



EB-2013-0196
EB-2013-0187
EB-2013-0198

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B) (the “Act”);

AND IN THE MATTER OF an application by Hydro One Inc. for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. under section 86(2)(b) of the Act;

AND IN THE MATTER OF an application by Norfolk Power Distribution Inc. seeking to include a rate rider in the 2013 Ontario Energy Board approved rate schedule of Norfolk Power Distribution Inc. to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act;

AND IN THE MATTER OF an application by Norfolk Power Distribution Inc. for leave to transfer its distribution system to Hydro One Networks Inc. under section 86(1)(a) of the Act;

AND IN THE MATTER OF an application by Norfolk Power Distribution Inc. for leave to transfer/assign its electricity distribution licence and rate order to Hydro One Networks Inc. under section 18 of the Act.

BEFORE: Paula Conboy
Presiding Member

Ken Quesnelle
Vice-Chair

Ellen Fry
Member

DECISION AND ORDER

July 3, 2014

Introduction

This proceeding seeks approval by the Ontario Energy Board (the “Board”) of several applications, as discussed in detail below (the “Applications”). The Applications concern:

1. The proposed acquisition by Hydro One Inc. of Norfolk Power Inc., the owner of Norfolk Power Distribution Inc. (“NPDI”); and
2. The subsequent proposed transfer of the NPDI’s electricity distribution system to Hydro One Networks Inc. (“HONI”).

The Board approves the Applications in accordance with this Decision, subject to the conditions set out below.

Consolidation of the electricity distribution sector has been the subject of much discussion since the late 1990s when the sector was first restructured under the *Energy Competition Act, 1998*. More recently, the Ontario Distribution Sector Review Panel has issued a report entitled *Renewing Ontario’s Electricity Distribution Sector: Putting the Consumer First*, which advocates consolidation of electricity distribution companies.

Given this context, the Board is of the view that this proceeding has likely attracted significant attention from electricity distributors and Ontario municipalities. The Board is also aware that negotiations are currently taking place concerning other proposed consolidations of distributors. These negotiations will undoubtedly lead to other applications to the Board for approval of consolidations in the near future.

The Board set out its policy on mergers and acquisitions in its decision in EB-2005-0234/0254/0257 (the “Combined Proceedings”). However, as discussed below, the current Applications contemplate consolidation transactions that are made in different circumstances and structured differently than was the case in the Combined Proceedings.

In applying the Board’s policy in this proceeding, the Board needs to take these differences into account in performing its analysis. The Board expects that its approach in this decision will inform parties contemplating future consolidation transactions.

The applicants in this proceeding will be referred to collectively as the “Applicants”.

The Proceeding

This was a lengthier proceeding than the parties and the Board would normally have expected. A key factor was the fact that the Applications seek approval for multiple transactions to achieve the proposed acquisition. The Applicants' business approach to the stages of the proposed acquisition evolved throughout the proceeding and led the Applicants to amend the Applications several times. A detailed account of the procedural record has been included in this decision to explain the causes of the length of the proceeding. The Board hopes that this will assist those contemplating similar applications.

HONI and NPDI, both licensed electricity distributors, and Hydro One Inc., HONI's parent company, filed related applications dated April 26, 2013 with the Board. The Applications were amended on October 25, 2013, further amended on November 8, 2013, and subsequently clarified on January 8, 2014.

The Applications, as clarified on January 8, 2014, are as follows:

1. an application by Hydro One Inc. for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. under section 86(2)(b) of the Act;
2. an application by NPDI to include a rate rider in the 2013 Board approved rate schedule of NPDI to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act;
3. an application by NPDI for leave to transfer its distribution system to HONI under section 86(1)(a) of the Act; and
4. an application by NPDI for leave to transfer/assign its electricity distribution licence and rate order to HONI under section 18 of the Act.

The purpose of the Applications is to give effect to the Share Purchase Agreement entered into between Hydro One Inc., and the Corporation of the County of Norfolk, the indirect owner of NPDI through Norfolk Power Inc. Subject to necessary approvals, Hydro One Inc. would purchase all of the issued and outstanding shares of Norfolk Power Inc., NPDI distribution rates would be set at 1% less than 2012 and frozen for five years, and within 18 months of the approval of the transaction by the Board NPDI would transfer its distribution assets to HONI. HONI seeks to defer until 2020 the setting of rates based on projected costs for the consolidated entity. HONI has stated that it will not pursue any form of harmonization of NPDI rates with HONI rates until 2020.

The Board received written submissions from the Applicants, Essex Powerlines Corporation, Bluewater Power Distribution Corporation, and Niagara-on-the Lake Hydro Inc. (collectively “EBN”), Consumers Council of Canada (“CCC”), School Energy Coalition, (“SEC”) Vulnerable Energy Consumers Coalition and Board staff.

As indicated above, the Applicants filed the original applications on April 26, 2013. The original applications were as follows:

1. Hydro One Inc. applied for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. under section 86(2)(b) of the Act¹;
2. NPDI applied for leave to transfer its distribution system to HONI under section 86(1)(a) of the Act²; and
3. HONI applied for inclusion of a rate rider in the 2013 Board approved rate schedule of NPDI to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders) under section 78 of the Act³.

Pursuant to its authority under section 21(5) of the Act, the Board decided to consider these applications together in a consolidated proceeding and issued its Notice of Applications and Hearing on May 31, 2013. HONI and NDPI then published the Notice and the Board received requests for intervenor status.

As part of their evidence, the Applicants filed their Share Purchase Agreement. Certain information was redacted from the Share Purchase Agreement based on the Applicants’ assertion that the information was not relevant and/or was confidential. However, a confidential, un-redacted version was not filed with the Board as is required under the Board’s *Practice Direction on Confidential Filings* (the “Practice Direction”).

