BACKGROUNDER
April 30, 2020

Decision and Order for Hydro One Inc. and Hydro One Networks Inc.'s application for approval to purchase all issued and outstanding shares of Orillia Power Distribution Corporation – EB-2018-0270

On April 30, 2020, The Ontario Energy Board (OEB) approved application EB-2018-0270 with conditions. A summary of the application and of the OEB's findings is set out below.

Background

On September 26, 2018, an application was filed with the OEB seeking approval for Hydro One Inc. to purchase all of the shares of Orillia Power Distribution Corporation (Orillia Power) for $41.3 million, consisting of $26.4 million in cash and $14.9 million in debt, and for Orillia Power to transfer its electricity distribution system to Hydro One Networks Inc. (Hydro One).

Hydro One owns and operates the largest electricity transmission and distribution system in Ontario. Its distribution system serves approximately 1.3 million customers in its service territory. Orillia Power serves approximately 13,800 residential, general service and large use customers.

This is the second time that an application has been made to the OEB for Hydro One to acquire Orillia Power's distribution system. The first application was denied by the OEB because the OEB was not satisfied that its "no harm" test (described below) had been met. In particular, the OEB found that Hydro One had failed to make the case that the underlying cost structures (and ultimately the distribution rates) for Orillia Power customers would be no greater than they would have been without the consolidation. That decision can be found here.

Assessing the Application

Before approving an application for utility consolidation, the OEB must be satisfied that the proposed transaction will have a positive or neutral effect on the price, quality and reliability of service to electricity customers, as well as on cost effectiveness, economic efficiency and financial viability. The OEB refers to this as the "no harm" test.

The "no harm" test does not consider why the parties to a proposed transaction have made the decision to sell or buy a utility, or whether a better deal could theoretically have been struck. The OEB also does not consider the loss of local, municipal control of a utility unless it can be shown to have an impact on price, reliability or the other issues noted above.

Similarly, the OEB also does not consider issues relating to the degree of public consultation, or public disclosure by the parties leading up to the filing of the transaction with the OEB.

In addition to seeking the OEB's approval for Hydro One Inc. to purchase all of Orillia Power's shares and for Orillia Power to transfer its electricity distribution system to Hydro One, the application also requests a number of other approvals, including approval to:

- Implement a 1% reduction in Orillia Power's base distribution rates for residential, general service and large use customers and freeze those rates for the first five years following the consolidation.
- Defer the resetting of Orillia Power's distribution rates for 10 years following the consolidation.
- Establish an earnings share mechanism for years 6 through 10 following the consolidation, to share with Orillia Power customers the forecast savings arising from the consolidation.

Hydro One submitted that the consolidation of Orillia Power and Hydro One will:

- Create ongoing operations, maintenance and administrative (OM&A) savings of approximately $4.7 million per year, representing an approximately 70% reduction in OM&A costs relative to Orillia Power's year 10 forecast without the consolidation.
- Reduce capital expenditures by approximately $200,000 per year by year 10 (based on the level of savings forecast to be achieved by year 10).

Decision

The OEB assessed the application by applying its "no harm" test and concluded that, with a number of conditions in place, the proposed consolidation meets that test. The OEB imposed unique conditions so that customers of Hydro One and Orillia Power will not be affected in the event that the projected cost savings (and commensurate beneficial impacts on rates) arising from the consolidation are not achieved.

Based on the application as approved and the OEB's conditions:

- Distribution rates for Orillia Power customers will be reduced by 1% and then frozen in years 1 to 5.
- In years 6 to 10, distribution rates for Orillia Power customers will be adjusted to keep pace with inflation, using an incentive rate-making formula that also encourages efficiency.
- Hydro One will not be eligible to apply to increase distribution rates for Orillia Power customers over the first 10 years to fund additional, unforeseen capital investments, as might otherwise have been allowable under the incentive rate-making framework that will apply in years 6 to 10.
- When Orillia Power's distribution rates are reset at the end of 10 years, they cannot increase more than they otherwise would have without the consolidation.
- Hydro One guarantees that savings will be shared with Orillia Power customers at the end of 10 years. As a result of the OEB's decision, the way in which the savings will be calculated is more favourable to Orillia Power's customers than the calculation that Hydro One proposed.
- Hydro One will provide customer service benefits to Orillia Power consumers through a number of measures – for example, extended call centre hours and the use of advanced technologies like email and text power outage notifications.

OEB FINDINGS
1. If the fully allocated revenue requirement for the Orillia Power service area in year 11 is higher than what the rates are forecast to be at that time without the consolidation, these excess costs will be borne by the shareholder and not the ratepayers. ***Section 4.1, Findings, p. 23 – Price, Economic Efficiency and Cost Effectiveness***
2. The fixed assets associated with serving customers in the Orillia Power service territory shall be tracked separately so that the information is available to ensure that costs are appropriately allocated in future rates proceedings. Orillia Power customers will be kept in their existing rate classes and will not be placed into Hydro One's rate classes. (Any change to rate classes or how costs are allocated would have to be approved by the OEB.) ***Section 5.3, Findings, p. 37 – Deferred Rebasing Period and 1% Reduction to OEB-Approved Rate Schedule for Orillia Power***
3. Given the robust predictions of efficiency that will be achieved through the consolidation and the overarching requirement to ensure no harm to customers in the Orillia Power service area, the OEB will not provide an opportunity for Hydro One to apply to increase rates to fund additional, unforeseen capital investments during the first 10 years (as might otherwise have been allowable under the incentive rate-making framework that will apply in years 6 to 10). ***Section 5.5, Findings, p. 39 – Incremental Capital Module***

OEB FINDINGS
4. The OEB accepts Hydro One's proposal to provide a Distribution System Plan (DSP) within 18 months following the integration of the distribution system into Hydro One's (a DSP contains a detailed analysis of the condition of a utility's assets and describe any needed investments and a plan to make those investments). ***Section 5.5, Findings, p. 39 – Incremental Capital Module***
5. The OEB approves Hydro One's proposal of a guaranteed earnings sharing mechanism to share with customers in the Orillia Power service area excess earnings through years 6 to 10. However, the OEB requires Hydro One to recalculate the excess earnings to be shared in a way that is more favourable to Orillia Power customers than the calculation that Hydro One proposed. The savings will be shared with Orillia Power customers on a 50:50 basis when rates are reset after year 10. ***Section 5.6, Findings, p. 43 – Earnings Sharing Mechanism***
6. Hydro One applied for approval to utilize US Generally Accepted Accounting Principles (US GAAP) for Orillia Power's financial reporting. US GAAP is used by Hydro One, whereas Orillia Power's financial statements are currently prepared under modified International Financial Reporting Standards (MIFRS). A change in accounting standards should not result in a financial benefit for a utility. Therefore, the OEB is establishing an account to track impacts of the transition from MIFRS to US GAAP with respect to how costs are capitalized and depreciated. This account will be reviewed when rates are reset after year 10 to determine the appropriate approach for disposition. ***Section 5.7, Findings, p. 44 - Accounting Matters***
7. The OEB agrees that it is appropriate to dispose of the balances in two existing Orillia Power accounts that Orillia Power currently uses to track financial differences arising from accounting changes. Hydro One is required to dispose of the balances in these accounts to customers in the Orillia Power service area within 12 months of the consolidation. ***Section 5.7, Findings, p. 44 – Accounting Matters***