB:

- Approval to amalgamate PDI and PUSI and to transfer PDI's distribution licence and rate order to the amalgamated corporation under section 86 of the OEB Act
- Approval to allow the amalgamated corporation to sell its distribution system to 1937680 Ontario Inc. and to transfer the amalgamated corporation's distribution licence and rate orders to 1937680 Ontario Inc. under sections 86 and 18 of the OEB Act
- Approval to allow 1937680 Ontario Inc. to dispose of its distribution system and transfer rate orders to Hydro One and to amend the Specific Service Charges (SSCs) in 1937680 Ontario Inc.'s transferred rate order to align with the SSCs that are approved by the OEB for the Hydro One Distribution Decision[2] under sections 86 and 78 of the OEB Act
- Approval to amend Hydro One's distribution licence to serve the customers of 1937680 Ontario Inc. and to cancel 1937680 Ontario Inc.'s distribution licence under section 74 of the OEB Act
- Approval to defer rebasing of PDI for ten years from the date of the closing of the proposed Transaction
- Approval to include a rate rider in PDI's OEB-approved rate schedules to give effect to a 1% reduction in base distribution delivery rates (exclusive of rate riders) for the first five years of the deferred rebasing period under section 78 of the OEB Act
- Approval to allow 1937680 Ontario Inc. and Hydro One to continue to track costs to regulatory assets accounts currently approved by the OEB for PDI and seek disposition of their balances at a future date
- Approval to allow Hydro One to use an earnings sharing mechanism (ESM) to operate between years six and ten of the deferred rebasing period

[2] EB-2017-0049

- Approval to allow Hydro One to establish a new deferral account to record costs of the ESM refund amount for future disposition
- Approval to allow 1937680 Ontario Inc. and Hydro One Inc. to use United States Generally Accepted Accounting Principles (US GAAP) for PDI financial reporting
- Approval to allow Hydro One to use an ICM, should it be required, for the former PDI service area, during the deferred rebasing period.

2.2 The Process

The OEB issued a Notice of Hearing on December 5, 2018. The following parties requested and were granted intervenor status:

- Consumers Council of Canada (CCC)
- Energy Probe Research Foundation (Energy Probe)
- Ms. Alison Davidson
- International Brotherhood of Electrical Workers, Local 636 (IBEW)
- Power Workers' Union (PWU)
- Save PDI Coalition
- School Energy Coalition (SEC)
- Vulnerable Energy Consumers Coalition (VECC)

Each of Ms. Davidson, CCC, Energy Probe, Save PDI Coalition, SEC, and VECC applied for and were granted eligibility for cost awards.

On January 30, 2019, the OEB issued Procedural Order No. 1, which established a schedule for written interrogatories.

Following the Applicants' responses to interrogatories, Hydro One filed a letter with the OEB on March 19, 2019 stating that given the nature of some of the conclusions reached by the OEB in its decision on the Hydro One distribution application, it would be filing supplemental evidence for this Application.[3]

On May 9, 2019, the OEB issued Procedural Order No. 3, which provided for interrogatories and interrogatory responses on the supplemental evidence filed by Hydro One. Hydro One filed a letter with the OEB on May 30, 2019 requesting an extension to the timelines set out in Procedural Order No. 3 for the filing of responses to

[3] EB-2017-0049

interrogatories from June 3, 2019 to June 14, 2019. The OEB approved Hydro One's request. Following review of the Applicants' responses to interrogatories, the OEB determined that a technical conference was required.

The OEB issued Procedural Order No. 4 on July 5, 2019, which established a schedule for the technical conference. Following the issuance of Procedural Order No. 4, Hydro One filed a letter with the OEB advising that representatives able to respond to questions at the technical conference scheduled for July 29 and 30, 2019 were not available until the week of August 26, 2019, at the earliest. As a result, Hydro One requested that a technical conference be rescheduled to dates during the week of August 26, 2019 or later (with the exclusion of the week of September 16). After the filing of the letter from Hydro One, other parties identified constraints in terms of their availability to attend a technical conference at a revised date, having made plans to attend on July 29 and 30. In order to allow representatives of all parties to attend, Procedural Order No. 5 established that the technical conference would be held on October 3 and 4, 2019.

Upon completion of the technical conference, the OEB issued a letter on October 28, 2019 requesting submissions from parties as to whether to proceed directly to written submissions or whether an oral hearing was required.

Following submissions from parties, the OEB issued Procedural Order No. 6 setting the date for an oral hearing. On November 28, 2019, the OEB issued Procedural Order No. 7, which clarified the scope of the oral hearing and established the dates for an Argument-in-Chief and submissions. The oral hearing was held on December 2 and 3, 2019.

The Applicants filed their Argument-in-Chief on December 13, 2019. Following the filing of submissions from parties, the OEB granted an extension to the Applicants who filed their reply submission on January 24, 2020.

3 RELEVANT REGULATORY PRINCIPLES

3.1 The No Harm Test

The OEB applies the no harm test when assessing applications under section 86 of the OEB Act. The no harm test was first established by the OEB in 2005 through its decision in an adjudicative proceeding, and has been used to guide OEB decision-making on mergers, acquisitions, amalgamations and divestitures (MAADs) applications since then.[4] The OEB recognizes that some of the approvals sought in the Application are not under section 86 of the OEB Act; for example, the 1% rate reduction request is under section 78 of the OEB Act. However, all of the approvals sought are part of a related Application, the ultimate purpose of which is for Hydro One to acquire the current PDI. The OEB will therefore review the Application using the no harm test.

The *Handbook to Electricity Distributor and Transmitter Consolidations* (MAADs Handbook), issued by the OEB on January 19, 2016, confirmed that the OEB will continue its practice of applying the no harm test when adjudicating utility consolidation requests. The OEB considers 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 with respect to electricity:[5]

> **Board objectives, electricity**
>
> 1(1) The Board, in carrying out its responsibilities under this or any other Act in relation to electricity, shall be guided by the following objectives:[6]
>
> 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.

[4] RP-2005-0018 / EB-2005-0234 / EB-2005-0254 / EB-2005-0257
[5] OEB Act, Section 1
[6] Note that on a date to be named by proclamation of the Lieutenant Governor, paragraph 1 of subsection 1 (1) will be repealed and replaced with To inform consumers and protect their interests with respect to prices and the adequacy, reliability and quality of electricity service, and paragraph 1.1 will be repealed.

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 connections of renewable energy generation facilities.

If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.[7] The OEB does not and cannot base its approval on considerations such as collateral benefits to the parties engaged in the consolidation or the possibility that a better deal might have been negotiated by those parties. Unless it can be shown to have an impact on the attainment of these statutory objectives, the OEB also does not base its approval on considerations such as the desire for local control of a utility.

3.2 OEB Policy on Rate-Making Associated with Consolidations

The OEB introduced policies that provide consolidating distributors with an opportunity to offset merger-related transaction costs with any achieved savings through deferral of the rate rebasing (deferred rebasing period) of the consolidated entity.

The OEB's policies on rate-making associated with consolidations are set out in the *Report of the Board – Rate-making Associated with Distributor Consolidation*, issued July 23, 2007 (the 2007 Report) and a further report issued under the same name on March 26, 2015 (the 2015 Report).[8,9] The 2007 Report permitted a deferred rebasing period of five years. The 2015 Report extended the deferred rebasing period, permitting consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

Consolidating distributors are required to select a definitive timeframe for the deferred rebasing period. The OEB's expectation is that when consolidating distributors select a

[7] MAADs Handbook / pp. 3-4
[8] https://www.oeb.ca/documents/cases/EB-2007-0028/report_ratemaking_20070723.pdf
[9] https://www.oeb.ca/oeb/_Documents/EB-2014-0138/Board_Report_MAADs_Ratemaking_20150326.pdf

deferred rebasing period, they have committed to a plan based on the circumstances of the consolidation and that, if an amendment to the selected deferred rebasing period is requested, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interests of customers.

The OEB requires consolidating entities that propose to defer rebasing beyond five years to implement an ESM for the period beyond five years to protect customers and ensure that they share in any increased benefits from consolidation during the deferred rebasing period.

4 DECISION ON THE ISSUES

In the subsections that follow the OEB has assessed the effect of the Transaction on attaining the following OEB objectives:

- Price, Economic Efficiency and Cost Effectiveness
- Reliability and Quality of Electricity Service
- Financial Viability

4.1 Price, Economic Efficiency and Cost Effectiveness

To demonstrate no harm, applicants must show there is a reasonable expectation based on underlying cost structures that the costs to serve customers following a consolidation will be no higher than they would otherwise have been.[10]

Costs and Savings

The Applicants submitted that the consolidation of PDI and Hydro One will result in operational synergies and lower ongoing cost structures when compared to the status quo.[11] The Applicants projected the Transaction will cause expected ongoing operations, maintenance and administrative (OM&A) savings of approximately $7.8 million per year and reductions in capital expenditures of approximately $1.3 million per year by year ten of the deferred rebasing period (based on the level of savings achieved by year ten).[12] The Applicants stated these efficiencies represent an OM&A reduction of about 65% of PDI’s year 10 status quo forecast.

Table 1 below summarizes savings anticipated by the Applicants for the first ten years of the Transaction. PDI’s projected costs as a stand-alone distributor are compared to the projected costs of operating PDI’s service area once it is integrated within Hydro One. Year 1 in the Table represents a 12-month period following the closing of the Transaction.