As stated in the Practice Direction, the Board relies on full and complete disclosure of all relevant information in order to ensure that its decisions are well-informed. However, it recognizes that some of that information may be of a confidential nature and should be protected as such. In this case, the Board considered that it could not rely solely on the Applicants’ assertion of confidentiality or relevance. It needed to have before it the information to adequately assess these claims.

¹ EB-2013-0196

² EB-2013-0187

³ EB-2013-0198

The Board issued Procedural Order No. 1 on July 3, 2013, in which the Board ordered the Applicants to file a complete and un-redacted version of the Share Purchase Agreement in accordance with the Practice Direction, and gave parties the opportunity for submissions on confidentiality and relevance. The Board received submissions from the Applicants, EBN, SEC and Board staff. While the Applicants reaffirmed their submission that the redactions were appropriate, other parties argued that it was not possible to make full submissions without reviewing the information that the Applicants had redacted.

After receiving the un-redacted version of the Share Purchase Agreement and the submissions, the Board issued Procedural Order No. 2 on August 1, 2013. The Board found that portions of the originally redacted information could remain confidential, but ordered the Applicants to produce a version of the Share Purchase Agreement with the remaining information unredacted (the "Confidential Version"). The Board further ordered the Applicants to provide the Confidential Version to counsel and external consultants ("qualified parties") that executed the Board's form of confidentiality Declaration and Undertaking, to enable them to make further submissions.

The Applicants sought a minor extension to the filing deadline and subsequently filed objections to which parties might be considered qualified parties. The Board issued its decision on these issues in Procedural Order No. 3 and Procedural Order No. 4, respectively. The filing deadline for submissions on the Applicants' claims concerning confidentiality and/or relevance was also extended to August 14, 2013. The Applicants were also given additional time to file reply submissions. The Board received written submissions from EBN, SEC and Board staff. The Applicants filed reply submissions on August 28, 2013.

The Board ruled on the Applicants' claims concerning confidentiality and/or relevance in its Decision on Confidentiality Request and Procedural Order No.5, dated September 27, 2013. The Procedural Order also provided for interrogatories ("IRs") which were subsequently filed on October 11, 2013. The Applicants filed their responses on October 25, 2013. The Procedural Order also set out the timelines for the remainder of the proceeding.

In their response to one of the IRs, the Applicants amended the approvals sought in the Applications as filed on April 26, 2013. The Applicants summarized the amended approvals requested as follows⁴:

- Hydro One Inc. continues to seek approval from the Board for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. pursuant to section 86(2)(b) of the *Ontario Energy Board Act, 1998*;
- Norfolk Power Distribution Inc. is no longer seeking approval from the Board for leave to transfer its distribution system to Hydro One Networks Inc. pursuant to section 86(1)(a) of the *Ontario Energy Board Act, 1998*;
- Norfolk Power Distribution Inc. is no longer seeking cancellation of its distribution licence pursuant to section 77(5) of the *Ontario Energy Board Act, 1998*;
- Hydro One Networks Inc. is no longer seeking an order to amend its distribution licence pursuant to section 74 of the *Ontario Energy Board Act, 1998*; and
- Norfolk Power Distribution Inc., not Hydro One Networks Inc., is now the party seeking to include a rate rider in the 2013 Board-approved rate schedule of Norfolk Power Distribution Inc. to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders), pursuant to section 78 of the *Ontario Energy Board Act, 1998*. The rate order amendment would take effect following the closing of the proposed transaction.

The Applicants refused to respond to certain IRs, submitting that they were outside the scope of the proceeding. On October 30, 2013, SEC filed a Notice of Motion. The motion requested an order requiring HONI and/or NPDI to provide information sought in IRs by SEC and other parties. It also requested an extension of the time periods set out in Procedural Order No. 5 with respect to intervenor evidence and submissions until a reasonable time after the information requested in the motion was provided to the parties.

In Procedural Order No. 6 dated November 5, 2013, the Board ordered the Applicants to file amended applications with the Board clarifying the approvals now

⁴ Exhibit I, Tab 1, Schedule 7, Page 2

being sought as described on October 25, 2013 and indicating the applicability of the original evidence filed to the Applicants' now amended Applications.

The Applicants were ordered to file the amended applications with the Board and serve them on all other parties on or before November 8, 2013. Procedural Order No. 6 also provided parties with the opportunity to file submissions with the Board on whether, as a result of the amended applications, provision for further IRs was necessary. SEC was also ordered to indicate the impact, if any, on its motion, of the change to the approvals sought by the Applicants.

The Applicants filed their amended applications on November 8, 2013. These amended applications made a further change to the approvals sought as set out in response to Board staff interrogatory 7.1. These amended applications were⁵:

- an application by Hydro One Inc. for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. made pursuant to section 86(2)(b) of the *Ontario Energy Board Act, 1998*;
- an application by Norfolk Power Distribution Inc. seeking to include a rate rider in the 2013 OEB-approved rate schedule of Norfolk Power Distribution Inc. to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders), made pursuant to section 78 of the *Ontario Energy Board Act, 1998*;

If the Board granted approval under section 86(2)(b) as stated above, and upon filing notice to the Board of completion of integration of Norfolk Power Distribution Inc. operations into Hydro One Networks Inc., the Applicants indicated that the following further requests were made:

- an application by Norfolk Power Distribution Inc. for leave to transfer its distribution system to Hydro One Networks Inc. made pursuant to section 86(1)(a) of the *Ontario Energy Board Act, 1998*;
- an application by Norfolk Power Distribution Inc. seeking cancellation of its distribution licence made pursuant to section 77(5) of the *Ontario Energy Board Act, 1998*;

⁵ Exhibit A, Tab 1, Schedule 1, Page 1

- an application by Hydro One Networks Inc. seeking an order to amend its distribution licence made pursuant to section 74 of the *Ontario Energy Board Act, 1998* to serve the customers of the former Norfolk Power Distribution Inc., or alternatively;
- an application by Hydro One Networks Inc. seeking an order to issue a separate distribution licence made pursuant to section 60 of the *Ontario Energy Board Act, 1998* to serve the customers of the former Norfolk Power Distribution Inc.

