EB-2023-0328

Hydro One Networks Inc.
Chapleau Public Utilities Corporation

Application for Hydro One to Acquire Chapleau Public Utilities

Final Submissions of VECC
March 14, 2024

Hydro One Networks Inc. (Hydro One) and Chapleau Public Utilities Corporation (CPUC) (the Applicants) applied to the Ontario Energy Board (OEB) on November 20, 2023, under sections 74, 77, 78, and 86 of the Ontario Energy Board Act, 1998, for approval for Hydro One to acquire CPUC and continue operations as Hydro One. CPUC requests approval to sell its distribution system assets to Hydro One pursuant to section 86(1)(a) of the Act.

Hydro One's distribution system serves approximately 1.5 million customers and CPUC serves approximately 1,300 customers. The Township of Chapleau (Township) is the sole shareholder of CPUC.[1]

For the following reasons, VECC supports the Applicants' request for Hydro One to acquire CPUC. Customers will benefit from this voluntary transaction.

The "No Harm" Test

The OEB applies the "no harm" test in its assessment of merger, acquisition, amalgamation and divestiture (MAAD) applications. 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. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.[2]

The objectives that are most directly relevant to the impact of the proposed transaction, namely, price, reliability and quality of electricity service to customers, as well as the cost-effectiveness, economic efficiency and financial viability of the consolidating utilities.

In considering the No Harm Test it is necessary to consider the unique challenges of CPUC and Hydro One's response.

Hydro One is Already Managing CPUC

On an interim basis, Hydro One is already responsible for managing the day-to-day operations of CPUC's business[3] for a period of six months. CPUC, with support from Hydro One and the Township of Chapleau, made this request to the OEB in its letter dated May 9, 2023.[4] CPUC was experiencing difficulty managing day-to-day operations of the utility and would not be able to continue providing reliable

[1] A-2-1 p.1
[22] MAADs Handbook p.3
[3] pursuant to an OEB Decision[3] and section 59 Order issued on May 23, 2023, appointing Hydro One as interim licensee
[4] Attachment 8

electricity distribution service due to financial and staffing issues. On June 13, 2023, Hydro One took over control of CPUC and is currently responsible for providing all distribution services within the Township of Chapleau, including the connection of new customers, and the reliable supply and distribution of electricity to the customers of CPUC. Hydro One is the host distributor for CPUC. CPUC's service territory is embedded within Hydro One's service territory, making Hydro One the logical choice to acquire CPUC. Hydro One is already familiar with CPUC's service territory.

CPUC Challenges

CPUC has experienced several challenges to sustain its operations related to staffing, succession planning and significant change in the electricity sector[5] requiring further resources, skillsets and capital investments beyond the capabilities of CPUC[6] which precipitated the need for Hydro One to agree to take over control. CPUC has also experienced difficulties with continued compliance with regulatory and government agencies due to staffing shortages. However, Hydro One has taken steps to rectify various noncompliance issues.[7]

With respect to CPUC's existing asset condition and operating conditions, Hydro One prepared an Observation Report in 2023[8] and identified significant concerns with the station assets, submarine cables and the potential need for several replacements based on the discovery of PCB oil and an obsolete billing system.

In response to the Observation Report and the current state of CPUC's distribution system, Hydro One proposes increased spending on capital to the end of 2027 relative to historic expenditures. Over the period, 2019 to 2022, CPUC spent on average $117 million per year on capital. For the period 2025 to 2027, Hydro One proposes to spend an average $241 million per year, a substantial increase.[9] In direct response to the Observation Report, Hydro One proposes to spend $73 million in 2025 to address PCBs and $38 million in 2026 to address submarine cables. Hydro One plans to have all targeted PCB equipment removed by the 2025 deadline.[10]

Forecast Capital ($M)	**2024 (Sept to Dec)**	**2025**	**2026**	**2027**
General Sustainment	$34	$107	$112	$117
PCB		$73		
Submarine Cable			$38	
Sustainment	$34	$180	$150	$117
Growth[11]	$30	$92	$93	$93
Total	**$62**	**$272**	**$243**	**$209**

[5] Distributed Energy Resources such as solar and wind generation, battery storage and other technologies
[6] Attachment 8
[7] A-2-1 p.17
[8] As directed by OEB in EB-2023-0144
[9] A-2-1 p.7; Staff IR-01
[10] Staff IR-05 p.2
[11] customer connections/ upgrades and system reinforcement (regional growth)

Hydro One anticipates that once some deficiencies noted in the Observation Report are addressed, capital cost levels will taper off to a steady state of approximately $209 million beyond 2027.[12] In 2028, CPUC's costs will be integrated into Hydro One's next rebasing application.