[10] MAADs Handbook / p. 7
[11] Hydro One Reply Submission / p. 28
[12] Exhibit A / Tab 2 / Schedule 1 / pp. 1-2

Table 1: Projected cost savings, years 1 through 10 ($ million)[13]

	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 Applicants submitted the Transaction will also reduce costs for PDI and Hydro One customers beyond the deferred rebasing period (i.e., in year 11 and afterwards). For example, the Applicants stated that Hydro One's residual cost to serve PDI in year 11 will be $17.0 million compared to PDI's projected revenue requirement of $26.3 million in year 11 as a stand-alone distributor (Table 2). Both values include year 11 low voltage charges (LV charges).[14] The Applicants used the term residual cost to serve to represent the additional revenue requirement that would be added to Hydro One's overall revenue requirement to serve current PDI customers in year 11, after anticipated synergies and efficiency gains have been reflected.[15] The residual cost to serve does not include any shared costs apportioned to historic PDI customers through the cost allocation process.[16]

[13] *Ibid.* / p. 2
[14] Exhibit I / Tab 1 / Schedule 48 / OEB Staff 48
[15] Exhibit I / Tab 1 / Schedule 6 / OEB Staff 6 and Exhibit I / Tab 1 / Schedule 7 / OEB Staff 7
[16] Exhibit I / Tab 1 / Schedule 45 / OEB Staff 45

Table 2: Projected year 11 cost savings from the Transaction: PDI status quo compared to residual cost to serve[17]

A	B	B-A
Year 11 with consolidation: Residual Cost-to-Serve PDI Customers	Year 11 without consolidation: Status Quo cost that would otherwise be collected from PDI Customers post-rebasing if Transaction is not approved	Year 11 comparison: Savings from the Transaction
$17.0 million	$26.3 million	$9.3 million

The Applicants stated that the $9.3 million difference between the projected year 11 status quo revenue requirement and residual cost to serve demonstrates the cost savings from the Transaction. The Applicants stated that projected cost savings reflect the elimination of functions, resources and assets that are currently used to serve the service area and which, for example, due to duplication, would no longer be needed to provide service.[18]

The Applicants submitted that cost savings from the Transaction will lead to lower rates for PDI and Hydro One legacy customers, assuming that PDI customers remain in separate rate classes. As shown in Table 3, the Applicants projected that rates charged to PDI and Hydro One legacy customers in year 11 will be lower than they would have been if the Transaction had not been not approved.

Table 3: Projected rates to be charged in year 11 (2030 Base Distribution Charges): with and without consolidation[19]

	Year 11 with Consolidation	Year 11 without Consolidation
PDI		
Residential (750 kWh)	$27.16	$37.67
GS< 50 kW (2000 kWh)	$61.55	$82.14
GS > 50 kW (250 kW)	$1,027.66	$1,508.51
Hydro One		
Residential UR (UR 750 kWh)	$41.44	$44.87
GS< 50 kW (UGe 2000 kWh)	$102.26	$108.84
GS > 50 kW (UGd 50 kW)	$3,238.09	$3,440.78

[17] Hydro One Reply Submission / p. 11
[18] Exhibit A / Tab 4 / Schedule 1 / p. 5
[19] Hydro One Reply Submission / pp. 9-10

New Rate Classes

The Applicants proposed to establish new, discrete rate classes for PDI residential and general service customers. The new rate classes will come into effect when the deferred rebasing period ends (i.e., in year 11 following the consolidation), subject to OEB approval.[20] The Applicants submitted that the new rate classes will allow Hydro One to allocate the costs to serve PDI's residential and general service customers more precisely than if they were put into an existing Hydro One legacy rate class.[21] The Applicants noted that the MAADs Handbook specifically provides for the creation of new rate classes.

The Applicants indicated that setting rates for the new PDI customer rate classes will involve an allocation of fixed costs as well as an allocation of shared costs.[22]

The Applicants plan to use adjustment factors to directly allocate the costs of local fixed assets used to serve acquired customers to the proposed new acquired rate classes. Local fixed assets refer to the assets in Uniform System of Accounts (USofA) 1815 to 1860, which include poles, wires, transformers and distribution stations. The Applicants submitted that a direct allocation approach is possible because PDI customers are located in a defined service area for which Hydro One can precisely identify the cost of the fixed assets that serve these customers. Hydro One plans to track the distribution gross fixed asset costs associated with serving PDI customers to inform ratemaking on an ongoing basis and to update the adjustment factors at the time of future cost of service applications, as necessary.[23]

The Applicants propose to allocate shared costs to PDI customer rate classes by applying the same allocation principles and allocators (e.g., number of customers, weighted number of bills) normally used in the OEB's cost allocation model (CAM) to allocate such costs. Hydro One does not plan to use adjustment factors to allocate shared costs.[24] The Applicants stated that shared costs include:

- Shared facilities used to provide operations and maintenance services (i.e., service centres and maintenance yards), billing and information technology (IT) system costs, and other miscellaneous general plant

[20] Exhibit I / Tab 1 / Schedule 47 / OEB Staff 47
[21] Hydro One Reply Submission / p. 12
[22] Exhibit A / Tab 5 / Schedule 1 / p. 4
[23] Hydro One Argument-in-Chief / p. 13
[24] Exhibit A / Tab 5 / Schedule 1 / p. 7

- OM&A costs associated with shared services, such as planning, finance, regulatory, human resources, IT, customer services and corporate communications
- Asset and related OM&A costs associated with upstream distribution facilities used by former PDI customers (i.e., costs formerly captured under LV charges)[25]

The Applicants clarified that only the portion of the PDI load that was previously supplied through upstream distribution facilities (i.e., not supplied directly from the transmission system) will be used to determine the allocation of upstream distribution costs to the new PDI customer rate classes.[26]

The Applicants submitted that establishing new rate classes for PDI residential and general service customers as described above is preferable to putting those customers into comparable existing Hydro One rate classes or into separate rate classes that are allocated average Hydro One costs.[27] The Applicants stated that placing residential and general service PDI customers into existing Hydro One rate classes or allocating average Hydro One costs to them would result in an over-allocation of the amount of local fixed assets required to serve PDI residential and general service customers. This, in turn, would drive an over-allocation of most OM&A and all asset-related costs.

The Applicants added that, in either of these situations, acquired customers would end up inappropriately paying for the costs associated with local fixed assets (e.g., poles, wires, transformers) that are being used to serve legacy customers, and whose function does not change as a result of the Transaction.

As an illustration, the Applicants presented the information in Table 4 below, which compares the cost of fixed assets that would be allocated to PDI customers under each of the three methods just outlined. In addition to representing a more precise allocation of costs to serve PDI customer classes, the Applicants submitted that their proposed approach would also result in a more precise allocation of costs required to serve the legacy customers.

[25] Exhibit A / Tab 4 / Schedule 1 / p. 6
[26] Exhibit A / Tab 5 / Schedule 1 / pp. 7-8
[27] Hydro One Reply Submission / p. 12

Table 4: Total local fixed assets in USofA 1815-1860 in year 11 (2030): comparison of known cost to serve with allocated costs[28]

A	B	C
Assets known to be required to serve acquired PDI customers based on data from financial reporting systems	**Assets allocated by CAM if acquired PDI customers are put into separate rate classes and allocated average Hydro One asset costs**	**Assets allocated by CAM if acquired PDI customers are merged into urban legacy classes and allocated average urban asset costs**
$148.8 million	$691.0 million	$341.1 million

Goalposts

The Applicants proposed that, following the ten year deferred rebasing period, Hydro One would begin to collect a portion of its shared costs from PDI customers so they will pay their share of the cost of the functions, resources and assets that are carried out or held centrally by Hydro One.[29]

Although the Applicants presented their proposal for how costs should be allocated, they stated that the manner in which shared costs will be allocated, and the amount that will be borne by acquired PDI customers, will be matters for a future OEB panel to consider and determine when Hydro One proposes a rate structure and rate harmonization plan as part of its rebasing application following the ten year deferred rebasing period.[30]

The Applicants committed to ensuring that the total costs collected from acquired PDI customers will remain between the “goalposts” of the projected year 11 residual cost-to-serve and PDI’s year 11 status quo revenue requirement.[31] The projected PDI year 11 revenue requirement (without consolidation) represents the “upper goalpost”; Hydro One’s residual cost to serve PDI customers (with consolidation) represents the “lower goalpost”. The Applicants noted that the difference between the two goalposts is equivalent to the cost savings of the proposed Transaction. The Applicants submitted that any amount of revenue collected from customers that falls between the goalposts results in a sharing of the benefits between Hydro One legacy customers and PDI customers.

[28] *Ibid.* / p. 13
[29] Hydro One Reply Submission / pp. 8-9
[30] Exhibit A / Tab 4 / Schedule 1 / pp. 6-7
[31] Hydro One Reply Submission / p. 10

Accordingly, as illustrated in Table 5, the Applicants submitted that the proposed collection of $20.6 million from PDI customers in year 11 would amount to a sharing of the benefits of the Transaction between PDI customers and legacy Hydro One customers:

> Since the total Residual Cost to serve including LV charges is $17.0M and the PDI 2030 Status Quo cost including LV charges is $26.3M, the collection of $20.6M from PDI customers means that legacy customers are benefitting from a reduction of $3.6M ($20.6 - $17.0) in revenue collected, while PDI customers are benefitting from a reduction of $5.7M ($26.3 - $20.6) relative to what they would pay if PDI is not acquired.[32]

The Applicants fully anticipated it would be possible to set rates for PDI acquired customers that result in a revenue to cost ratio that falls within OEB-approved ranges and results in an allocation of savings to both PDI customers and legacy Hydro One customers.[33] The Applicants submitted that rates established based on a revenue to cost ratio within the OEB's approved ranges are considered to appropriately reflect the OEB's rate setting objectives.

Table 5: Net savings in year 11 for legacy and acquired customers per Hydro One's proposed cost allocation and rate design[34]

A	B	C	B-A	C-B
Residual Cost to Serve PDI Customers (lower goalpost)	**Forecast Costs to be Collected from PDI Customers post-rebasing**	**Status Quo costs that would otherwise be collected from PDI Customers post- rebasing if Transaction is not approved (upper goal post)**	**Net Benefits to Legacy Customers**	**Net Benefits to PDI Customers**
$17.0 million	$20.6 million	$26.3 million	$3.6 million	$5.7 million

In summary, the Applicants stated that the proposed consolidation will produce 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.[35] The

[32] Exhibit I / Tab 1 / Schedule 48 / OEB Staff 48
[33] Exhibit A / Tab 5 / Schedule 1 / p. 8
[34] Hydro One Reply Submission / p. 11
[35] Hydro One Argument-in-Chief / p. 7

Applicants submitted that PDI customers will have both lower cost structures and lower rates beyond the deferred rebasing period, together with lower rates for Hydro One legacy customers.[36]

Submissions from Parties and OEB Staff

PWU supported the Application, and agreed with the Applicants that the Transaction will reduce the underlying cost structures to serve the former PDI service area and that cost savings from the Transaction will accrue to both PDI and legacy Hydro One customers.[37] PWU added that the Applicants' rate class and allocation proposal will maintain the delineation of costs attributable to PDI and Hydro One's legacy assets and prevent cross-subsidization.

VECC submitted that Hydro One's current cost to serve similar customers is higher than PDI's.[38] While VECC accepted that there are efficiencies and cost reductions to be gained from the Transaction, VECC submitted that savings as set out in the Application are overstated. VECC concluded that the Applicants' proposals for setting rates following the deferred rebasing period do not ensure that the no harm test will be met.