SEC, EBN, Board staff, and the Applicants filed submissions with the Board on whether a second IR process was necessary as a result of the amended applications.

SEC also filed correspondence on November 13, 2013 indicating that in its view with one exception, all of the approvals sought in its motion remained necessary, and no amendments to the Notice of Motion were required.

The Board heard the SEC motion on December 12, 2013. At the outset of the motion hearing, Hydro One Inc. and HONI (collectively, "Hydro One") were asked to file written confirmation of the approvals sought. This confirmation was filed during the motion hearing. After reviewing this confirmation, EBN and Board staff submitted that in their view the approvals sought remained unclear. On January 8, 2014, Hydro One filed a letter with the Board in which it listed the approvals sought in this proceeding as follows:

- an application by Hydro One Inc. for leave to purchase all of the issued and outstanding shares of Norfolk Power Inc. made pursuant to section 86(2)(b) of the *Ontario Energy Board Act, 1998*;
- an application by Norfolk Power Distribution Inc. seeking to include a rate rider in the 2013 OEB-approved rate schedule of Norfolk Power Distribution Inc. to give effect to a 1% reduction relative to 2012 base electricity delivery rates (exclusive of rate riders), made pursuant to section 78 of the *Ontario Energy Board Act, 1998*;

- an application by Norfolk Power Distribution Inc. for leave to transfer Norfolk Power Distribution Inc.'s distribution system to Hydro One Networks Inc. made pursuant to section 86(1)(a) of the *Ontario Energy Board Act, 1998*; and
- an application by Norfolk Power Distribution Inc. for leave to transfer/assign Norfolk Power Distribution Inc.'s distribution licence and rate order to Hydro One Networks Inc. made pursuant to section 18 of the *Ontario Energy Board Act, 1998*.

Hydro One submitted that the revisions to what was filed on November 8, 2013 would simplify the description of the regulatory approvals sought. They also confirmed the withdrawal of the following requests for approval that were previously made:

- an application by NPDI seeking cancellation of its distribution licence made pursuant to section 77(5) of the *Ontario Energy Board Act, 1998*;
- an application by HONI seeking an order to amend its distribution licence made pursuant to section 74 of the *Ontario Energy Board Act, 1998* to serve the customers of the former NPDI, or alternatively;
- an application by HONI seeking an order to issue a separate distribution licence made pursuant to section 60 of the *Ontario Energy Board Act, 1998* to serve the customers of the former NPDI.

The Applicants also filed revised responses to two IRs which made reference to this updated information.

On January 24, 2014, the Board issued its Decision and Order on the Motion and Procedural Order No. 8. (the "Motion Decision"). In the Motion Decision, among other things, the Board directed intervenors and Board staff to notify the Board by February 14, 2014 if they intended to file evidence. EBN filed a letter with the Board indicating that it intended to file evidence, and on February 18, 2014, the Board issued Procedural Order No. 9, in which it set a schedule for filing of EBN's evidence, IRs on that evidence and final submissions on the Applications.

EBN filed its evidence on February 26, 2014. The Applicants and Board staff filed IRs on EBN's evidence and EBN responded to the IRs on March 25, 2014. The Applicants filed their submissions on April 4, 2014 and intervenors and Board staff

filed their submissions on April 14, 2014. The Applicants filed their reply submissions on April 24, 2014.

Board's Decision on the Applications

As indicated above, the Board approves the Applications in accordance with this Decision, subject to the conditions set out below.

The “No Harm” Test

All the parties agree that the Board should apply the “no harm” test in considering the Applications. The Applicants submit that the no harm test has been satisfied and that the Applications should therefore be approved. The intervenors submit that the no harm test has not been satisfied and that the Applications should therefore be denied. Board staff submits that the no harm test has been satisfied and that the Applications should be approved conditionally.

The parameters of the no harm test, and the Board's analysis of the proposed acquisition in applying the no harm test, are set out below.

In the Combined Proceedings, the Board made two significant determinations on how the Board will review applications for leave to acquire shares or amalgamate under section 86 of the Act.

First, the Board determined that the factors to be considered in deciding such applications are the Board's objectives as set out in the Act:

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:
 1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
 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.
 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 connection of renewable energy generation facilities. 2004, c. 23, Sched. B, s. 1; 2009, c. 12, Sched. D, s. 1.

The Board notes that these objectives encompass a range of factors that are both financial and non-financial in nature, and that the affected consumers include both HONI's existing customers and NPDI's customers.

Second, the Board determined that in deciding this type of application it would use a "no harm" test in considering its statutory objectives.

In other words, the Board determined that it would approve a share acquisition or amalgamation transaction if satisfied that the transaction would not have an adverse effect in terms of the factors identified in the Board's objectives in the Act.

The proposal in this proceeding is different from the type of consolidation that was the subject of the Combined Proceedings.