OM&A

As a result of the transaction, Hydro One estimates OM&A savings of over 50% per year beginning in 2025 primarily through cost reductions in administrative and back-office business functions such as, finance, regulatory, legal, information technology, and board of directors.

OM&A	2019	2020	2021	2022	2024[13]	2025	2026	2027
Total ($M)	$832	$839	$732	$755	$108[14]	$351	$350	$362

In Staff IR-12, Hydro One provides a breakdown of implied OM&A savings when comparing 2022 actuals to the Hydro One forecast for 2025-2027. The majority of the savings are generated from a reduction in General and Administrative costs. The savings would be even greater as the calculation does not account for inflationary pressures on CPUC's 2022 actuals.

No Harm - Price

With respect to price, the MAADS Handbook states:[15]

"A simple comparison of current rates between consolidating distributors does not reveal the potential for lower cost service delivery. These entities may have dissimilar service territories, each with a different customer mix resulting in differing rate class structure characteristics. For these reasons, the OEB will assess the underlying cost structures of the consolidating utilities. As distribution rates are based on a distributor's current and projected costs, it is important for the OEB to consider the impact of a transaction on the cost structure of consolidating entities both now and in the future, particularly if there appear to be significant differences in the size or demographics of consolidating distributors."

To demonstrate no harm, applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been.[16]

Hydro One provided the preceding four years of costs as a proxy of the OM&A and capital expenditures necessary to operate the utility. However, it is Hydro One's view that using these cost structures is not an appropriate gauge to determine the no harm test. Prior expenditures have inadequately positioned CPUC to continue to operate reliably to meet its obligations. Hydro One states, "If the utility were to continue operations consistent with existing expenditure levels, CPUC customers could be facing loss of supply, safety and environmental risks and large capital investments in the near future which will impact their cost to serve." Thus, Hydro One has not provided an existing utility status quo forecast for CPUC.[17]

[12] Staff IR-01
[13] September to December 2024
[14] Updated Staff IR-12
[15] MAADs Handbook p.6
[16] MAADs Handbook p.7
[17] A-2-1 p.5

VECC accepts Hydro One's position that CPUC's past expenditure levels should not be used as a cost comparator for assessing no-harm. With the integration of CPUC into Hydro One, significant OM&A savings are expected and Hydro One proposes increased capital expenditures and OM&A savings post-consolidation. VECC submits an increase in capital spending is appropriate and required to address the asset deficiencies documented in the Observation Report and support the modest forecast growth in customer numbers.[18]

VECC concurs with the Applicants that the transaction is not expected to harm customers with respect to price.

No Harm - Adequacy, Reliability and Quality of Electricity of Service

Hydro One indicates CPUC customers can expect to benefit from operational efficiencies by having the CPUC assets integrated into Hydro One's larger distribution system. In addition, CPUC customers will benefit from additional customer services not previously available to them such as customer center support availability, outage management, initiatives to help customers manage their bills and new services such as like Green Button, Ultra Low Overnight rate, and faster access to recent emerging needs such as EV charging networks, broadband internet, DERs and other emerging technologies.[19]

With respect to economic efficiency and cost effectiveness, Hydro One has forecasted $143 million in savings in 2024 and on average $400 million per year for 2025-2027.

Hydro One indicates that by planning the electricity requirements for both the local Hydro One and CPUC service areas, Hydro One will be able to efficiently assess both the operating and capital needs associated with serving customers across the broader local area.[20] In this application, Hydro One has not identified any capital savings. VECC submits through this consolidation, capital savings and additional operating savings beyond the current forecast are possible.

Hydro One plans to retain institutional knowledge from CPUC staff and that coupled with Hydro One's proximity and resource availability, quicker customer connections and response times are expected.[21]

In addition, ancillary reliability and quality of service benefits are expected for adjacent existing Hydro One customers once the artificial distribution service area between Hydro One and CPUC is removed. Customers located near the Township of Chapleau and other customers on the outskirts of the Township, who are currently served by Hydro One's Timmins Operations Centre, approximately 200 km away, will now have access to CPUC's established Service Centre, resulting in shorter response times.[22]

VECC concurs with the Applicants that the proposed transaction is not expected to cause any degradation in the adequacy, reliability, or quality of electricity service in CPUC or Hydro One's service territory, and it will have a positive impact on CPUC's economic efficiency and cost effectiveness.