Energy Probe similarly submitted there is no evidence on the record that Hydro One can provide services or buy assets at lower cost than PDI, and that the Applicants' projected savings are based on assumptions that exaggerate the costs of the no-consolidation scenario and minimize the costs of the consolidation scenario.[39] Energy Probe added that the Applicants' proposal to establish new rate classes for PDI customers and to use adjustment factors to allocate their local asset costs will result in PDI customers getting a better deal than customers of other previously acquired utilities.

Save PDI Coalition submitted that the Transaction will, among other things, increase rates for PDI customers.[40] Save PDI Coalition argued that Hydro One's OEB scorecard shows it has among the highest prices and worst service levels of all local distribution companies (LDCs) in Ontario. On the subject of economies of scale, Save PDI Coalition asserted that PDI is not too small to succeed and that bigger is not always better.

CCC stated that Hydro One remains the highest cost utility in the province and if the OM&A cost per customer is presented on a truly comparable basis (as set out by

[36] Hydro One Reply Submission / p. 1
[37] PWU Submission / p. 6
[38] VECC Submission / p. 6
[39] Energy Probe Submission / p. 3
[40] Save PDI Coalition Submission / p. 1

VECC), PDI's costs are lower.[41] CCC questioned how acquisitions of lower cost utilities, by a high cost utility like Hydro One, can be justified without compromising well established cost allocation and rate design principles. CCC further questioned whether the savings projected by the Applicants could be achieved in light of the fact that Hydro One has never demonstrated that its acquisitions result in lower costs for the acquired customers, and submitted that the projected PDI revenue requirement is overstated. CCC submitted the Applicants' proposed cost allocation approach is inconsistent with OEB practices and unfair to the legacy customers, and that the Applicants have not demonstrated that the underlying cost structures for PDI customers will result in costs that will be lower than if the Transaction did not take place.

SEC argued that Hydro One will not serve PDI customers at a lower cost than would be the case if they were not acquired by Hydro One.[42] SEC submitted that, across a range of metrics, Hydro One is a higher cost utility than PDI, even after accounting for its rural business conditions. SEC further submitted that Hydro One's previous utility acquisitions have not resulted in cost savings to acquired or legacy customers, SEC noted that all the customers Hydro One has acquired so far now have costs higher than their peers in other LDCs, and almost all of them have been harmed by very substantial rate increases.

SEC submitted that the Applicants' proposal for direct allocation has never been approved by the OEB for any similar use and would result in unfairness between groups of customers. SEC stated that, while direct allocation is permitted today with qualifications, at no time has the OEB considered direct allocation for assets that are distinguished by the geographic location of a class of customers being served.

OEB staff acknowledged that the Transaction has the potential to provide benefits and is consistent with public policy that encourages consolidation transactions, but without specific conditions in place, there is a realistic chance that customers may be harmed.

OEB staff submitted that Hydro One's current base distribution charges are higher than PDI's and that PDI customers would be harmed if they were to pay Hydro One's existing distribution rates.[43] OEB staff also submitted that it is concerned that Hydro One's overall per-unit costs to serve the acquired utility will be higher over the long term and that despite requests made by parties for Hydro One to compare its long-term costs to PDI's, or to support its suggestions of economies of scale, Hydro One has not done so. OEB staff argued that it has not been demonstrated that Hydro One can do the same

[41] CCC Submission / pp. 7-8
[42] SEC Submission / p. 40
[43] OEB Staff Submission / p. 10

job as PDI for the same or lower costs. While OEB staff accepted that some savings can be achieved through the proposed consolidation, OEB staff submitted that Hydro One may be overstating the likely savings, and that there is a risk that consolidation synergies achieved in the near term may be exceeded in the longer term by Hydro One's potentially higher per-unit costs.

OEB staff submitted that the MAADs Handbook allows distributors to create new rate classes for acquired customers and establishes the expectation that rates will reflect the cost to serve them. OEB staff submitted that it is not clear whether Hydro One's acquired rate class proposal for PDI reflects cost causality or whether it is a way of avoiding the higher rates of Hydro One's existing rate classes. OEB staff submitted that where costs associated with specific rate classes are known, direct allocation is appropriate, and that Hydro One's proposal to use adjustment factors as a proxy for direct allocation is reasonable.

OEB staff noted that Hydro One proposes to allocate shared costs among acquired and legacy rate classes using the OEB CAM, and that Hydro One will ensure that PDI rates remain between the goalposts of the status quo and residual cost to serve. OEB staff submitted that it is not evident how such goal seeking is consistent with principles of cost causation and equity to all customers.

OEB staff proposed a number of conditions for the approval. OEB staff argued that conditions are necessary given uncertainties in Hydro One's ability to satisfy the no harm test following the end of the deferred rebasing period. OEB staff submitted that if the conditions are deemed not to be feasible, and if there are no viable alternatives put forward by Hydro One that meet the intent of OEB staff's conditions, the Application should be denied.

SEC submitted that approval with conditions is not appropriate for three reasons.[44]

- Designing conditions to protect all classes of customers and place risk on shareholders is not a trivial task, and that the number of checks and balances would not be small.
- The OEB has generally not required its regulated entities to guarantee certain future events, and put the shareholders directly at risk for those results. SEC submitted that while this approach could be considered, it would be a relatively

[44] SEC Submission / p. 51

broad change in the OEB's approach to regulation that would benefit from a broader consultation with the industry.

- If the OEB is not willing to say no when faced with an exception, that unwillingness will limit the OEB's ability to ensure consolidation will truly benefit the industry and the customers.

Reply Argument from Hydro One

In its reply argument, Hydro One submitted that its proposal for direct allocation is consistent with previous OEB approvals for Hydro One and for other distributors.[45] For example, the OEB has approved Hydro One's direct allocation of costs for sentinel lights and settlement costs for interval meter customers, which are directly allocated to a group of four rate classes. There are several other distributors that have used direct allocation to establish the rates for Large User and Embedded Distributor rate classes, as well as some other rate classes. Hydro One submitted that the direct allocation of costs to the acquired customers of PDI is an appropriate way to allocate costs in these circumstances, because the information is available and it allows for rates to those customers to more accurately reflect the costs to serve them.

Hydro One disagreed with SEC's submission that the Applicants' proposed cost allocation approach (and utilization of the goalposts) violates the primary rate-setting principle of cost causality, because it gives Hydro One discretion to allocate the cost savings of the Transaction between acquired customers and Hydro One legacy customers.

Rather, Hydro One submitted that at no point will Hydro One allocate any savings from the Transaction. Instead, Hydro One stated that after the rebasing period it will allocate all costs (including shared costs) across both legacy and acquired customers and will do so in accordance with the OEB's cost allocation principles. Hydro One underscored that the rates will then be set following the OEB's normal rate design practice and that the cost allocation and rate design approach proposed affords Hydro One no discretion to allocate the savings.

Hydro One submitted that the intervenor arguments that the cost allocation proposals are unfair to legacy customers who have not benefitted from a similar approach are not a relevant consideration in this Application. Hydro One submitted that its proposed cost allocation and rate design approach is fair to all customers:

[45] Hydro One Reply Submission / p. 15

> The simple fact that Hydro One's urban class rates are different than the proposed rates for the acquired classes does not mean that legacy customers are being treated unfairly or "unequally". Both sets of rates are based on using the OEB's cost allocation principles and rate design policies, the only difference being that density factors are used to reflect the cost of serving the wide range of urban areas included in Hydro One's legacy class, whereas the PDI […] acquired class rates reflect the fact that the amount of local fixed assets required to serve them are known and can be directly allocated.[46]

Hydro One addressed VECC and OEB staff concerns with Hydro One's proposal to adjust revenue to cost ratios, if necessary, to bring the revenues to be recovered from the acquired classes back within the goalposts. Hydro One argued that it is highly unlikely the proposed revenue requirement to be collected will fall outside the goalposts. However, if that did happen, Hydro One stated that it would likely adjust the revenue to cost ratios for those classes which are furthest away from a ratio of 1.0 in a manner consistent with its past practice for making such adjustments, and which has been approved by the OEB on numerous occasions. Hydro One added that its approach in this regard would be subject to review and approval by the OEB panel in a future rates proceeding.

Responding to the submission by some intervenors that Hydro One is a higher cost utility than PDI, Hydro One stated that Hydro One serves a sparsely populated, largely rural area. As a result, a significant proportion of Hydro One's customers are located in parts of the province that present challenging construction and maintenance conditions, and a significant portion of Hydro One's costs and revenue requirement are associated with assets that are used to serve the customers of embedded distributors.

Hydro One submitted that, given these factors, it is not surprising that Hydro One's average cost, or revenue, per customer, would appear to be higher than other distributors. With reference to SEC's comparison of certain Hydro One-wide rates and revenue information, Hydro One submitted that SEC's comparison of Hydro One's urban rate classes and the rate classes of other urban distributors is not relevant and that these rate classes are not directly comparable.

Hydro One submitted that there are many factors that need to be considered in comparing utilities' rates before any conclusions can be made with respect to the unit cost to serve. Hydro One stated that because of the nature of its distribution area, Hydro

[46] *Ibid.* / p. 22

One will have higher system-wide costs to serve its customers. However, this does not mean that the Residual Cost-to-Serve forecast for this Transaction is inaccurate. Hydro One addressed VECC's challenge of Hydro One's evidence that Hydro One's OM&A cost per customer is higher than PDI's. Hydro One stated that VECC's conclusion is surprising because it is based on a single point of comparison which exists completely outside the Transaction and only addresses OM&A costs, not the total cost to serve (i.e., it excludes capital). Hydro One noted that the no harm test is applied to the impacts of the consolidation transaction, not to a current rate comparison.

Hydro One disputed the diseconomies of scale argument made by SEC. Hydro One submitted that there is no evidence on the record regarding diseconomies of scale, and that SEC's analysis is not evidence. Hydro One submitted there is no data or analysis done as to whether Hydro One's cost structure is reflective of the diseconomies of scale theory. Hydro One also stated that Hydro One's own economist indicated that diseconomies of scale would not apply in the case of a utility acquisition. Hydro One argued that SEC's submission that past Hydro One acquisitions have not resulted in cost savings is not persuasive, for the following reasons.

First, Hydro One submitted that the OEB in past MAADs proceedings has stated that what transpired in previous MAADs cases is irrelevant.

Second, Hydro One submitted that SEC's comparison erroneously compares customer rates that are based on a CAM versus the actual cost to serve customers and that SEC's comparison does not say anything about the cost savings associated with the past acquisitions. Hydro One submitted that to quantify cost savings, it would be necessary to understand how Hydro One's revenue requirement associated with serving both its own customers and the customers from past acquisitions compares with what the total revenue requirement would have been for Hydro One and all past acquired distributors if the acquisitions had never happened.