In this proceeding, the proposal is for a large distributor with service areas covering a wide range of customer density to acquire a much smaller distributor with a predominately homogeneous urban density service area. When comparing two distributors with similar rate structures it may be possible to draw inferences about the comparability of their underlying cost structures. In that situation the differences in their rates can be used as a proxy for the differences in their cost structures. However, in this case HONI has a multiplicity of different rate structures and density levels that are not significantly comparable to those of NPDI. Accordingly, it is not appropriate to compare HONI rates with those of NPDI as a basis for drawing inferences about their respective underlying cost structures. This was not the situation in the Combined Proceedings, where the rate structures of the buying and selling distributors were more comparable.

The acquisition that is the subject of this proceeding also contains a structural element not found in the consolidations that were the subject of the Combined Proceedings. In addition to including a share purchase transaction, the integration of NPDI's operations into those of HONI, and licensing arrangements in recognition of

the outcomes of the transactions, the Application proposes a 1% reduction in distribution rates for a period of 5 years.

As discussed below, the Board needs to apply the no harm test in this proceeding in a way that takes into account the differences between the circumstances in this proceeding and in the transactions covered by the Combined Proceedings.

The Board applied this approach in its Motion Decision. In that decision, the Board stated that in assessing whether NPDI customers would ultimately be harmed by the transaction, the proposed 1% reduction in rates for 5 years has no determinative value. This conclusion recognized that the proposed 1% reduction in rates was not directly driven by any contemplated change in the underlying cost structure. Accordingly, it was not indicative of the level of costs that would underpin rates after the initial 5 year rate reduction.

The Board determined that to assess the ultimate impact on NPDI customers, it would need to examine the cost structures that would result from the transfer of NPDI's distribution system to HONI. The Board considers that the relationship between costs and rates is of prime importance in understanding the impact of the proposed acquisition. Clearly increased or decreased costs would be expected to have a corresponding effect on future rates.

The Board also considers that in applying the no harm test it needs to take into account its current regulatory policies, such as the principles embodied in the Renewed Regulatory Framework for Electricity Distributors, given that these policies are an important vehicle in pursuing the objectives established by section 1 of the Act.

The Board also considers it important that its assessment of whether the proposed transaction would have an adverse effect take into account both current and forward looking considerations. For example, continuous improvement is a key regulatory policy consideration. The Board expects that the benefits of continuous improvement to customers should have no less potential of occurring as a result of a transaction. Otherwise there would be harm done to those customers.

The issues raised by the parties in this proceeding have been confined to whether the no harm test has been satisfied in relation to the Board's first two objectives provided for in section 1 of the Act. The Board notes that at the time of the Combined Proceedings the Act only provided for the first two of its current section 1

objectives. However, as set out above, the Board is required by law to be guided by all five of the objectives in section 1, and the Board accordingly considers that the no harm test should be applied in relation to all five of its objectives. For example, objective 4 requires the Board to facilitate the implementation of a smart grid in Ontario. In applying the no harm test it would be appropriate for the Board to consider whether future development of a smart grid would be adversely affected by the transaction.

In assessing the acquisition proposed in this particular proceeding, the Board does not consider that there is any reasonable indication that harm would be caused in the context of the last three objectives in section 1.

Similarly, the issues raised in this proceeding concerning compliance with Board policies have been largely confined to issues concerning the Board policy on consolidations. In assessing the proposed acquisition, the Board does not consider that there is any reasonable indication that harm would be caused in the context of other Board policies.

EBN submits that as part of the no harm test, the Board should consider this acquisition as being a component of a series of potential future acquisitions by HONI that will at a future point have a material negative financial impact on HONI. The Board does not consider that the consideration of cumulative impact in light of potential future transactions is encompassed by the no harm test. However, under the no harm test, the Board considers the impact of the proposed acquisition on the acquiring utility relative to its circumstances at the time of the application. If the circumstances of the acquiring utility included a negative cumulative impact of past transactions, this would be part of the Board's consideration.

Board Policy on Rate-Making Associated with Distributor Consolidation

In 2007, the Board issued a report on key rate-making issues associated with consolidation in the electricity distribution sector (the "2007 Report").⁶ There are two issues addressed in the 2007 Report that are particularly relevant to this proceeding, which were identified in Board staff submissions:

- "[D]istributors that apply to the Board for approval of a consolidation transaction may propose to defer the rate rebasing of the consolidated entity for up to five years from the date of closing of the transaction";

⁶ *Rate-making Associated with Distributor Consolidation*, issued July 23, 2007

- [The] issue of rate harmonization in the context of a consolidation transaction is better examined at the time of rebasing”. However, parties should indicate in their application “whether they intend to undertake a rate harmonization process after the proposed transaction is completed and if they do, to provide a description of the plan”.

The 2007 Report states that the reason for permitting the deferral of rate rebasing is to allow a time period in which efficiency gains due to the consolidation can offset transaction costs. The expected efficiency gains and transaction costs resulting from the acquisition are discussed below.

As indicated above, NPDI is seeking a 1% reduction from its 2012 rates for 5 years. After this, HONI intends to apply under the Board’s Incentive Regulation Mechanism to adjust NPDI’s rates during the period prior to rate rebasing. The Applicants propose that rate rebasing of the consolidated entity be deferred until approval of 2020 rates. Given that the Applicants contemplate that the closing of the consolidation transaction will occur within 18 months of this Decision, this timeframe is consistent with the timeframe contemplated in the 2007 Report.

HONI indicates that at the time of rebasing, HONI may propose to:

- Create new HONI rate classes for the former NPDI customers;
- Move former NPDI customers into an appropriate HONI rate class; or
- Pursue a different option not yet specified.