[18] Staff IR-4
[19] A-2-1 p.2-3
[20] A-2-1 p.4
[21] A-2-1 p.4
[22] A-2-1 p.4

Status of CPUC's Current Reliability Metric

CPUC's reliability with respect to duration of outages is deteriorating. CPUC's 2022 OEB Regulatory Scorecard shows the target of 4.06 for SAIDI has not been met. In 2022 SAIDI is 9.78, significantly above this level. CPUC's reliability results for the 5-year period 2018-2022 are as follows:[23]

	2018	2019	2020	2021	2022
SAIDI	12.51	6.91	5.87	2.68	9.78
SAIFI	4.49	2.56	2.33	1.14	1.31

Hydro One does not intend to track reliability metrics specifically for CPUC's service territory from 2024-2027.[24] Given the current reliability results for CPUC and the need for substantial capital investments until 2027, VECC submits Hydro One should track CPUC's reliability metrics so that this information is available at the time of rebasing to review the impact of the increased levels of capital expenditures 2025-2027 and better inform the need for future investment levels in CPUC's service territory.

Significant future investments have been identified for CPUC. The Observation Report found the biggest risk to the supply of power in Chapleau is the failure of station equipment – specifically the two transformers located inside the station.[25] Hydro One believes that a large-scale investment to address the station assets' age and safety related deficiencies will be required within the next few years and planning for this should begin immediately so that reliability and quality of service do not deteriorate.[26] The capital cost to address deficiencies at the substation is forecast to be in the range of $3M[27] (pending a detailed study post integration, and is expected to occur outside the forecast period.[28] This investment need is incremental to the steady state capital level contemplated by 2028. Also, the need for a major voltage conversion project (i.e. 4 kV to 25 kV) was identified in CPUC's last DSP for beyond the period 2019-2023.[29]

In VECC's view, tracking reliability results for CPUC leading up to the next investment cycle is in the best interests of customers.

Financial Viability

The MAADS Handbook states:[30]

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 also be assessed. The OEB's primary considerations in this regard are:

[23] VECC-10
[24] VECC-10 e
[25] Attachment 7 p.2
[26] Attachment 7 p.4
[27] 2023 $
[28] Staff IR-01
[29] VECC- IR-09
[30] MAADs Handbook p.8

- 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

On November 6, 2023, CPUC and Hydro One entered into a voluntary Agreement of Purchase and Sale. Hydro One will pay $2.3 million for the acquisition of CPUC's assets.[31]

The OEB made it clear that the selling price of a utility is relevant only if the price paid is so high as to create a financial burden on the acquiring company.[32] CPUC has an annual revenue requirement of approximately $1 million which is consistent with Hydro One's materiality threshold. Hydro One's 2021 revenue and net income are $5,420 million and $413 million,[33] respectively. Hydro One's acquisition of CPUC does not create a financial burden for Hydro One.

Hydro One's incremental transaction costs are estimated to be approximately $18,000 which includes tax costs related to completion of the transaction, and cost associated with the necessary regulatory approvals. Hydro One is not expecting to incur any ongoing transition costs. Incremental integration costs are estimated at $350,000 for up-front costs to integrate existing CPUC customers from their obsolete billing to Hydro One's customer and outage management system,[34] and integrate assets and employees. Transaction costs will be financed through productivity gains associated with the transaction and integration costs will not be funded by ratepayers.[35]

Hydro One indicates it will initially finance the proposed transaction through cash or its commercial paper program. Long-term financing will be through its Medium-Term Note program.[36]

The net book value of CPUC's fixed assets based on the audited 2022 financial statements is $1,574,349.[37] The premium paid over the assets' book value will not have a material impact on Hydro One's financial viability. Hydro One indicates the transaction price accounts for less than 0.1% of Hydro One'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.

VECC submits Hydro One's acquisition of CPUC will not negatively impact the financial viability of Hydro One.