Third, Hydro One submitted that the rate-setting approach being proposed in this case is entirely different from the rate proposals in the acquisitions of the early 2000s. Specifically, Hydro One stated that although acquired customers were brought into Hydro One's existing rate classes in those earlier acquisitions, the proposal before the OEB in the Application is to put PDI residential and general service customers in discrete, new, acquired customer classes for the long-term, potentially in perpetuity.

Fourth, Hydro One submitted that for SEC to support its assertions, it would need substantive details on the asset conditions of the acquired utilities, service quality the customers had pre-acquisitions, the return on equity the acquired distributors were achieving, and if there was any cross-subsidization between property tax ratepayers and electricity ratepayers – all of which would have impacted the 2005 rates.

Fifth, Hydro One submitted that while cost savings were not tracked on these much older acquisitions, the evidence shows very clearly that cost savings have been achieved for Hydro One's three most recent acquisitions in Haldimand County Hydro Inc., Norfolk Power Distribution Inc. and Woodstock Hydro Services Inc. (Haldimand, Norfolk and Woodstock).[47,48,49] Indeed, Hydro One submitted that cost savings from all three of these most recent transactions have exceeded the forecasted costs savings.

Finally, Hydro One addressed SEC's submission that, since 2005, Hydro One's distribution revenue requirement per customer increased at a faster rate than other LDCs. Hydro One submitted that since 2005 it has made no acquisitions that could have had the effect of contributing to distribution revenue per customer increases. Hydro One has continued to treat Haldimand, Norfolk and Woodstock as separate entities from a revenue requirement and rates perspective.

Hydro One disagreed with intervenor and OEB staff submissions that the Applicants' status quo projection of PDI costs is too high and that Hydro One's residual cost to serve projection is too low. For example, Hydro One submitted that PDI has provided a reasonable status quo forecast that reflects the capital and operating needs that they believe will be required to serve their customers in the next ten years. Hydro One further submitted that if OEB staff had compared the appropriate data, it would show that the status quo revenue requirement forecast in the Application has a compound annual growth rate of 2.9%, and this is reasonable as it is aligned with industry averages. Hydro One submitted that PDI's return on equity in recent years was artificially inflated and observed that by the time of its next rebasing, PDI will not have had a cost-of-service rate case in 17 years. Hydro One submitted that consideration of any revenue requirement increases must take these factors into account.

Hydro One submitted that the evidence about station replacement in PDI's service area does not support the proposition that Hydro One's asset replacement costs are higher than PDI's. Hydro One submitted that the evidence is not indicative of PDI's customers getting less capital infrastructure for the same expenditures going forward, nor does it justify OEB staff's concern that Hydro One has not appropriately accounted for the asset replacement needs of PDI over the coming decade.

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[47] EB-2014-0244
[48] EB-2013-0196 / EB-2013-0187 / EB-2013-0198
[49] EB-2014-0213

For example, while PDI plans to replace or refurbish nine stations, Hydro One's investment plan and capital forecasting process suggests that capital spending on the stations (at this stage) should be spent on replacing or refurbishing six stations. Hydro One stated there would be adequate funding to deal with seven or more other stations that would be determined once Hydro One has an opportunity to operate these stations. Hydro One submitted that the fact that Hydro One's approach is different from PDI's is precisely what should be expected in the context of a consolidation. Hydro One added that determinations by Hydro One will be driven by its initial experience operating the PDI stations, reliability metrics, safety considerations and potential cost and engineering efficiencies.

Hydro One disagreed with OEB staff's and SEC's proposition that Hydro One's higher cost-based SSCs are indicative of Hydro One's higher unit costs compared to PDI. Hydro One noted that the SSCs in PDI's tariff schedule are from the *2006 Electricity Distribution Rate Handbook* (2006 Rate Handbook) and that the specific SSCs referenced by OEB staff have not been updated since then and are not reflective of the PDI cost to serve. Hydro One submitted that the charges outlined by the 2006 Rate Handbook cannot be used as a basis for comparison to Hydro One's cost of providing those services, which reflect the actual 2018 cost of providing those services. Hydro One added that the fact that Hydro One's SSCs are higher than other utilities has no correlation to unit costs or to the cost it has forecast to serve PDI customers.

Hydro One submitted that the conditions of approval proposed by OEB staff are unnecessary as the Transaction clearly creates no harm, and even if the risk alleged by OEB staff was material, the OEB has the inherent jurisdiction to protect ratepayers in the absence of the proposed conditions. Hydro One also stated that some proposed conditions are unworkable.

Hydro One submitted that since the OEB will assess the resulting rates after the deferred rebasing period, the consolidating entity bears the risk of achieving those forecasts. Hydro One added that the OEB's responsibility to protect the interests of ratepayers is not lost following a decision finding no harm resulting from the approval of this Application. Hydro One submitted that the cost consequences arising from the Transaction will not fully materialize until after the deferred rebasing period. At that time, the OEB retains the power to evaluate those costs and determine how they will affect rates. Hydro One submitted that because the OEB retains ongoing jurisdiction to set just and reasonable rates, the rate consequences of the Transaction are in no way permanent, unalterable or foreordained.

Hydro One submitted that in circumstances where the OEB has the inherent jurisdiction to deal with the circumstance that a condition is attempting to control, then a condition should not be imposed. Hydro One stated that as the OEB has the inherent power to deal with the issue in question in a future proceeding, then the condition is unnecessary. The ratepayer will be protected from the perceived risk by the OEB, which must exercise its statutory powers reasonably and, in some cases, according to a standard of correctness. Second, Hydro One stated that imposing conditions over circumstances that the OEB has inherent jurisdiction to address in future proceedings would fetter the discretion of a future panel in dealing with those issues differently based on changed circumstances or new/better evidence.

Hydro One provided detailed comments in its reply argument on each of the conditions proposed by OEB staff. In addition to those comments, and to the broader submissions noted above, Hydro One stated that to the extent that the OEB considers it necessary to impose one or more of the conditions proposed by OEB staff, Hydro One has proposed alternative approaches which, when combined with the OEB's inherent powers, provide ratepayers with the protections intended by OEB staff.

Findings

The OEB finds that the proposed Transaction offers the potential for cost savings for both acquired customers and legacy customers. These savings are forecast to be reflected in the cost structures that will be present in year 11 following the Transaction. The anticipated savings provided the basis for the Applicants' case that both acquired and legacy customers will suffer no harm as a result of the Transaction.

However, there does arise the potential for a diminishment of the savings projected based on a number of factors beyond the inherent difficulties of projections of costs ten years in advance. Hydro One's overall distribution rates and revenue requirement per customer are higher than PDI, even when allowing for the length of time that has passed since PDI's rebasing. Hydro One, for a variety of reasons, is a high cost distributor, and where shared costs are incurred, there may be increased costs allocated to the acquired utility, although these may be offset by potential procurement savings arising from economies of scale. Replacement of assets in the acquired utility may also be under-accounted for in the Application.[50]

However, as the findings in this Decision require Hydro One's shareholder to absorb any costs above the status quo goalpost, the Hydro One legacy customers will not be harmed by the Transaction.

[50] Hydro One in its reply submission noted the difficulty of ensuring a distribution system plan (DSP) for the acquired utilities given its lack of access to their assets.

While Hydro One has suggested that future OEB panels may correct for undesirable results associated with unrealized savings in the same manner that revenue shortfalls were dealt with by the OEB in the Hydro One EB-2017-0049 proceeding, the OEB believes that measures must be put in place in this Decision to insulate acquired customers from a failure of the Applicant's projections. As a practical matter, a MAADs decision is largely irreversible, and the OEB must provide for the continuance of cost structures beyond the deferred rebasing period that provide rate results that are no worse than what would have occurred if no transaction had taken place. The provision of these safeguards as conditions of approval in no way abrogates the OEB's overarching statutory responsibility to set future rates that are just and reasonable.

The OEB is assisted by the Applicants' analogy to goalposts in the determination of no harm. In developing the goalpost for the status quo without consolidation, the Applicants have provided the projected revenue requirement that matches with the compound annual growth rate projected for PDI. While the size of costs savings projected by the Applicants provides some measure of reassurance, the OEB finds that if the fully allocated revenue requirement for the new year 11 PDI rate classes is higher than the year 11 status quo forecast of Hydro One, these excess costs shall be borne by the shareholder and not by the ratepayers.

The OEB also notes the concern, principally raised by SEC, that the direct allocation of costs to the customers of the acquired utility results in unfairness to other Hydro One customers in urban areas. Rates paid by existing urban customers are only relevant in this Application to the extent they might increase as a result of the Transaction. The Transaction is projected to modestly reduce Hydro One's costs for all legacy customers.

Hydro One's evidence was clear that the Transaction would result in no increases to its common management, corporate governance, regulatory, financial and information technology costs. Hydro One projects very modest increases to other total administration costs, which are forecast to be much lower than PDI's current costs.[51] Since the PDI customers will be contributing to Hydro One's common costs, there will be some benefit for the Hydro One legacy customers.

4.2 Reliability and Quality of Electricity Service

The MAADs Handbook requires utilities to provide the impact that a proposed transaction will have on customers with respect to reliability and quality of electricity

[51] Oral Hearing Transcript / Vol. 2 / pp.184-185 and JT2.11

service. In considering the impact of a proposed transaction on the quality and reliability of electricity service, and whether the no harm test has been met, the MAADs Handbook states that the OEB will be informed by the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard.[52]

The MAADs Handbook notes that, under the OEB's regulatory framework, utilities are expected to deliver continuous improvement for both reliability and service quality performance to benefit customers. This continuous improvement is expected to continue after a consolidation, and will continue to be monitored for the consolidated entity under the same established requirements.

Reliability

The Applicants submitted that the consolidation of PDI and Hydro One is expected to maintain or improve the adequacy, reliability and quality of electricity service.[53] The Applicants submitted that 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. Hydro One submitted that it also has the ability to leverage its field crews that are dispersed across the province to address any emergency situation that may arise.[54]

The Applicants further submitted that with the consolidation, there is an opportunity to improve reliability for PDI customers through new tools and technologies that Hydro One currently uses on its distribution system. For example, Hydro One has recently installed technology that will automate switching processes as well as assist in fault location on Hydro One operated lines. Via smart meter technology Hydro One is able to confirm outages and restoration that is meter point specific. Hydro One submitted that these should result in faster response and restoration times.