None of the parties submit that timeframe for rate rebasing proposed in the Applications is inconsistent with the 2007 Report. The Board agrees that this timeframe is consistent with the 2007 Report. As indicated above, the Board considers that an assessment of projected cost structures is required because of the impact of these cost structures on future rates for NPDI customers. This analysis will be done below. Concerning the setting of future rates, it is the Board’s expectation that at the time of rate rebasing HONI will propose rate classes for NPDI customers that reflect costs to serve the NPDI service area, as impacted by the productivity gains due to the consolidation.

The Purchase Price

The purchase price Hydro One Inc. has agreed to pay is \$93 million. This price includes a premium of \$39.1 million above the \$53.9 million net book value of NPDI. Intervenors submit that if Hydro One Inc. pays such a significant premium this

potentially compromises the rational consolidation of the electricity distribution sector, since in their view this would cause Hydro One Inc. to become a dominant buyer. CCC also submits that such a significant premium may not ultimately benefit HONI's existing customers.

Hydro One submits that none of the premium of \$39.1 million will be funded by ratepayers. Board staff submits that if the Board approves the transaction, the Board should explicitly state that it is relying on its understanding that neither HONI nor any party acting under its direction or control will apply to recover any portion of the premium in rates.

In its Motion Decision, the Board stated that "the market price of a utility company established between a willing buyer and a willing seller is informed by the anticipated future revenues that the purchased entity will generate". In other words, the amount of future revenue that the purchased entity is expected to generate is a natural limitation on the amount of the premium that the parties agree to include in the purchase price.

The Board's approach to setting future rates is key to the parties' determination of the future revenues that the purchased entity is expected to generate. As indicated in the 2007 Report, it is clear Board policy that premiums paid by a purchaser of a utility are not costs that will be recoverable in the setting of future rates. The Board's policy is that any premium paid by a purchaser is part of the costs to be offset by the savings from consolidation that are obtained over the 5 year deferral period prior to rate rebasing. The Board's future rate setting will be focused on costs going forward, and will not cover historic premiums.

The intent of the framework established by the 2007 Report is that the amount of a premium paid by a purchaser would be determined by the purchaser's ability to serve the acquired service area at a lower cost, over a given period. The difference between the actual cost of service and the revenues generated during the given rate deferral period is intended to provide the purchaser with the funds to cover the transaction costs of the acquisition, including any premium. This aspect of the framework acts as a positive economic factor in the consolidation marketplace by favoring the purchaser that is able to serve the acquired service area at the lowest cost. The Board's future rate setting (whether or not on a harmonized basis) will be based on forward costs, and a purchaser should not expect that the revenues from future rates will provide any funds to cover any purchase premium.

As indicated in the Motion Decision, in applying the no harm test it is not relevant for the Board to consider whether the purchase price has been set at an appropriate level. Since the Board's policy is that the premium will not find its way into future rates, the only issue for the Board to consider is whether the purchase price is set at a level that would create a financial burden on Hydro One.

NPDI submits that the premium being paid will have no material impact on Hydro One Inc., given that the amount of the premium is \$39.1 million and Hydro one Inc.'s total owned asset base is \$20.8 billion, based on the 2012 audited financial statements. Board staff expresses the same view. The Board agrees.

Cost Structures

The intervenors have expressed concern that the acquisition would result in increased rates for NPDI customers after the initial 5 year period.

In accordance with the 2007 Report, the Board's decision will not consider future rates at this time. However, as indicated in the Motion Decision, in applying the no harm test it is appropriate for the Board to assess the cost structures that will be introduced as a result of the acquisition, in comparison to the cost structures that underpin NPDI's current rates. A downward impact on cost structures would tend to decrease rates, whereas an upward impact on cost structures would tend to increase rates. This will occur regardless of what decision is taken concerning rate harmonization at the time of rate rebasing.

The Applications include an application by NPDI for a 1% reduction in rates from its 2012 base delivery rates for a period of five years. NPDI's 2012 base delivery rates are directly indicative of its cost structure, since they are based on a prospective estimate of its future costs as determined by the Board.⁷ As stated above, the proposed 1% reduction in rates is not driven directly by any specifically contemplated change in the underlying cost structure or indicative of the level of costs that will underpin future rates. Accordingly, the Board will consider other evidence to assess the impact of the acquisition on cost structures.

The Applicants submit that the acquisition will result in savings and operational efficiencies. Board staff submits that this is a reasonable expectation, considering the benefits of geographical contiguity and economies of scale.

⁷ EB-2011-0272

Intervenors take the position that the acquisition will cause NPDI costs to increase. They make four main arguments:

1. Historically, ratepayers of utilities acquired by Hydro One have experienced an increase in rates;
2. HONI's current operations, maintenance and administration ("OM&A") cost per customer is higher than that of NPDI;
3. HONI's application for 2015-19 rates, presently before the Board (EB-2013-0416) shows a significant increase in HONI rates, which will affect future NPDI rates; and
4. Hydro One has not substantiated adequately the various types of projected savings due to the acquisition.

Historical Acquisitions

The Board does not consider that the rates of other acquired utilities are relevant to this proceeding. The Board considers that the question to be addressed is what impact the acquisition will have on NPDI's cost structures in the specific circumstances of the contemplated acquisition. The Board stated above that it considers the cost structures that underpin rates to be of prime importance in understanding the impacts of this particular proposed acquisition. The Board does not consider the rates paid by customers served by other acquired utilities to be determinative of whether or not the underpinning costs for NPDI customers will be higher. The Board notes that the rates paid by the customers of previously acquired entities will have been influenced by the rate harmonization approach and customer classes implemented by HONI. The Board also notes that, as indicated in the Motion Decision, Hydro One's past acquisitions occurred prior to the Board's articulation of the no harm test and the 2007 Report.

OM&A Per Customer

The Board is of the view that it is informative to compare the OM&A cost per customer of HONI to that of NPDI.