[31] A-1-1 p.3
[32] MAADs Handbook p.8
[33] Attachment 5 p.4
[34] One-time cost of $0.1 million to set up Hydro One billing system and integrate CPUC's customers
[35] Staff IR-07
[36] A-2-1 p.18
[37] VECC IR-7 a

Integration of CPUC into Hydro One Rate Classes

Hydro One requests that the Board, pursuant to section 78 of the Act, approve the transition of CPUC customers to Hydro One's existing OEB-approved distribution rates, including specific service charges at the time of integration.[38]

Based on customer density categorization, CPUC's residential customers will be mapped into Hydro One's R1 residential class and CPUC's general service customers will be mapped into either GS energy billed or GS demand billed rate classes. Other CPUC customers outside the residential and general service rate classes will be mapped into the appropriate Hydro One classes.[39] [40]

Hydro One indicates the rationale for its proposal to transition existing CPUC customers to Hydro One as new customers in lieu of pursuing a deferred rebasing period is premised on the circumstances associated with the acquisition of a small utility and the unique circumstances challenging the current operations of CPUC. Hydro One indicates establishing a separate rate class for this sized utility (1,300 customers) would be cost prohibitive, especially given the small number of customers transitioning to those rate classes. Based on CPUC's average net income $70,684/year, Hydro One estimates it would take several years to recoup the costs to establish separate rates for CPUC. In addition, the distribution rates revenue currently collected is insufficient and has resulted in the utility being in the likely scenario of failing. [41]

VECC accepts Hydro One's rationale and takes no issue with Hydro One's request to integrate CPUC's customers into Hydro One's existing rate classes.

2024 Rate Plan

The resulting impacts on CPUC's typical residential and general service customers' total bill upon integration in the absence of any bill impact mitigation is as follows:

- Residential: $6.35 or 5%
- GS<50 kW: $89.57 or 25%
- GS>50 kW: $1,448.27 or 22%

The total bill impacts for CPUC's residential customers is below 10% due to the applicable Distribution Rate Protection (DRP) credit and no further mitigation is proposed for residential customers. For all non-residential customers, Hydro One proposes to freeze distribution charges at the OEB-approved 2024 values between the integration date (expected in September 2024) and December 31, 2024) resulting in a total bill impact below 10% as follows:

- GS<50 kW: $16.46 or 4.6%
- GS>50 kW: $23.76 or 0.4%

[38] A-1-1 p.5
[39] A-1-1 p.4
[40] A-2-1 p.9
[41] Staff IR-02 (d)

2025 to 2027 Rate Plan

Starting January 2025, Hydro One proposes to limit the annual total bill impacts for all non-residential CPUC customers to no more than 10%.[42] With DRP, the total bill impact for Hydro One R1 Residential customers will be below 10% and therefore they will not require mitigation.

VECC takes no issue with Hydro One's rate mitigation plans for 2025-2027.

Financial Reporting – Accounting Standards

CPUC currently uses IFRS for financial accounting purposes and MIFRS for regulatory accounting purposes. CPUC's financial results will be incorporated into Hydro One's results using USGAAP.[43] Hydro One does not intend to establish a new regulatory account but does intend to create a new sub-account to track the differences resulting from accounting policy changes specific to CPUC in the already established account that was created for Peterborough Distribution Inc (PDI)and Orillia Power Distribution Corporation (OPDC).[44] VECC submits this approach is sufficient and the establishment of a new accounting policy deferral account is not required.

Regulatory Accounts

Hydro One seeks the following:

- approval to continue to track costs to CPUC's previously established regulatory accounts, as approved by the OEB and to seek disposition of their balances at a future date. All CPUC rate riders will continue as per CPUC's existing rate schedules until expiry.
- approval to continue to have the use of the deferral account established in EB-2023-0144 to record costs of operation and maintenance of CPUC outside of what rates were established on.

VECC supports the above requests.

New Deferral Accounts

Hydro One seeks the following approval in this Application to establish two new deferral accounts:

- a Bill Impact Mitigation deferral account to implement bill mitigation for CPUC customers, as necessary, and track these costs in this Bill Impact Mitigation deferral account.
- Chapleau Historical Land Rights Deferral Account to track all costs necessitated by the need to secure land rights for the distribution facilities that are not obtained by CPUC prior to the closing.

VECC supports Hydro One's requests to establish the above two new deferral accounts.

Conclusion

In the EB-2023-0144, OEB Decision and Order, the OEB determined that based on the May 9, 2023, from CPUC to the OEB outlining its difficulties, CPUC is likely to fail to meet its obligations relating to the

[42] consistent with the OEB's historical use of the 10% mitigation threshold
[43] A-2-1 p.14
[44] Staff IR-09

supply of electricity to consumers in the Township of Chapleau. Accordingly, VECC supports Hydro One's acquisition of CPUC. VECC submits the evidence in this proceeding demonstrates the proposed transaction will have a positive effect on the attainment of the OEB's statutory objectives and the OEB should approve the application. Hydro One's acquisition of CPUC will result in no harm to CPUC customers or Hydro One customers.