The Applicants provided historical System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI) results as shown in Table 6 below.[55] The Applicants indicated that as a proxy, Hydro One's data reflects reliability statistics for feeders in the vicinity of PDI.[56] While the Applicants provided this particular

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[52] MAADs Handbook / p. 7
[53] Hydro One Argument-in-Chief / p. 13
[54] Exhibit I / Tab 1 / Schedule 28
[55] SAIDI indicates the average number of hours that a customer's power is interrupted. SAIFI indicates the average number of times that a customer's power is interrupted.
[56] Hydro One Reply Submission / p. 57

data to offer a data set most comparable to PDI's reliability, the Applicants submitted that in reality the SAIDI and SAIFI values of Hydro One and PDI are difficult to compare directly, given that PDI's service area is more urban than Hydro One's feeders in the vicinity of PDI's system.[57]

Table 6: Reliability Metrics (excluding Loss of Supply interruptions attributable to assets that are not part of the Hydro One Distribution System or the PDI Distribution System)[58]

	2014		2015		2016		2017	
	Hydro One	PDI	Hydro One	PDI	Hydro One	PDI	Hydro One	PDI
Duration (SAIDI)	5.35	0.90	5.78	3.59	2.09	2.01	3.72	2.22
Frequency (SAIFI)	2.01	0.83	1.49	2.81	0.89	2.34	1.18	2.53

The Applicants submitted that with respect to frequency of interruption (SAIFI), Hydro One's statistics were better than those of PDI. With respect to duration (SAIDI), PDI had lower duration statistics relative to Hydro One's proxy area. The Applicants submitted that in general, the higher frequency of outages in urban areas and the longer hours of power outage duration hours in rural areas is normal:

> Power distribution in rural areas has the disadvantage of longer restoration times for outages, on the basis that it takes significantly longer to patrol, locate the cause of the outage faults. These factors result in longer duration hours for customers and thus higher SAIDI values. With respect to the SAIFI metrics, the interruptions caused by higher foreign interference due to dense population in this urban area results in a higher amount of outages for PDI.[59]

The Applicants submitted that the difference in reliability metrics for Hydro One's existing area is not expected to be reflective of anticipated reliability in the current PDI service area.

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[57] Exhibit I / Tab 1 / Schedule 28
[58] Exhibit A / Tab 2 / Schedule 1 / p. 9 – November 29, 2019 update
[59] Exhibit I / Tab 1 / Schedule 28

Submissions from Parties and OEB Staff

PWU submitted that the Applicants have provided sufficient evidence that the transfer of PDI's distribution system to Hydro One would maintain or improve the adequacy, reliability and quality of service for PDI customers.[60]

VECC submitted there is no evidence that reliability for former PDI customers will improve in the future based on Hydro One's plans. Overall, VECC submitted that the evidence regarding the no harm test vis-à-vis reliability of service is mixed.[61] VECC added that the available evidence suggests that service quality for PDI customers could just as easily decline as it could increase as a result of the Application.

SEC submitted that reliability statistics for customers in Hydro One urban areas (rather than stations in the vicinity of PDI) would have been more useful for comparing Hydro One and PDI reliability, but that such statistics do not appear to be available.[62] SEC further submitted that its bigger concern is that Hydro One may underinvest in the infrastructure in the PDI service area to achieve cost savings, causing a decline in reliability.

OEB staff submitted that the effect of Hydro One's historical reliability performance on PDI customers is uncertain, and that it is unclear whether SAIDI and SAIFI levels for Hydro One legacy customers would improve or deteriorate following consolidation.[63]

Reply Argument from Hydro One

Hydro One submitted that notwithstanding the submissions of OEB staff and the intervenors, the Transaction allows the OEB to conclude that there will be no harm with respect to reliability and service quality.[64] Hydro One stated that OEB staff's and intervenors' treatments of the reliability statistics was superficial at best and, at worst, they either ignored evidence on the record or did not accurately articulate the evidence on which they relied. Instead, Hydro One submitted that the evidence clearly demonstrates that reliability will be maintained and that there are plans in place for its continuous improvement.

With respect to SAIDI, Hydro One submitted that no party has acknowledged the key fact that Hydro One will be operating within an urban environment in the PDI service

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[60] PWU Submission / p. 5
[61] VECC Submission / p. 10
[62] SEC Submission / p. 46
[63] OEB Staff Submission / p. 19
[64] Hydro One Reply Submission / p. 57

area. In addition, Hydro One stated that it will retain knowledge from existing PDI staff and PDI will have access to Hydro One's larger pool of direct trades and technical staff to serve the consolidated region's needs. Hydro One submitted that this retained local knowledge, in coordination with Hydro One's regional operations and staff, will allow Hydro One to maintain or improve reliability.

Quality of Service

The Application describes various initiatives and customer services that Hydro One provides its customers and which would be offered to the customers of PDI, including the following:[65]

- Hydro One has Contact Centres open on Saturdays from 9:00 a.m. to 3:00 p.m. and extended weekday hours from 7:30 a.m. to 8:00 p.m., 4½ hours per day longer, on Monday to Friday than PDI.
- Hydro One's Call Centre is supported by a 24/7 Interactive Voice Response system in addition to customer service staff.
- Hydro One provides 24-hour assistance for power outages and other emergencies.
- Hydro One customers have the option to receive e-mail or text outage notifications.
- Hydro One continues to increase its presence in local communities through drop-in sessions.
- Hydro One has a traveling customer service team that meets customers face-to-face to help answer questions about their bills, provide information about smart meters and help them learn more about conserving energy and reducing their bills.
- PDI customers would benefit from provincial programs that are not currently included in PDI's Conservation and Demand Management Plan.
- Hydro One has eliminated security deposits for residential customers, significantly reduced deposit requirements for business customers, and has expanded relief measures to help customers who accumulated balances on their accounts over the winter.

[65] Exhibit A / Tab 2 / Schedule 1 / p. 16

In brief, Hydro One submitted that it is able to offer the acquired customers a high level of service quality and the ability to take advantage of technological changes that PDI cannot provide. Hydro One further submitted that, in this regard, the proposed Transaction not only does no harm, but will be to the benefit of PDI customers.[66]

Submissions from Parties and OEB Staff

CCC and SEC submitted that Hydro One's scorecard metrics related to answering phone calls and first contact resolution are worse than PDI's. CCC stated that customers of PDI may experience reduced service in these areas, despite Hydro One's promised enhanced customer service through longer call centre hours and outage notification. CCC further submitted that the situation could be exacerbated by the elimination of local employees. For these reasons, CCC submitted that Hydro One cannot conclude that customer service for PDI customers will be enhanced through the proposed Transaction.

VECC's submission referenced the Applicants' response to VECC interrogatory 14 that compares Hydro One's and PDI's performance across a range of quality of service metrics. VECC identified that the response demonstrated that for virtually all of the measures where comparable data is available for both distributors, PDI's current performance equals or exceeds those of Hydro One.[67] VECC also addressed Hydro One's position that it is inappropriate to compare these metrics for Hydro One (largely a rural utility) with PDI (largely an urban utility). VECC noted that, during the technical conference, Hydro One had confirmed that the service quality indicators were not influenced by whether a utility is urban or rural. VECC submitted that the evidence suggests that service quality for PDI customers could just as easily decline as it could increase as a result of the Application.

SEC submitted that Hydro One's customer service metrics demonstrate that PDI customers will have worse customer service if the Transaction is allowed to proceed.[68] SEC also questioned whether Hydro One's call centre would be able to handle an additional 50,000 calls per year given Hydro One is not planning to add call centre staff. SEC argued that there may be declines in performance of the first contact resolution metric if Hydro One is unable to provide the same customer service as a local utility.

With respect to the additional customer benefits that would be available to PDI customers as a result of the Transaction, SEC stated that it was not convinced that

[66] Hydro One Reply Submission / p. 63
[67] VECC Submission / p. 10
[68] SEC Submission / p. 8

these additional benefits sufficiently offset the drawbacks of not being able to get a problem resolved on the first call, 13% of the time, or ten people a day not getting an answer when they call their utility.

OEB staff submitted that, although PDI customers are likely to gain certain service-level benefits from the Transaction, the potential for decreasing performance in PDI's telephone call abandonment rate metric is possible. To appropriately monitor this metric, OEB staff submitted that Hydro One should continue to annually report PDI-specific telephone call abandonment rates. As part of this reporting, if it is shown that the decline is attributable to the consolidation, Hydro One should be required make the investments necessary to return performance to, at a minimum, pre-consolidation levels.

Reply Argument from Hydro One

Hydro One highlighted that both Hydro One and PDI exceed the OEB's target scorecard metric for key service quality metrics. As a result, all are performing above expectations.[69] Hydro One argued that the OEB should not accept the assertions of OEB staff and intervenors that customers may be worse off or see no improvement as a result of the Transaction.

With respect to quality of service, Hydro One's Reply Argument addressed the primary issue raised by parties: the telephone answered on time metric. Hydro One pointed out that this metric reflects the percentage of calls that are answered within 30 seconds, and not the number of calls that are not answered. Hydro One's metric significantly exceeds the OEB target of 65%.

Hydro One also submitted that the evidence on record demonstrates that Hydro One does expect to expand capacity to handle an additional 50,000 calls per year, as shown in this exchange at the technical conference:

> MR. FALTAOUS: Okay. Yeah. And so customer care, you know, we would generally refer to this as shared costs, but there is incremental customer-care costs with taking on a lot more customers, so that would be representing the incremental portion of customer-care costs.
>
> MR. HARPER: I understand. I was just trying to categorize them, because yesterday we were talking about what were shared costs and what were not

[69] Hydro One Reply Submission / p. 60

> shared costs. And I just wanted to clarify, because I appreciate -- and I think we clarified yesterday, customer care was in the shared-cost category.
>
> MR. FALTAOUS: It is shared, but there is also an incremental element of cost.
>
> MR. HARPER: I fully understand that.[70]

Hydro One stated that its forecasts consider all incremental OM&A costs, including incremental administration and support services, which includes customer care (e.g., billing and call centre).

Hydro One reiterated that it can offer PDI customers a high level of customer service, as well as access to technological changes that PDI cannot provide. Hydro One therefore submitted that the proposed Transaction not only does no harm, but will be to the benefit of PDI customers.

Findings

The OEB accepts Hydro One's assertions that the retention of the expertise of relevant PDI staff coupled with Hydro One's new tools and technologies, and its ability to leverage field crews for emergencies, will be sufficient to prevent a deterioration of PDI system reliability and quality of service following the Transaction. The OEB's findings are also supported by Hydro One's assurance of additional customer service benefits in the form of longer call centre hours, online outage notices including emails, and interactive voice response, as well as the planned expansion of telephone call answering capacity.

While it would have been helpful to have a comparison of PDI metrics with Hydro One's urban customer areas, the OEB does not find a need to require a separate reporting procedure for reliability and service quality metrics for the acquired utility based upon OEB staff concerns.

4.3 Financial Viability

The MAADs Handbook establishes that the impact of a proposed transaction on the acquiring utility's financial viability for an acquisition, or on the financial viability of the consolidated entity in the case of a merger, will be assessed from the following perspectives:

[70] Hydro One Reply Submission / p. 61

- The effect of the purchase price, including any premium paid above the historic (book) value of the assets involved
- The financing of incremental costs (transaction and integration costs) to implement the consolidation transaction

The Applicants stated that 1937680 Ontario Inc. has agreed to purchase the business and distribution assets of PDI at a price of $105.0 million.[71] The purchase price represents a $23 million premium above PDI's net asset value of $82 million.[72] As contemplated in the asset purchase agreement underpinning the sale, the final purchase price is subject to closing adjustments. According to the Applicants, the purchase price represents the commercial value of the assets established through negotiations with an arm's length third party.[73]

With respect to the impact of the financial transaction on Hydro One's financial viability, the Applicants stated:

> The premium paid over the asset's book value will not have a material impact on Hydro One Inc.'s financial viability. This transaction price accounts for less than 2% of Hydro One Distribution's net fixed assets. In addition, the premium paid will not be included in Hydro One's revenue requirement and thus will not be funded by ratepayers.[74]

Hydro One submitted that it expects to incur incremental transaction costs of approximately $0.2 million for legal and tax costs related to the completion of the Transaction and costs associated with the necessary regulatory approvals. In addition, Hydro One expects to incur $9 million in integration costs, which includes up-front costs to transfer the customers into Hydro One's customer and outage management systems. Hydro One confirmed that all of these costs will be financed through productivity gains associated with the Transaction and will not be funded by ratepayers.

Submissions from Parties and OEB Staff

OEB staff submitted that the proposed financing of the Transaction, and the premiums paid, would not have an adverse impact on Hydro One's financial viability. As a result,

[71] Exhibit A / Tab 2 / Schedule 1 / p. 19
[72] Exhibit I / Tab 1 / Schedule 40 / p. 2
[73] Exhibit A / Tab 2 / Schedule 1 / p. 20
[74] *Ibid.*

OEB staff stated that the Application meets the no harm test with regards to financial viability.

Findings

The OEB agrees with OEB staff and Hydro One that there will be no adverse impact on Hydro One's financial viability as a result of the Transaction.

5 DECISION ON OTHER MATTERS

5.1 Loss of Local Control

Save PDI Coalition argued that the sale would result in loss of municipal control over PDI. Save PDI Coalition stated that municipal control is important to ensuring, among other factors, that investment decisions reflect local needs. Save PDI Coalition also expressed concern that Hydro One, a large company that is increasingly focused on international business and large urban centres, is less likely to adapt to the future needs of a small city like Peterborough when it is needed.[75]

Findings

The OEB finds that as local control of a utility is not a separate consideration as part of the no harm test, there must be evidence that change of control would be likely to have a negative effect on at least one of the criteria the OEB considers (as described throughout this Decision). There was no evidence in this proceeding that any of the criteria the OEB has a mandate to consider under the OEB Act would be affected by a loss of local control.

5.2 Deferred Rebasing Period and 1% Reduction to OEB-Approved Rate Schedule for PDI

The Applicants proposed to defer the rebasing of rates for ten years from the date of the closing of the Transaction. During the first five years of the deferred rebasing period, Hydro One proposed to include a rate rider in the current OEB-approved rate schedule of PDI to give effect to a 1% reduction relative to the Base Distribution Delivery Rates (exclusive of rate riders) for residential, general service and large use customers.[76] Hydro One noted that the rate reduction will provide PDI customers with $3.5 million worth of benefits over the five-year period.[77] The cost of providing the rate rider would be approximately $135,000 per year. However, this cost would be recovered from synergies generated from the consolidation, and would not be recouped through future rate increases.[78]

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[75] Save PDI Coalition Submission / p. 2
[76] For PDI, the current rates as of the closing of the proposed Transaction based upon the revenue requirement approved in EB-2017-0266.
[77] Hydro One Reply Submission / p. 5
[78] Hydro One Argument-in-Chief / p. 10

CCC submitted that it accepts that during the deferred rebasing period, PDI customers will be better off relative to the scenario that would occur without the consolidation of PDI and Hydro One.[79]

In its submission, OEB staff highlighted that the OEB previously approved the implementation of a 1% reduction to each of the acquired utilities' rates in the cases of Haldimand, Norfolk and Woodstock. However, OEB staff questioned Hydro One's proposed method of implementation through a volumetric rate rider to five decimal places for the residential class, as PDI has transitioned to fully-fixed distribution charges.[80] In its reply submission, Hydro One agreed that it could use a fixed rate rider.[81]

In years six to ten of the deferred rebasing period, the Applicants proposed that rates for the PDI service area will be set using the Price Cap Index adjustment mechanism. Hydro One proposed that it will annually apply the OEB's Price Cap Index formula, utilizing PDI's efficiency cohort factor of 0.45%. This will be anchored to then current PDI Base Distribution Delivery Rates, and applied annually.

VECC submitted that the rate setting proposal put forward by Hydro One for the deferred rebasing period is reasonable provided that Hydro One's legacy customers are not burdened with the costs to serve acquired PDI customers. VECC submitted that Hydro One should be required to provide clear and conclusive evidence in any rate applications applicable to its legacy customers during the deferred rebasing period that no costs associated with serving the acquired PDI customers (including incremental costs incurred by its administrative and support functions or by centralized service such as its Utility Arborist division) are included in the rates to its legacy customers.[82]

Findings

The OEB accepts the Applicant's rate proposal during the ten year deferred rebasing period, with some modifications as discussed in this Decision.

The completion of the Transaction shall result in the creation of separate rate classes for PDI within the post-merger consolidated Hydro One entity. These rate classes will provide for the continuation of the existing rates paid by the acquired customers prior to consolidation subject to the following terms:

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[79] CCC Submission / p. 7
[80] OEB Staff Submission / p. 22
[81] Hydro One Reply Submission / p. 5
[82] VECC Submission / p. 13

1. Rates in the separate PDI classes will not be rebased during a ten year deferred rebasing period following consolidation.
2. During years one to five of the deferred rebasing period, all base delivery rates for the acquired customers will be subject to a reduction of 1% implemented by way of a rate rider that would be fixed for residential customers.
3. During years six to ten of the deferred rebasing period, the OEB's Price Cap incentive rate-setting (Price Cap IR) adjustment mechanism will apply to the last approved rates for the acquired customers, except that the ICM will not be available. Acquired customers will be guaranteed an ESM Benefits as set out later in this Decision.

The OEB finds that the Applicant's proposal for the cost allocation to be used in the setting of rates for the new rate classes for residential and general service acquired customers following the deferred rebasing period is reasonable. As well, the OEB approves the direct allocation of costs associated with the local fixed assets in the acquired utility in the USofA to the acquired customers. Any specific adjustment factors used to complete the direct allocation must be approved in Hydro One's first rates application following the expiration of the deferred rebasing period, at which time the OEB will approve the new rate classes.

The distribution fixed asset costs associated with serving acquired customers shall be tracked separately so that the information is available, if required for future rate proceedings.

5.3 Specific Service Charges (SSCs)

The Application proposes that following consolidation, PDI's tariffs would remain as approved by the OEB in their respective rate orders, with the exception of the SSCs which would become those of Hydro One.

In its submission, SEC noted that some of the Hydro One SSCs are notably higher than those of PDI, and that PDI has some SSCs for which Hydro One does not charge at all. SEC submitted that Hydro One should be required to use the existing SSCs of PDI and stated that Hydro One did not demonstrate that the Hydro One SSCs are more appropriate for PDI customers.[83]

[83] SEC Submission / p. 49

OEB staff stated that it supports the proposal to alter the SSCs of PDI to align with those of Hydro One as the revenue differences arising between Hydro One's and PDI's SSCs do not appear to be significant.[84]

Reply Argument from Hydro One

In its reply submission, Hydro One submitted that the majority of SSCs are the same amount or less for Hydro One as compared to PDI. Hydro One further stated that the difference in miscellaneous service revenue between applying PDI versus Hydro One SSCs is $295,000.[85] As such, Hydro One argued that SSCs of PDI should be aligned with those of Hydro One following consolidation.

Findings

The OEB finds that while there are differences in individual SSCs, as the overall level of SSCs is similar, it is reasonable to apply the Hydro One SSCs following consolidation.

5.4 Incremental Capital Module (ICM)

Hydro One requested access, if the need arises, to an ICM to service unforeseen capital needs within the PDI service area during the deferred rebasing period. Hydro One further stated that it currently has no plan to apply for ICM relief during the deferred rebasing period, however if circumstances prevail where Hydro One does require an ICM, the details pertaining to the ICM will be provided in that future application.[86]

Several parties to the proceeding addressed the matter of Hydro One having access to an ICM during the deferred rebasing period. Energy Probe submitted that there is no commitment from Hydro One to forgo ICM applications. In addition, Energy Probe noted that the primary reason many distributors have obtained rate increases above inflation is OEB approval of ICM applications.[87]

SEC submitted that it has general concerns with respect to the potential for misuse of the ICM in a deferred rebasing period. However, SEC also observed that Hydro One has no history of such misuse, and that there is no reason that Hydro One should not have the same ability to apply for an ICM as any other consolidating distributor.[88] Similarly, VECC acknowledged that the ICM is available to Hydro One to address

[84] OEB Staff Submission / p. 23
[85] Hydro One Reply Submission / p. 69-70
[86] Exhibit A / Tab 2 / Schedule 1 / p. 22
[87] Energy Probe Submission / pp. 4-5
[88] SEC Submission / p. 49

capital needs in the PDI service area – should the need arise and the proposal meets the prescribed eligibility criteria. VECC did submit, however, that no such need for an ICM has been identified in the Application, nor has a specific application for a discrete capital project, or projects, been presented. As a result, VECC stated that the request was premature and should not be granted by the OEB at this time.[89]

OEB staff did not object to Hydro One having access to an ICM, but noted that PDI has not filed a consolidated DSP since the onset of the OEB's requirement. As such, OEB staff submitted that Hydro One should be required to provide a DSP for the PDI service area in its next cost-based application – currently scheduled in 2022 for 2023 rates. However, should Hydro One require an ICM in advance of 2023 rates, OEB staff submitted that Hydro One should file a DSP for PDI as part of the ICM application, and it should include information on the current condition of the distribution assets as well as the planned capital investments.[90] This DSP should also provide an explanation for any significant differences from PDI's plans.