EON submitted that HONI's OM&A per customer is significantly higher than that of NPDI, based on the Board's 2012 OEB Electricity Yearbook, where HONI's cost per customer is shown as \$439.77, compared to NPDI's cost of \$333.43.

HONI submitted that \$439.77 is its average cost per customer over its entire service area, including the full range of largely rural areas, semi-urban areas and urban

areas, with different tree-cover, geology and climate. Accordingly, HONI submitted that OM&A costs for NPDI customers would be more comparable to its forecast for high and medium density residential rate classes (UR and R1 classes). However, HONI did not indicate to what extent it considered NPDI customers would fit into the parameters for each of these classes.

The Board agrees that it would be more informative to look at HONI OM&A costs for the groups of HONI customers that are most comparable to NPDI customers.

HONI's UR rate class covers areas containing 3,000 or more customers with a density of at least 60 customers per kilometer. Its R1 rate class covers areas containing 100 or more customers with a density of at least 15 customers per kilometer.

Based on the information in the Board's 2012 Electricity Yearbook, there are 24.5 customers per kilometer in NPDI service territory overall. However, given the fact that there is undoubtedly a higher concentration of customers in urban areas than in rural areas, it is likely that a majority of customers are located in areas with density higher than 30 customers per kilometer. In any event, this information indicates that the vast majority of NPDI customers are likely in areas with a density at least as great as that of HONI's R1 class.

HONI's 2015-19 rate application shows HONI's OM&A cost per customer for the UR class as \$181 and for the R1 class as \$275. Both of these rate classes have a significantly lower OM&A cost per customer than NPDI's 2012 cost of \$333.43.

Board staff has noted that although the OM&A cost for NPDI includes costs for some non-residential customers, the vast majority of customers are residential. Taking this into account, the Board does not consider that the OM&A cost comparison would be likely to change significantly if NPDI non-residential customers were removed from its average cost calculation.

As stated earlier HONI indicates that at the time of rebasing, HONI may propose to:

- Create new HONI rate classes for the former NPDI customers;
- Move former NPDI customers into an appropriate HONI rate class; or
- Pursue a different option not yet specified.

The Board concludes that the acquisition is likely to have a downward impact on NPDI's OM&A costs, overall.

As indicated above, it is the Board's expectation that when HONI makes its application for rate rebasing, it will propose customer classes for NPDI customers that reflect the costs of serving those customers.

HONI's 2015-19 Rates Application

As discussed above, HONI's 2015-19 rates application is informative to the extent that it shows a lower OM&A cost per customer than NPDI for relevant rate classes. As discussed below, the capital component of HONI's future rates calculation does not assist in assessing NPDI's future cost structure as it pertains to capital spending.

Projected Cost Savings

The majority of the geographical area served by NPDI is immediately adjacent to HONI's service area. In addition, NPDI provides service to Delhi and Port Rowan, each of which is essentially embedded within HONI's service area. Hydro One submits that the elimination of "artificial electrical borders" between HONI and NPDI will create opportunities for operational efficiencies. In Hydro One's submission, these would include the ability to:

- Eliminate or repurpose duplicate facilities such as service centres;
- Increase efficiency in operating and maintenance work schedules;
- Increase efficiency in utilizing work equipment, leading to lower capital replacement needs over time; and
- Achieve more rational and efficient planning and development of the distribution system.

Hydro One submits that comparing the circumstances after the acquisition to the status quo, the forecast aggregate savings for NPDI operations to the year 2023 are \$38-58 million. It submits that these projections are based on savings due to HONI's asset management systems and staff integration, operational savings and financial savings, as outlined below.

Hydro One submits that NPDI assets can be merged into HONI's asset management programs, resulting in cost savings due to economies of scale. Hydro One submits that in projecting cost savings it used the HONI Asset Risk Assessment ("ARA") asset management system to assess NPDI's capital needs. This resulted in a capital expenditure forecast that is lower than NPDI's status quo forecast. As pointed out by the intervenors, Hydro One has not provided detailed information about its ARA analysis.

The Board accepts the Applicants' submission that unit cost savings should result from including the NPDI assets in HONI's asset management process rather than having a separate NPDI asset management process. However, the outcome of doing this in terms of NPDI capital expenditures is not a determinative factor for the Board. NPDI and HONI currently have different asset management systems. However, both of these systems have the objective of determining the appropriate level of capital expenditure to achieve the appropriate level of service quality and reliability. There is nothing to indicate that merging NPDI's assets into HONI's ARA process will cause harm to NPDI customers in terms of achieving this objective.

Hydro One submits that its projected savings due to integration of NPDI and HONI staff will lead to the elimination of 30 NPDI positions and approximately \$2 million of savings per year. These savings would come from more efficient work scheduling due to the elimination of electrical borders and integration of management, back office and support functions.

Hydro One submits that operational savings would come from:

- Elimination of redundant administrative and processing functions;
- Scheduling efficiencies (since HONI and NPDI crews travel the same areas);
- Elimination of duplicate back office systems (billing, outage, finance, security, etc.);
- Savings from the allocation of the costs of the remaining back office systems over a larger customer base;
- Reduced Board of Director costs, membership fees for energy associations, regulatory filing expenses, and Conservation and Demand Management ("CDM") program administration costs;
- Using existing systems, processes and corporate shared services within HONI; and
- Consolidation of HONI and NPDI's operating business centres.

Hydro One also indicates that the acquisition will yield planning efficiencies due to the elimination of electrical borders.

Hydro One submits that there will be financing savings because NPDI customers will access lower cost debt, as HONI's long term weighted average cost of capital is based on a larger portfolio of debt instruments than NPDI's long term debt.