Reply Argument from Hydro One

Through its reply submission, Hydro One submitted that it would provide a DSP for the PDI service area, but stated that the timing for filing the DSP (i.e., for 2023 rates), as proposed by OEB staff, may be problematic due to the time and effort associated with the integration and assessment of PDI assets and the subsequent efforts required to create a DSP. To address this problem Hydro One proposed to commit to filing a DSP within 18 months of integration, a timeline that would enable Hydro One to assess the condition of the purchased assets and how they align with the needs of customers.[91]

Findings

The OEB finds Hydro One's evidence pertaining to its ability to manage the PDI assets persuasive. Given the robust predictions of efficiency that will be achieved during the deferred rebasing period, and the overarching requirement to ensure no harm to the acquired customers, the OEB will not provide for ICMs that might otherwise be available under Price Cap IR. ICMs directed to capital expenditures incurred in PDI's service area will not be considered and approved for addition to rates by the OEB in the ten year deferred rebasing period. The OEB confirms that Z-factor adjustments will be available for rates of the acquired utilities based on the OEB's criteria for such adjustments by

[89] VECC Submission / p. 16
[90] OEB Staff Submission / p. 23
[91] Hydro One Reply Submission / p. 81

electricity distributors. The OEB accepts Hydro One's proposal to provide a DSP within 18 months of the integration of PDI's assets.

5.5 Proposed Earnings Sharing Mechanism (ESM)

Hydro One proposed the implementation of an ESM, for years six to ten of the deferred rebasing period, which would guarantee a cumulative $1.8 million of overearnings to be provided to former PDI customers based on forecast savings. In both its Argument-in-Chief and reply submission, Hydro One submitted that its proposed ESM protects acquired PDI customers better than the ESM set out in the MAADs Handbook, which contemplates using the consolidated entity's audited financial statements.[92]

The proposed ESM calculates the excess earnings on the operation of PDI as opposed to the consolidated entity's earnings due to the relative size of PDI compared to Hydro One, where any savings resulting from the Transaction would have a limited impact on the overall earnings shown in Hydro One's financial statements.[93] To calculate the excess earnings on the operation of PDI, Hydro One proposed to use forecast OM&A and capital costs – of which the OM&A forecast includes a 20% risk factor. The guaranteed refund due to ratepayers would be recorded in a deferral account accruing interest as prescribed by the OEB. Hydro One proposed to dispose of the balance in the deferral account in year ten of the deferred rebasing period, but was also not opposed to refunding the ESM earnings on an annual basis.

PWU supported the ESM as proposed by Hydro One submitting that it would better protect customers of PDI than the ESM as set out in the OEB's 2015 Report – which would be calculated on the basis of return on equity overearnings by Hydro One.[94]

OEB staff also accepted Hydro One's proposal to guarantee an ESM for PDI customers, but stated that the guaranteed amount should be a minimum amount. To the extent that the savings exceed the guaranteed amount, OEB staff submitted that Hydro One should be required to share the savings on a 50:50 basis with all PDI customers.[95]

OEB staff also supported Hydro One's request to establish a deferral account to track costs associated with the ESM, but submitted that Hydro One should provide a draft accounting order as a condition of OEB approval or should file the accounting order as a subsequent application. In its reply submission, Hydro One committed to filing such a

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[92] Hydro One Argument-in-Chief / p. 15 and Hydro One Reply Submission / p. 63
[93] Hydro One Argument-in-Chief / p. 15
[94] PWU Submission / p. 5
[95] OEB Staff Submission / p. 24

draft accounting order upon approval of the Application or prior to any entries being made into such an account.[96]

In its submission, VECC stated that Hydro One's proposed ESM varied from the MAADs Handbook in one unique, but significant aspect – the determination of the earnings to be shared is pre-calculated using forecast OM&A and capital costs. VECC noted that the MAADs Handbook states that an ESM calculation will be completed based on actual results and reflect the actual savings achieved. As such, Hydro One should be in the position to calculate the actual earnings attributable to the PDI service area.

VECC also took issue with the proposed methodology for the ESM and submitted that in order for ratepayers to share in the benefits from consolidation, it is necessary for Hydro One to use its cost of capital parameters (i.e., debt costs and return on equity) in the calculation of the ESM, as opposed to those currently approved for PDI. VECC further submitted that this requirement also extends to the assumptions used by Hydro One in its calculation for working capital as Hydro One has based it on PDI's current approved allowance as opposed to Hydro One's working capital allowance percentage. As a result, in order to be consistent with the spirit of the MAADs Handbook, VECC submitted that the ESM calculation, to the extent possible, should forecast what would actually be reported as earnings and overearnings. In this regard, if prepared, the actual financial statements for PDI would presumably reflect Hydro One's cost of debt and approved working capital, while the calculation of overearnings would be completed using Hydro One's approved return on equity.[97]

VECC also questioned the 20% risk premium that Hydro One added to the forecast OM&A for calculating the ESM. VECC stated that the addition of the premium reduces the value of the ESM by more than 30% and submitted that Hydro One has provided no evidence to demonstrate that this level of risk is justified. As a result, VECC submitted that the proposed risk premium of 20% was excessive. However, if the OEB approves the proposal for a guaranteed fixed ESM, VECC stated that the ESM calculation should be based on Hydro One's approved cost of capital, depreciation rates and working capital allowance for the relevant years, and the risk premium added to OM&A should be no more than 10%.

SEC submitted that Hydro One did not propose a true ESM for PDI, but instead, proposed to make a predetermined payment of $1.8 million to the customers of PDI, in

[96] Hydro One Reply Submission / p. 81
[97] VECC Submission, p. 15

lieu of a calculation and sharing of earnings. SEC noted that any calculation of overearnings (which equates to a portion of the expected cost savings) applicable to the PDI service area will, if done properly, show that there are no overearnings, because there are no cost savings. However, the Hydro One proposal, in SEC's view, is not real earnings sharing, and has been adjusted to artificially reduce the earnings expected to be saved. SEC submitted that, in the event that the OEB approves the Application, the adjustments to the earnings sharing forecast should be removed, and earnings actually expected by Hydro One should be shared (i.e., restating the earnings sharing calculation to remove the reduction to OM&A and remove the adjustments to cost of capital).

Reply Argument from Hydro One

In its reply submission, Hydro One noted that if it were forced to adopt a different version of the ESM, one that is calculated based on actuals, the risk of not achieving the cost forecast is then shared between Hydro One shareholders and acquired PDI customers. Hydro One submitted that an ESM calculated based on actual results for years six to ten does not protect ratepayers better than the guaranteed ESM it proposes in the Application.[98]

Hydro One submitted that the 20% risk premium is reasonable based on the fact that Hydro One's shareholder is accepting the risk that the OM&A forecast is not achieved, the risk that the assets are not in the condition anticipated, and the risk that the anticipated load and customer profiles do not materialize.

In the event that the OEB does not approve the proposed ESM, Hydro One submitted that the OEB's alternative would be to establish an ESM as provided by the MAADs Handbook. In this circumstance, Hydro One would use the actual cost to serve PDI to calculate an ESM – in a form that closely aligns with that outlined in the MAADs Handbook. This calculation would include actual depreciation charged on the assets associated with serving PDI as well as the then-current debt and tax rates. Any overearnings, in years six to ten of the deferred rebasing period, that is 300 basis points over the current OEB-approved return on equity for PDI would be shared with customers. Hydro One stated in its reply submission that there would be no guaranteed amount through this ESM approach, and that Hydro One would not be able to provide audited statements. Instead, Hydro One would provide working papers to show how the overearning calculations were derived.

[98] Hydro One Reply Submission / p. 64

Findings

The OEB approves the proposal of a guaranteed ESM that calculates excess earnings by way of forecast OM&A and capital expenses through years six through ten of the deferred rebasing period. These excess earnings will be shared with PDI ratepayers on a 50:50 basis. The ESM proposed by Hydro One will be simple to administer and guarantees a payment to the PDI customers. The OEB concludes that this is a reasonable approach compared to the alternative option that would require numerous estimates and assumptions to implement.

However, the OEB finds that a risk premium of 10% for the forecast OM&A should be sufficient to provide compensation for assumed risk given Hydro's One's confidence in its forecast and the ordinary risks borne by all distribution utilities that customer load and customer profiles do not materialize. Hydro One shall recalculate the excess earnings to be shared as part of the draft rate order process to this proceeding. Hydro One shall also file a draft accounting order for a deferral account that will be used to record the ESM amount to be provided to acquired PDI customers. The balance in the deferral account will be disposed of at the conclusion of the deferred rebasing period.

5.6 Accounting Matters

Hydro One applied for approval to utilize US GAAP for PDI financial reporting as PDI's financial statements are currently prepared under modified International Financial Reporting Standards (MIFRS). In its Argument-in-Chief, Hydro One noted that 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.

Both SEC and OEB staff supported Hydro One's request to use US GAAP for PDI financial reporting. However, OEB staff submitted that if the transition from MIFRS to US GAAP results in any material revenue requirement impact that could potentially be refunded to ratepayers, the OEB should establish a deferral account to capture any material transition impact that is favourable to acquired PDI customers. If the establishment of such deferral account is approved, OEB staff submitted that Hydro One could file a draft accounting order at the same time it files the draft accounting order for the proposed ESM.

SEC stated that there are substantial balances accruing, to the benefit of customers, in Accounts 1575 and/or 1576 and that Hydro One has indicated that it believes it has a contractual obligation to clear these accounts to the benefit of customers immediately after closing of the Transaction. As such, SEC submitted that if the OEB approves the Application, a condition of approval should be that the amounts to the credit of customers in Accounts 1575 and 1576 be cleared to customers within 12 months after the closing of the Transaction – a condition that Hydro One submitted is acceptable.

SEC further submitted that Hydro One should be required to record in a variance account (likely 1576), the difference between the depreciation used for current rates and the Hydro One depreciation rates used going forward on all assets serving PDI customers.[99]

Reply Argument from Hydro One

Hydro One took no issue with the establishment of a deferral account to capture any material impact on the transition to US GAAP to the extent that it is symmetrical in the treatment of ratepayers and Hydro One. However, Hydro One submitted that if the OEB approves a deferral account that is asymmetrical, as OEB staff proposes, it does not believe a deferral account that is asymmetrical would reflect a measured or balanced approach to setting conditions for this Application or encourage further consolidations.

Findings

For regulatory accounting, Hydro One uses US GAAP and PDI is under MIFRS. The OEB accepts Hydro One's proposal to use US GAAP for PDI for consistency. However, this may result in transitional issues that can have an effect on the utility's revenue requirement. These transitional issues have not been examined in detail in this proceeding. The OEB is establishing a deferral account to record the impact of accounting changes to depreciation expense and capitalization policies on property, plant and equipment (PPE)[100] resulting from the transition to US GAAP, in a similar manner to the approach used with Account 1576 when distributors transitioned to MIFRS.

The OEB notes that in its last distribution proceeding, Hydro One indicated that it capitalizes more than would be permitted under MIFRS. A transition from MIFRS to US GAAP could then result in a shifting of costs for PDI from OM&A to capital, and a resultant increase in net income. This shifting of costs would have been addressed if the revenue requirement was reset through rebasing. However, during the deferred

[99] SEC Submission / p. 50
[100] This includes PPE that would in the normal course be eligible for inclusion in a distributor's rate base.

rebasing period, rates will be set using the Price Cap IR mechanism for which costs and revenue requirement for the utility are disconnected.

A change in accounting should not result in a financial benefit for a utility. If a cost would have been expensed under MIFRS but is capitalized under US GAAP, an adjustment may have to be made to ensure the accounting change is neutral to the revenue requirement at the time of the next rebasing application. The deferral account being established will track impacts (both debits and credits) of the transition to US GAAP with respect to how costs are capitalized and depreciated. This deferral account will be reviewed at the next rebasing rate application to determine the appropriate approach for disposition. Hydro One shall file a draft accounting order for the entries to the account to be considered as part of the draft rate order process.

The OEB agrees that it is appropriate to dispose of the balances in current PDI Accounts 1575 and 1576 to current PDI customers within twelve months of the closing of the Transaction. The OEB is therefore establishing this as a condition of approval of the Application.

5.7 Amendment and Cancellation of Electricity Distribution Licence

In order to effect the proposed consolidation, the Applicants requested approval of electricity distribution licence amendments and cancellations. In its submission, OEB staff supported the amendments and cancellations in order to effect the consolidation.[101]

Findings

The OEB approves the Applicants' requests for licence amendments and cancellations. They are the natural outcome of the OEB's findings throughout this Decision.

5.8 Tax Bump

In its submission, SEC stated that the value of assets or goodwill for tax purposes will increase as a result of the Transaction. However, as the benefit of the fair market value (FMV) bump for tax purposes being shared between customers and shareholders is currently before the courts, SEC submitted that Hydro One should be required to

[101] OEB Staff Submission / p. 25

calculate that benefit and hold it in a deferral account. The amount would then be considered by the OEB in the future.

Reply Argument from Hydro One

Hydro One disagreed with SEC's submission and stated that it would be inappropriate to have Hydro One calculate and track the FMV bump to be shared with ratepayers in a deferral account for the Transaction outlined in the Application.[102]

PDI, through its reply submission, stated that even if there is a tax bump, this would be attributable to goodwill and would not be recoverable in distribution rates.[103]

Findings

The OEB agrees with PDI that any tax benefit associated with an increase in FMV will be as a result of goodwill. The amount being paid by Hydro One for goodwill is a shareholder expense, and not recoverable in rates. There is therefore no basis to require Hydro One to share any portion of any tax benefit resulting from this aspect of the Transaction with the ratepayers.

[102] Hydro One Reply Submission / p. 69
[103] PDI Reply Submission / p. 10

6 SUMMARY OF CONDITIONS

The approval of this Application is subject to the following conditions:

If the fully allocated revenue requirement for the new year 11 PDI rate classes is higher than the year 11 status quo forecast as set out in the evidence and Table 5 of this Decision, these excess costs will be borne by the shareholder and not the ratepayers.

The distribution fixed asset costs associated with serving acquired customers shall be tracked separately by Hydro One so that the information is available if required for future rate proceedings.

During the ten year deferred rebasing period, Hydro One will not be eligible to apply for ICMs relating to projects in the PDI service area that might otherwise be available under Price Cap IR.

Hydro One shall provide a DSP within 18 months of integration of PDI's assets.

An ESM for years six to ten of the deferred rebasing period shall provide a guaranteed fixed amount to PDI ratepayers based on forecast excess earnings. Hydro One shall recalculate the excess earnings based on a risk premium of 10% on forecast OM&A expenditures. Excess earnings shall be shared with customers on a 50:50 basis. Hydro One shall also file a draft accounting order for a deferral account that will be used to record the ESM amount to be provided to acquired PDI customers. The ESM deferral account will be disposed of at the conclusion of the deferred rebasing period.

The OEB is establishing a deferral account to track impacts (both debits and credits) of the transition to US GAAP with respect to how costs are capitalized and depreciated.

Hydro One shall dispose of the balances in current PDI Accounts 1575 and 1576 to acquired PDI customers within 12 months of the closing of the Transaction.

7 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Peterborough Distribution Inc. and Peterborough Utility Services Inc. are granted leave to amalgamate and to transfer Peterborough Distribution Inc.'s distribution licence and rate order to the amalgamated corporation.

2. The amalgamated corporation is granted leave to sell its distribution system to 1937680 Ontario Inc. and to transfer the amalgamated corporation's distribution licence and rate orders to 1937680 Ontario Inc.

3. 1937680 Ontario Inc. is granted leave to dispose of its distribution system to Hydro One Networks Inc.

4. The leaves granted in paragraphs 1, 2, and 3 of this Order shall expire 21 months from the date of this Decision and Order. If the transactions have not been completed by that date, a new application will be required in order for the transactions to proceed, absent further direction from the OEB.

5. Hydro One Networks Inc. and 1937680 Ontario Inc. shall promptly notify the OEB of the completion of the transaction referred to in paragraph 3 of this Order.

6. Once the notice referred to in paragraph 5 of this Order has been provided to the OEB, the OEB will transfer the Electricity Distribution Licence and rate order of 1937680 Ontario Inc. to Hydro One Networks Inc.

7. When the OEB transfers 1937680 Ontario Inc.'s Electricity Distribution Licence to Hydro One Networks Inc., it will cancel the Electricity Distribution Licence of 1937680 Ontario Inc.

8. Once the notice referred to in paragraph 5 of this Order has been provided to the OEB, the OEB will amend the Electricity Distribution Licence of Hydro One Networks Inc. to include the service area formerly served by 1937680 Ontario Inc.

9. Hydro One Networks Inc. shall file with the OEB, and shall forward to OEB staff and intervenors, a Draft Rate Order for 1937680 Ontario Inc. that includes a proposed Tariff of Rates and Charges reflecting the OEB's findings in this Decision and Order by **May 14, 2020**.

10. For the earnings sharing mechanism, Hydro One Networks Inc. shall recalculate the excess earnings based on a risk premium of 10% on forecast OM&A expenditures, and file the calculation with details as part of the draft rate order. Excess earnings

shall be shared with the customers in the former Peterborough Distribution Inc.'s service area on a 50:50 basis.

11. Hydro One Networks Inc. shall apply for electricity rates for customers in the current Peterborough Distribution Inc. service area in accordance with the Price Cap Incentive Rate-setting adjustment mechanism for years six to ten of the deferred rebasing period, except that the incremental capital module will not be available.

12. Hydro One Networks Inc. shall file Draft Accounting Orders with the OEB no later than **May 14, 2020** for:

    - A deferral account to track impacts of the transition to United States Generally Accepted Accounting Principles with respect to how costs are capitalized and depreciated

    - A deferral account to track the amounts associated with the earning sharing mechanism, for disposition following conclusion of the ten year deferred rebasing period.

13. OEB staff and intervenors shall file any comments on the Draft Rate Order and Draft Accounting Orders with the OEB, and forward them to Hydro One Networks Inc. no later than **May 28, 2020**.

14. Hydro One Networks Inc. shall file with the OEB any comments in response to OEB staff and intervenor comments on the Draft Rate Order and Draft Accounting Orders no later than **June 11, 2020**.

15. Hydro One Networks Inc. is required to file an application to dispose of the balances in current Peterborough Distribution Inc. Accounts 1575 and 1576 to current Peterborough Distribution Inc. customers within 12 months of the closing of the transaction referred to in paragraph 3 of this Order.

16. Hydro One Networks Inc. is required to separately track the distribution fixed asset costs associated with serving customers in the former Peterborough Distribution Inc. service area during the deferred rebasing period.

17. Hydro One Networks Inc. shall file a distribution system plan for the current Peterborough Distribution Inc. service area within 18 months of the integration of Peterborough Distribution Inc.'s assets.

18. Eligible intervenors shall file with the OEB and forward to Peterborough Distribution Inc. and Hydro One Networks Inc. their respective cost claims no later than **June 4, 2020**.

19. Peterborough Distribution Inc. and Hydro One Networks Inc. shall file with the OEB and forward to the applicable intervenor any objections to the claimed costs by **June 18, 2020**.

20. Intervenors shall file with the OEB and forward to Peterborough Distribution Inc. and Hydro One Networks Inc. any responses to any objections to their cost claims by **July 2, 2020**.

21. Peterborough Distribution Inc. and Hydro One Networks Inc. shall pay the OEB's costs of and incidental to this proceeding immediately upon receipt of the OEB's invoice.

All materials filed with the OEB must quote the file number, **EB-2018-0242**, be made in a searchable/unrestricted PDF format and sent electronically through the OEB's web portal at https://pes.ontarioenergyboard.ca/eservice. Filings must clearly state the sender's name, postal address and telephone number, fax number and email address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at https://www.oeb.ca/industry. If the web portal is not available parties may email their documents to boardsec@oeb.ca.

NOTE: The OEB is temporarily waiving the paper copy filing requirement until further notice. All communications should be directed to the attention of Board Secretary and be received no later than 4:45 p.m. on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Andrew Bishop, at Andrew.Bishop@oeb.ca and OEB Counsel, Michael Millar, at Michael.Millar@oeb.ca.

DATED at Toronto April 30, 2020

ONTARIO ENERGY BOARD

Original Signed By

Christine E. Long
Registrar and Board Secretary