Intervenors submit that Hydro One has not adequately substantiated its projected cost savings and that some of the specific areas of cost savings are overstated.

Hydro One has not provided a detailed breakdown of the calculation of its aggregate projections of savings, and therefore it is not possible for the Board to assess the accuracy of the calculation. Accordingly, it is possible that intervenors are correct in submitting that some of the specific areas of projected savings are overstated.

Based on Hydro One's evidence and submissions, the Board considers it probable that there will be significant downward pressure on NPDI's OM&A and capital costs because of efficiencies due to geographic integration, economies of scale, integration of common administrative and management functions and asset management, lower financing costs and integrated planning of the distribution system.

Reliability and Quality of Electricity Service

Hydro One submits that the service quality and reliability of NPDI will not be negatively impacted as a result of the acquisition.

Intervenors express concern that the forecast decrease in NPDI's capital budget as a result of the acquisition may result in a decrease in quality and reliability. Hydro One submits that its forecast capital budget for NPDI operations results from a review using the tools of HONI's established ARA, and reflects the operational efficiencies discussed above.

As indicated above, the Board considers that there is no indication that there will be harm in terms of service quality and reliability as a result of including NPDI assets in HONI's asset management system.

Intervenors submit that based on the reliability statistics in the Board's 2012 Electricity Yearbook, NPDI's service reliability is greater than that of HONI. HONI has provided reliability statistics for its Simcoe Operations area, which consists of the portion of Norfolk County not served by NPDI. Hydro One submits that these statistics are a more appropriate basis for comparison than the overall HONI statistics referred to by the intervenors. Board staff submits that HONI's Simcoe Operations statistics show a reliability level comparable to that of NPDI.

The Applicants also submit that there are several other factors that will promote service quality and reliability:

- HONI will incorporate NPDI into its operating and maintenance and asset management processes;
- An advisory committee with representatives of HONI and Norfolk County will provide an opportunity for dialogue;
- HONI will retain staff of NPDI who provide direct service to customers and transition this staff to work within an expanded service area that includes NPDI's existing service area; and
- HONI will have the ability to optimize supply to the Village of Delhi through the use of alternative supply feeder arrangements.

Board staff submits that HONI can reasonably be expected to maintain the reliability and service level currently provided by NPDI, considering the statistics on reliability level and HONI's arrangements to retain local knowledge, as outlined above.

Given HONI's transitional arrangements for service continuity to NPDI customers, the Board does not consider HONI's system-wide reliability statistics to be predictive of the future service quality and reliability levels that will be provided to NPDI customers. The Board does not consider that there is any reasonable indication of likely harm to service quality and reliability for NPDI customers.

Transaction Costs

As indicated above, the 2007 Report permits a delay of 5 years prior to rate rebasing. During this period, applicants are able to keep the savings resulting from consolidation efficiency gains. Within this framework they are to use these savings to offset their transaction costs of acquisition. The Applicants indicate that they will delay rate rebasing until 2020 rates in accordance with this Board policy.

Given this policy, the Board does not need to assess whether the efficiency gains due to consolidation are likely to be sufficient to cover the transaction costs. Transaction costs are to be borne by the purchaser and are to be covered by the savings that will accrue during the 5 year rate setting deferral period. Ratepayers are not at risk to pay any deficiency in future rates.

As discussed above, the Board is satisfied that there are enduring savings that will flow into the ratemaking process after the rate rebasing deferral period has been completed.

Board staff submits that the Board's decision should be conditional on HONI filing a report on the actual savings and transactional costs associated with the acquisition, when it first applies for rates encompassing the NPDI service area. While the Board does not need to assess the net outcome of the transaction costs versus the productivity gains, the Board finds that such a report would be helpful in best informing the Board's future decisions on rates for the NPDI service area.

Promotion of Economic Efficiency and Cost Effectiveness

As discussed above, the acquisition would result in a single electric distribution service provider for all of Norfolk County, eliminating the current electrical service boundaries. It is reasonable to conclude that ultimately this will result in greater economic efficiency and cost effectiveness, through greater economies of scale and enhanced efficiencies.

Request to Use US GAAP

HONI has received Board approval to use US GAAP methodology for regulatory accounting and reporting purposes. NPDI is currently using MIFRS methodology, which was the regulatory accounting basis used to set its 2012 rates. The Applications include a request for Board approval to change accounting for NPDI operations to US GAAP, for consistency with HONI and to simplify future integration.

Board staff opposes this request, submitting that NPDI's regulatory reporting and filing should be consistent with the regulatory accounting basis used to set its most recent base rates (MIFRS).

The Board agrees that using USGAAP methodology in accounting for NPDI operations will be more efficient than continuing to use MIFRS methodology. Accordingly, the Board grants this request.

Other Approvals

The Applications also include a request for Board approval to allow NPDI to:

- a. continue the "Application for Tax Changes" rate rider currently approved for NPDI (effective until April 30, 2014) until NPDI's rates are rebased and to true-up the balance at the next rebasing; and
- b. continue to track variances in Board-approved versus actual revenue resulting from CDM initiatives from 2013 to the time of rebasing in the Lost Revenue Adjustment Mechanism ("LRAM") account.

The Board finds it appropriate to grant the above requested approvals. The continuance of these two accounts is aligned with the Board's requirement that the costs associated with the operation of the NPDI service area be discernible at the time of HONI's first rate application that includes the costs associated NPDI's service area.

Other Issues

CCC has submitted that the Board should consider delaying its decision on the Applications until the Board has completed the review of its policy on rate-making associated with distributor consolidation (the "Consolidation Rate-Making Review") and its consultation on revenue decoupling.

The Board does not consider that it would be appropriate to do this. The Applicants have a reasonable expectation that the Board's decision in this proceeding will be in accordance with existing Board policy. The Consolidation Rate-Making Review will provide a forum for generic discussion on potential policy alterations, but the Board considers that the principles adopted in the Combined Proceeding and the 2007 Report remain relevant in the current policy environment. As discussed above, in applying its policy in this proceeding, the Board has taken into consideration how the policy should apply in the circumstances of this specific acquisition. Accordingly, the Board does not consider it appropriate to impose any delay in the acquisition that would result from waiting for the completion of this policy review.

The Board does not consider the issues being considered in its consultation on revenue decoupling to have any bearing on the analysis required to apply the no harm test. The revenue decoupling policy initiative is focused on rate design options that are intended to be revenue generation neutral in effect. Any option selected in that consultation is intended to be applied to all distributors equally. The Board has based its analysis in this application on the impact on cost structures. The determinative factors would remain the same irrespective of the introduction of any of the options being canvassed in the revenue decoupling consultation.

SEC submitted in its closing argument that the Board's decision on the substance of the Applications should have been made based on an oral hearing rather than a written hearing, to allow exploration of issues via cross-examination. In Procedural Order No. 9 the Board set out future process steps based on a written hearing process. Hydro One submits that if an intervenor wanted to request an oral hearing, there was ample time to submit a motion requesting this prior to the submission of

written argument. The Board agrees, given that Procedural Order No. 9 was issued on February 18, 2014 and written argument was not submitted until April.

Conclusion and Decision

The Board concludes that the consolidation proposed in the Applications satisfies the no harm test, subject to the conditions set out below. The Board therefore approves the Applications subject to the following conditions:

1. That NPDI transfer its distribution assets to HONI within 18 months of the date of this decision;
2. That with its first rates application that includes costs associated with NPDI's service area, HONI file a report with the Board delineating:
 - a. The costs for NPDI's service area, tracked separately ;
 - b. The savings achieved as a result of the acquisition; and
 - c. The portion of NPDI's and HONI's costs that are incremental costs incurred in connection with the acquisition.

The Board's approval of NPDI's proposal for a 1% reduction relative to 2012 base electricity delivery rates changes NPDI's currently approved Tariff of Rates and Charges (EB-2012-0151). The Board therefore expects NPDI to file a draft Rate Order, reflecting the Board's finding in this proceeding, as outlined below. The draft Rate Order shall include a proposed effective and implementation date.

THE BOARD ORDERS THAT:

1. Hydro One Inc. is granted leave to acquire all of the issued and outstanding shares of Norfolk Power Inc.
2. The Applicants shall promptly notify the Board of the completion of the transaction referred to in paragraph 1 above.
3. NPDI is granted leave to transfer its distribution system to HONI.
4. The Applicants shall promptly notify the Board of the completion of the transaction referred to in paragraph 3 above.
5. The leave granted in paragraphs 1 and 3 above shall expire 18 months from the date of this Decision and Order. If the transactions have not been completed by that date, new applications will be required to seek approval for the transactions

to proceed.

6. US GAAP may be used for regulatory accounting purposes, in relation to NPDI, following the closing of the transaction referred to in paragraph 1 above.
7. NPDI may continue to apply the “Application for Tax Changes” rate rider until its rates are rebased, and to true-up the balance at the time of rebasing.
8. NPDI may continue to track variances in Board-approved versus actual revenue resulting from CDM initiatives from 2013 to the time of rebasing in the LRAM account.
9. NPDI shall file with the Board, and shall also forward to intervenors, a draft Rate Order that includes a proposed Tariff of Rates and Charges reflecting the Board’s findings in this Decision and Order.
10. Intervenors and Board staff shall file any comments on the draft Rate Order with the Board and forward to the Applicants within **7 days** of the date of filing of the draft Rate Order.
11. By the date referred to in paragraph 10, eligible intervenors shall also file with the Board and forward to the Applicants their respective cost claims.
12. The Applicants shall file with the Board and forward to intervenors responses to any comments on the draft Rate Order within **7 days** of the date of receipt of intervenor and/or Board staff comments.
13. By the date referred to in paragraph 12, the Applicants shall also file with the Board and forward to the intervenors any objections to the claimed costs of the intervenors.
14. Intervenors shall file with the Board and forward to the Applicants any responses to any objections for cost claims within **7 days** of the date of receipt of the objections.
15. The Applicants shall pay the Board’s costs of, and incidental to, this proceeding immediately upon receipt of the Board’s invoice.
16. Once the notice referred to in paragraph 4 above is provided to the Board, the Board will transfer NPDI’s electricity distribution licence ED-2002-0521 and NPDI’s Rate Order to HONI.

All filings to the Board must quote file numbers, **EB-2013-0196**, **EB-2013-0187** and **EB-2013-0198**, be made electronically through the Board's web portal at www.pes.ontarioenergyboard.ca/eservice/ in searchable/unrestricted PDF format. Two paper copies must also be filed at the Board's address provided below. Filings must clearly state the sender's name, postal address and telephone number, fax number and e-mail address. Parties must use the document naming conventions and document submission standards outlined in the RESS Document Guideline found at www.ontarioenergyboard.ca/OEB/Industry. If the web portal is not available parties may email their documents to the address below. Those who do not have internet access are required to submit all filings on a CD in PDF format, along with two paper copies. Those who do not have computer access are required to file 7 paper copies.

All communications should be directed to the attention of the Board Secretary at the address below, 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, Gona Jaff at gona.jaff@ontarioenergyboard.ca and Board Counsel, Jennifer Lea at Jennifer.lea@ontarioenergyboard.ca.

ADDRESS

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DATED at Toronto July 3, 2014

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary