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

DECISION AND ORDER

EB-2019-0015

NORTH BAY (ESPANOLA) ACQUISITION INC.

Application for approval for North Bay (Espanola) Acquisition Inc. to purchase Espanola Regional Hydro Holdings Corporation and Espanola Regional Hydro Distribution Corporation, and amalgamate with them

BEFORE: **Lynne Anderson**
Presiding Member

Michael Janigan
Member

August 22, 2019

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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 North Bay (Espanola) Acquisition Inc. (Applicant). The transaction proposed in the Application was for OEB approval, pursuant to Section 86 of the *Ontario Energy Board Act, 1998* (OEB Act)[1], for the Applicant to purchase Espanola Regional Hydro Holdings Corporation (Espanola Hydro Holdings) and Espanola Regional Hydro Distribution Corporation (Espanola Hydro), amalgamate with them, and operate the amalgamated company under the name Espanola Regional Hydro Distribution Corporation (New Espanola Hydro). The Applicant also sought approval of a proposed rate making framework (Proposed Rate Framework) which it defined as an integral and non-severable component of the Application.

A unique element of the Application was that the Applicant noted that the requests sought for in the Application were for Phase 1 of a two-phase transaction. The Application indicated that the approvals for Phase 2 will be requested in a separate application filed later – approximately in 2022 – at which time North Bay Hydro Distribution Limited (North Bay Hydro) would seek approval to amalgamate with New Espanola Hydro. Following the Phase 1 transaction, New Espanola Hydro and North Bay Hydro would be separate companies owned by North Bay Hydro Holdings Ltd. (North Bay Hydro Holdings). The proposed corporate structure is included in Schedule A to this Decision.[2]

The Application also requested approval, pursuant to Section 78 of the OEB Act, of the Proposed Rate Framework. The Proposed Rate Framework entails that following completion of the Phase 1 transaction, North Bay Hydro and New Espanola Hydro will be permitted to operate as independent utilities until 2022. The Applicant proposes that North Bay Hydro will file a cost of service application for rates effective 2021 and New Espanola Hydro will file a cost of service application for rates effective May 1, 2021. Following the separate cost of service applications for North Bay Hydro and New Espanola Hydro, the Phase 2 application to amalgamate North Bay Hydro and New Espanola Hydro will be filed with the OEB.

The OEB has applied the “no harm” test in assessing the Application and has concluded that the Phase 1 transaction meets the test. The OEB therefore approves the purchase of Espanola Hydro Holdings and Espanola Hydro by the Applicant, and the

[1] S.O. 1998, c. 15 Schedule B
[2] As provided in the Application.

amalgamation of the Applicant, Espanola Hydro Holdings and Espanola Hydro to form New Espanola Hydro. The OEB finds the Applicant’s proposal to file separate cost of service rate applications for 2021 rates for North Bay Hydro and New Espanola Hydro reasonable. However, this OEB panel cannot bind the future OEB panels that would hear those rate applications with specific determinations that would form part of the decisions of those panels.

2 APPLICATION AND PROCEEDING OVERVIEW

2.1 The Applicant

The Applicant is a wholly owned subsidiary of North Bay Hydro Holdings. North Bay Hydro Holdings is also the sole owner of North Bay Hydro, North Bay Hydro Services Inc. and North Bay Hydro Generations Limited.

2.2 The Application

The Applicant sought OEB approval under Section 86 of the OEB Act to acquire 100% of the issued and outstanding shares of Espanola Hydro Holdings, 100% of the special shares of Espanola Hydro, and to amalgamate with Espanola Hydro Holdings and Espanola Hydro to create New Espanola Hydro. The Applicant will pay a purchase price of $7,989,530 that is subject to adjustment following the closing date.

The Applicant also sought OEB approval of the Proposed Rate Framework under Section 78 of the OEB Act. The Proposed Rate Framework entails:

- Following completion of the Phase 1 transaction, North Bay Hydro and New Espanola Hydro will operate as independent utilities until 2022
- North Bay Hydro and New Espanola Hydro will file separate cost of service applications prior to 2022

The approvals sought in the Application are for what the Applicant refers to as Phase 1 of a two-phase transaction. The Phase 1 transaction is characterized as the approvals required to effect the Applicant’s purchase of Espanola Hydro Holdings and Espanola Hydro, and its amalgamation with these companies to create New Espanola Hydro. Further, the Application stated that following completion of the Phase 1 transaction, North Bay Hydro’s cost of service application will be filed for rates effective May 1, 2020 and New Espanola Hydro’s cost of service application will be filed for rates effective May 1, 2021. In its Argument-in-Chief, the Applicant stated that North Bay Hydro now intends to file its cost of service application for rates effective 2021.[3]

[3] The Applicant did not state whether this would be for January 1, 2021 rates or May 1, 2021 rates. North Bay Hydro is currently on a May 1 rate year.

The Applicant noted that approvals for Phase 2 would be requested in a separate application that will be filed later – approximately in 2022 – following completion of the New Espanola Hydro cost of service rate application, the North Bay Hydro cost of service rate application, the transition of services from PUC Services Inc. (PUC) to North Bay Hydro, and the expiry of the PUC Services Agreement.[4] The Phase 2 application will seek OEB approval for North Bay Hydro to amalgamate with New Espanola Hydro. Pending OEB approval, and the completion of the Phase 2 transaction, the ultimate amalgamated company would be called North Bay Hydro Distribution Limited (New North Bay Hydro). The Applicant highlighted in the Application that New North Bay Hydro would commit to only defer rebasing and rate harmonization for five years after completion of the Phase 2 transaction.

Charts outlining the Applicant's proposed two-phase transaction are provided as Schedule A of this Decision and Order.[5]

2.3 The Process

The OEB issued a Notice of Hearing on February 26, 2019 inviting interested parties to register as intervenors or to file letters of comment with the OEB. School Energy Coalition (SEC) and Mr. Donald Rennick applied for, and were granted, intervenor status.

As part of the Application, the Applicant submitted a Notice of Proposal under Section 81 of the OEB Act in relation to the Applicant's interest in a qualifying generation facility and its acquisition of Espanola Hydro. Under a different file number,[6] the OEB issued a letter stating that it did not intend to issue a notice of review of the proposal.

In accordance with Procedural Order No. 1, OEB staff, SEC, and Mr. Rennick filed interrogatories. The Applicant's responses to interrogatories were received by the OEB on April 29, 2019.

Following the issuance of Procedural Order No. 2, Mr. Rennick filed a Notice of Motion with the OEB on May 1, 2019 in which he requested "the Applicant provide more

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[4] Espanola Hydro receives services under the PUC Services Agreement effective June 1, 2016 until February 28, 2022, pursuant to which PUC provides a comprehensive suite of management services, customer services and IT services to support the operations of Espanola Hydro.
[5] As provided in the Application.
[6] EB-2019-0085

fulsome responses and additional explanations to the interrogatories". The OEB issued Procedural Order No. 3 in which a submission schedule for the motion was established.

Following submissions from both the Applicant and Mr. Rennick, the OEB issued the Decision on Motion and Procedural Order No. 4 on June 6, 2019, which denied Mr. Rennick's motion.

In addition, the Decision on Motion and Procedural Order No. 4 established the schedule for the Applicant's Argument-in-Chief as well as a submission schedule. The Applicant filed its Argument-in-Chief on June 14, 2019 while OEB staff, SEC, and Mr. Rennick filed submissions on June 28, 2019. A reply submission from the Applicant was filed on July 12, 2019.

3 REGULATORY PRINCIPLES

3.1 The "No Harm" Test

The OEB applies the "no harm" test when assessing applications for approval of utility consolidations.[7] The "no harm" test was first established by the OEB in 2005 through its decision in an adjudicative proceeding,[8] and has been used to guide OEB decision making on applications for mergers, acquisitions, amalgamations and divestitures (MAADs) since then.

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. Those objectives include:[9]

> **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:[10]
>
> 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.

[7] The term consolidation is inclusive of mergers, acquisitions, amalgamations and divestitures (MAADs).
[8] RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257
[9] OEB Act, Section 1
[10] 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 connection of renewable energy generation facilities. 2004, c. 23, Sched. B, s. 1; 2009, c. 12, Sched. D, s. 1; 2015, c. 29, s. 7.

If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.[11]

3.2 OEB Policy on Rate Making Associated with Consolidations

The OEB introduced policies that provide consolidating electricity distributors with an opportunity to offset merger-related transaction costs with any achieved savings by allowing the consolidated entity to defer rebasing its costs for a period of time (deferred rebasing period).

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*,[12] issued July 23, 2007 (the 2007 Report) and a further report[13] issued under the same name on March 26, 2015 (the 2015 Report) (collectively called the MAADs policies). The 2007 Report permitted a deferred rebasing period of five years. The 2015 Report extended the deferred rebasing period, permitting consolidating electricity distributors to defer rebasing for up to ten years from the closing of the transaction.

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

[11] MAADs Handbook, pp. 3-4
[12] https://www.oeb.ca/documents/cases/EB-2007-0028/report_ratemaking_20070723.pdf
[13] https://www.oeb.ca/oeb/_Documents/EB-2014-0138/Board_Report_MAADs_Ratemaking_20150326.pdf

distributors select a 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 earnings sharing mechanism (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

4.1 Two-Phase Transaction

The Applicant has stated that it is planning a two-phase transaction. This proceeding relates to Phase 1, in which the Applicant is seeking approval to purchase Espanola Hydro Holdings and Espanola Hydro, and to amalgamate with these two companies. As part of Phase 1, the Applicant is also seeking approval of a Proposed Rate Framework. This Decision first addresses the approvals for the Phase 1 transaction then addresses the Proposed Rate Framework.

Findings

The Phase 1 transaction is approved.

The Applicant has provided numerous details about the proposal for Phase 2 but will not be seeking approval for this until approximately 2022. While the information the Applicant provided about Phase 2 is informative, these future plans are not in scope of this proceeding. The OEB has therefore made its findings for Phase 1 on a stand-alone basis, regardless of the plans for Phase 2 and whether it is ultimately approved. No findings are being made related to Phase 2 at this time.

The OEB has assessed the Phase 1 transaction based on the “no harm” test, the details of which are in the sections that follow.

4.2 Application of the “No Harm” Test

Price, Economic Efficiency and Cost Effectiveness

The basis for determining distribution rates is a distributor’s costs. In order to demonstrate no harm, applicants are required to show that there is a reasonable expectation based on underlying cost structures that the costs to serve customers following a transaction will be no higher than they would otherwise have been.[14] For the Phase 1 transaction, the Applicant is proposing that North Bay Hydro and New

[14] MAADs Handbook, p. 7

Espanola Hydro continue to operate as separate entities. The Applicant would not seek approval to amalgamate North Bay Hydro and New Espanola Hydro until Phase 2.

The MAADs Handbook allows a consolidating utility to elect, as part of the application, to defer rebasing for up to a maximum of ten years.[15] This deferral period is to allow the acquiring or merging utility an opportunity to recover transaction costs, which are not normally allowed to be recovered directly from customers, through operational and capital efficiencies resulting from the transaction over a reasonable period of time. The Applicant proposed not to adopt a deferred rebasing period following the Phase 1 transaction. The Applicant estimated that it will incur $450,000 in transaction costs and $75,000 in transition costs, but noted that these costs will not be recovered from ratepayers as they will be funded through company residual earnings.[16] It was also highlighted by the Applicant that any costs incurred for retaining independent and financial advisors will be borne by the parties themselves and that ratepayers will not fund any of these costs.[17]

Through its Argument-in-Chief, the Applicant stated that following completion of the Phase 1 transaction, there will be no impact with respect to price or underlying costs due to the continuation of the PUC Services Agreement. However, following the expiry of the PUC Services Agreement, the Applicant anticipates significant Operational, Maintenance, and Administrative (OM&A) savings and efficiency gains. Such savings and efficiency gains would be made through the consolidation of administrative practices and economies of scale – including the consolidation of management, billing, customer service, finance, and regulatory functions. Further, the Applicant noted that customers of Espanola Hydro will benefit because North Bay Hydro can largely replace the services provided under the PUC Services Agreement at no incremental cost to customers.[18] In its reply submission, the Applicant reiterated the synergies following the Phase 2 transaction and noted that such future synergies would not be possible should the OEB deny the approvals sought in the Application.[19]

OEB staff submitted that the Phase 1 transaction will have a neutral effect on the ratepayers of Espanola Hydro and North Bay Hydro as there will be no synergies or savings experienced in Phase 1, nor will there be any costs to ratepayers as transaction

[15] MAADs Handbook, p. 12
[16] Response to Interrogatories OEB Staff-1 and OEB Staff-2
[17] Applicant Argument-in-Chief, p. 11
[18] Applicant Argument-in-Chief, p. 7
[19] Applicant Reply Submission, p. 12

and transition costs will be funded through residual earnings.[20] SEC submitted that it agreed with OEB staff as "there is no reasonable likelihood the customers of either [Espanola Hydro] or [North Bay Hydro] will be harmed as a result of the change of control proposed."[21]

Contrasting this view, Mr. Rennick submitted that the transaction does not meet the "no harm" test in regards to price and should be denied.[22] Mr. Rennick stated that the funds used to pay for transaction and transition costs come from customers through the delivery rates paid by them. As a result, the funds, whether paid by customers in the past, currently or in the future, represent additional costs and are harmful to North Bay Hydro customers compared to the status quo.[23] In its reply submission, the Applicant noted that under OEB policies, utilities are entitled to earn a return on equity (ROE) that can result in residual cash, and the use of residual cash to fund transactions does not constitute harm to customers.[24]

Mr. Rennick noted in his submission that North Bay Hydro customers will not benefit from any savings resulting from the amalgamation of administrative functions of the two utilities and that tax liabilities associated with the forecasted savings will amount to 21% at current rates and have not been considered.[25] Mr. Rennick also submitted that since any savings will increase taxable income, the tax liability will range from $120,000 to $145,000 per year and would result in a reduction of actual savings.[26]

The Applicant disagreed with Mr. Rennick's submission that North Bay Hydro customers will not benefit from any savings resulting from the amalgamation. In its reply submission, the Applicant highlighted that "in 2026, the total OM&A cost to serve [Espanola Hydro] and [North Bay Hydro] customers will reduce from $10,467k in the status quo scenario to $9,781k if the Board approves both the Phase 1 and Phase 2 Transactions."[27] Further, the Applicant argued that no customers will be harmed by the proposed transaction; instead both groups of customers stand to benefit.

The Applicant also stated in its reply submission that tax liabilities are imposed on net income not forecasted savings. Further, under the Proposed Rate Framework, the rate

[20] OEB Staff Submission, p. 9
[21] SEC Submission, p. 2
[22] Mr. Rennick Submission, p. 5
[23] Mr. Rennick Submission, p. 3
[24] Applicant Reply Submission, p. 15
[25] Mr. Rennick Submission, p. 2
[26] *Ibid.*
[27] Applicant Reply Submission, p. 13

rebasing for both North Bay Hydro and New Espanola Hydro will occur before any forecasted savings will occur due to the PUC Services Agreement continuing until 2022.[28] Thus, the Applicant submitted that the rebased rates will not include any allowance for any increased tax liabilities arising after the savings occur and, therefore, result in no harm to ratepayers.

In his submission, Mr. Rennick stated that New Espanola Hydro will experience an increase in underlying costs resulting from the principal and interest payments required to service the $8 million purchase price loan. Based on his calculations, Mr. Rennick submitted that such additional costs would amount to approximately $1.2 million over three years until 2022 and represent harm to customers when compared to the status quo.[29] Further, Mr. Rennick stated that the loan principal payments are not deductible for tax purposes and are paid out of after tax cash and that the OM&A costs also do not take into account the purchase price loan principal repayments which must be supplied by customers.[30] In its reply submission, the Applicant submitted that the OEB's 2009 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*[31] already provides for ratepayer funding to support both debt and equity financing. In addition, the Applicant highlighted that the OEB's ratemaking policies indicate that this funding is applied on a deemed capital structure. As a result of using a deemed capital structure for ratemaking purposes, the acquisition of new debt to fund the acquisition will have no negative impacts on customers with regards to price.[32]

Through his submission, Mr. Rennick further noted that the distance between North Bay Hydro and Espanola Hydro had not been sufficiently addressed in the evidence supplied. Mr. Rennick highlighted that North Bay Hydro and Espanola Hydro are not contiguous as they are over 175 km apart from each other and, therefore, not conducive to efficient operations.

SEC highlighted in its submission that it was unable to identify, based on the evidence before the OEB, that there is any indication that customers of Espanola Hydro and North Bay Hydro have a risk of being harmed if the Application is approved.[33] Further, with regards to economic efficiencies, SEC submitted that even though the PUC Services Agreement will still be in place following the completion of the Phase 1

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[28] Applicant Reply Submission, p. 14
[29] Mr. Rennick Submission, p. 2
[30] Mr. Rennick Submission, p. 3
[31] EB-2009-0084
[32] Applicant Reply Submission, pp. 12-13
[33] SEC Submission, p. 3

transaction, it is likely that there will be some near term efficiencies and improvements. For instance, the implementation of any best practices followed by North Bay Hydro being applied in the Espanola Hydro service territory, or vice versa.[34] SEC further noted in its submission that, without even considering the effect of the Phase 2 transaction (which is not before the OEB in this Application), it would appear clear that there will be some economies of scale, and thus material savings that will ultimately benefit customers.[35]

Findings

The OEB accepts that there is no harm to customers with respect to price, economic efficiency and cost effectiveness. With the Phase 1 transaction, North Bay Hydro and New Espanola Hydro will remain separate companies under the same ownership by North Bay Hydro Holdings. The OEB is not at this time considering the Phase 2 transaction in which North Bay Hydro and New Espanola Hydro plan to merge. Savings related to the Phase 2 transaction will be considered in a future proceeding when North Bay Hydro files an application to amalgamate with New Espanola Hydro. For the Phase 1 transaction, the OEB took into consideration that:

- The estimated $450,000 in transaction costs and $75,000 in transition costs will not be recovered from customers through distribution rates. To do so would require the Applicant to include these costs in a future cost of service application, and this would be contrary to the OEB MAADs policy. The Applicant has also confirmed that it will not seek recovery of these costs.

- The OEB's rate-setting policies set rates based on a deemed capital structure of 60% debt and 40% equity[36] applied to a rate base. This means that rates are generally set based on a deemed debt level of 60% of rate base regardless of the actual debt of the utility.[37] While there will be an actual incremental interest expense related to the $8 million purchase price loan, rates have already been set based on a deemed debt of 60% of rate base. The Applicant has forecast that actual combined debt for the Applicant and North Bay Hydro will remain below that 60% level.

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[34] SEC Submission, p. 3.
[35] *Ibid.*
[36] EB-2009-0084 *Report of the Board on the Cost of Capital for Ontario's Regulated Utilities*, December 11, 2009
[37] The interest rate for debt is generally lower than the rate of ROE. There could be exceptions for extraordinary circumstances.

- The OEB's test is one of no harm, not positive benefits. The Applicant has not forecast any synergies as a result of the Phase 1 transaction. The Applicant has also not forecast any incremental costs as stand-alone entities that will be recovered from customers through distribution rates. Any efficiencies resulting from the Phase 1 transaction are discussed later in the Proposed Rate Framework section of this Decision.

The OEB is satisfied that there is no deterioration of price, economic efficiency or cost effectiveness as a result of the Phase 1 transaction.

Reliability and Quality of Electricity Service

The MAADs Handbook requires consolidating utilities to indicate the impact that the proposed transaction will have on customers with respect to quality and reliability of electricity 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 OEB is informed by, among other things, the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard.[38]

Through responses to interrogatories, the Applicant highlighted that following the Phase 1 transaction, the current Espanola Hydro distribution system will continue to be operated from the operations centre in Espanola, as well as continue to be operated by Espanola Hydro staff and managed by PUC pursuant to the PUC Services Agreement. In addition, the Applicant noted that there are no proposed reductions to Espanola Hydro line crew or operations staff as the Securities Purchase Agreement contains a two-year guarantee on employment for employees of Espanola Hydro following the closing date of the Phase 1 transaction. In its Argument-in-Chief, the Applicant reiterated that the transaction will have no negative impacts on quality of service.[39]

OEB staff was of the view that service quality and reliability would not be impacted by the Phase 1 transaction. Following review of Espanola Hydro's 2013 to 2017 System Average Interruption Duration Index and System Average Interruption Frequency Index statistics, OEB staff noted that Espanola Hydro has been able to maintain fairly consistent reliability performance. OEB staff submitted that the service quality and

[38] MAADs Handbook, p. 4
[39] Applicant Argument-in-Chief, p. 8

reliability levels in the Espanola Hydro service area are likely to be maintained following the amalgamation.

In the Application, the Applicant noted that the transaction will result in the sharing of engineering and operational expertise between Espanola Hydro and North Bay Hydro, which will lead to higher quality operations and maintenance plans that will benefit customers of both North Bay Hydro and Espanola Hydro.[40] In his submission, Mr. Rennick challenged this assertion by the Applicant. Mr. Rennick submitted that the Applicant's response to a request for further clarification regarding the matter of how customers of both North Bay Hydro and Espanola Hydro would benefit was nothing more than promotional rhetoric. In addition, Mr. Rennick submitted that there appears to be no benefit accruing to the customers of North Bay Hydro in the sharing of expertise with Espanola Hydro.[41]

Findings

The OEB accepts that there is no harm to customers with respect to reliability and quality of service for the Phase 1 transaction. The companies will be operating for the most part on a stand-alone basis in a similar manner to how they have operated in the past. There is no reason to conclude that services to customers will deteriorate. As noted by the Applicant, there may be some service quality benefits to the New Espanola Hydro as a result of the Phase 1 transaction. While there may be no similar positive benefits to reliability and quality of service expected for North Bay Hydro customers at this time, the OEB concludes that there also will be no harm.

Financial Viability

The MAADs Handbook indicates 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. The OEB's primary considerations in this regard are:

- The effect of the purchase price, including any premium paid above the historic (book) value of the assets involved

[40] Application, p. 16
[41] Mr. Rennick Submission, p. 1

- The financing of incremental costs (transaction and transition costs) to implement the consolidation transaction

The Phase 1 transaction, which will be 100% financed by a newly arranged bank term loan, involves consideration paid in the amount of $7,989,530 – plus a purchase price adjustment – by the Applicant in exchange for 100% of the issued and outstanding common shares of Espanola Hydro Holdings and 100% of the special shares of Espanola Hydro.

The Applicant noted that, following Phase 1, it will see significant increases in its debt to equity ratios during the period up to 2022, and that its ratios tied to liquidity will decline – under the premise that the Applicant's leverage and liquidity ratios are evaluated on a standalone basis.[42] However, the Applicant anticipates that the increase in its debt to equity ratios and decrease in liquidity will be during Phase 1 of the two-phase transaction. Following the Phase 2 amalgamation, the Applicant projects that New North Bay Hydro will have strong liquidity and debt service ratios as well as more optimal debt to equity ratios with financial capacity for necessary borrowing.[43]

The Applicant highlighted that it has negotiated financial terms with its lender that recognize the circumstances of Espanola Hydro and the intention of the Phase 2 transaction in 2022. This was illustrated through the third-party lending arrangements containing two key elements:

1. The requirement for the Applicant to annually comply with various standard debt covenants associated with the new term loan is being waived by the lender until the year ended December 31, 2022.
2. North Bay Hydro acting as guarantor for the Applicant's obligation under the new term loan.

In its Argument-in-Chief, the Applicant also noted that before the proposed transaction, neither North Bay Hydro nor Espanola Hydro were levered at the full 60:40 debt-to-equity ratio, and consequently, both North Bay Hydro and Espanola Hydro have the capacity to take on additional debt.[44]

Through its submission, OEB staff supported the notion that financial viability will not be negatively impacted due to the third-party lender's waiver of debt covenants attached to

[42] Application, p. 36
[43] Application, p. 37
[44] Applicant Argument-in-Chief, p. 10

the bank loan until such time as the year ending December 31, 2022.[45] Further, OEB staff submitted that North Bay Hydro's role as guarantor in the new debt financing of the Applicant alleviates much of the risk of the Applicant's proposal, given North Bay Hydro's current financial resources and borrowing capacity. OEB staff also submitted that it was of the view that the guarantor role of North Bay Hydro will not adversely impact North Bay Hydro's financial viability. As a result, through reviewing the terms of the proposed bank loan, the pro forma financial statements of the entities involved in the transaction, and the projected financial health and performance of the entities during both Phase 1 and Phase 2, OEB staff submitted that the Phase 1 transaction will not adversely affect the financial viability of the Applicant.

The Applicant's evidence with respect to financial viability was generally presented on a consolidated basis with North Bay Hydro. As a result, OEB staff submitted that in the unlikely scenario that the Phase 2 transaction does not materialize, actions would need to be taken. OEB staff stated that it would expect that the ownership group of the Applicant would prudently monitor New Espanola Hydro's financial health as a standalone entity, which may include cash infusions or equity injections in order to maintain a financially viable capital structure without undue reliance on the financial position of North Bay Hydro.[46]

In response to OEB staff's submission, the Applicant outlined that in the event the Phase 2 transaction does not materialize, it will prudently monitor New Espanola Hydro's financial health as a standalone entity and will take all steps necessary to ensure the financial viability of New Espanola Hydro.[47]

Findings

The OEB concludes that the financial viability of the Applicant is not at risk as a result of the Phase 1 transaction.

Both North Bay Hydro and Espanola Hydro are operating at well below a 1.5 debt to equity ratio (the deemed capital structure). Even with the purchase price loan of $8 million included, the evidence provided by the Applicant shows a debt to equity ratio combined for the Applicant and North Bay Hydro of 1.3. This should provide room for additional leverage should an extraordinary need arise.

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[45] OEB Staff Submission, p. 12
[46] *Ibid.*
[47] Applicant Reply Submission, p. 16

The OEB also notes that with the proposed transaction, the Applicant would be acquiring Espanola Hydro and Espanola Hydro Holdings for a purchase price of $7,989,530. The 2016 rate base for Espanola Hydro was $6,128,438. This is a purchase price to rate base multiple of 1.3, well within the range that the OEB has previously approved for other utilities[48].

4.3 Other Considerations

Proposed Rate Framework

In the Application and evidence filed, the Applicant highlighted the unique circumstances that influenced the need for the two-phase transaction and Proposed Rate Framework. Espanola Hydro's last cost of service rate application was for 2012 rates and rates have not been adjusted at all in nearly four years. The OEB set the rates for Espanola Hydro on an interim basis effective May 1, 2016. The interim order was the result of the OEB's review of Espanola Hydro's 2014 performance scorecard in which the ROE in 2014 was significantly greater than the amount its rates were designed to generate. Setting rates on an interim basis was to allow the OEB to consider whether excess revenues earned after January 31, 2016 should be returned to customers.

The Applicant highlighted that in more recent years Espanola Hydro has not been performing well financially and that this trend is expected to continue if the OEB does not approve the Application.[49]

OEB staff addressed the matter of Espanola Hydro's financial performance in its submission by stating that it was of the view that Espanola Hydro's historical performance, based upon an ROE perspective, has not been as ominous as the scenario characterized in the Application. However, OEB staff noted that it is important to be cognizant of Espanola Hydro's financial trend moving forward.[50]

Under the Proposed Rate Framework, following the completion of the Phase 1 transaction, North Bay Hydro and New Espanola Hydro would be permitted to operate as independent utilities until the PUC Services Agreement expires in 2022. This would

[48] For example, in the EB-2014-0217 and EB-2017-0269 proceedings, the purchase price to asset multiples were 1.7 and 1.8, respectively.
[49] Application, p. 7
[50] OEB Staff Submission, p. 18

include the filing of separate cost of service rate applications by both utilities. The Phase 2 transaction would occur after these applications.

For New Espanola Hydro, a cost of service application would be filed for rates effective May 1, 2021.[51] The Applicant stated that the New Espanola Hydro cost of service application will maintain the ongoing financial viability of the utility as well as address regulatory matters, which include:

- New Espanola Hydro to begin the transition of residential customers towards fully-fixed rates
- Ending a current Incremental Capital Module (ICM) rate rider,[52] and rolling the substation properly into base rates, which will help reduce rates to the benefit of customers (the actual costs of the substation were less than what was previously forecasted)
- Filing a comprehensive five-year consolidated distribution system plan in accordance with the OEB's requirements
- Disposing of Group 1 Deferral and Variance Accounts, which were last disposed of for December 31, 2013 balances, and the Lost Revenue Adjustment Mechanism last cleared for programs ending April 2012
- Updating New Espanola Hydro's load forecast, cost allocation and rate design to reflect more current information[53]

In the Application, it was noted that North Bay Hydro would file a cost of service rate application for rates effective May 1, 2020. However, in its Argument-in-Chief, the Applicant stated that due to delays and the work effort required, North Bay Hydro intends to file its cost of service application for rates effective 2021, subject to workflow limitations.[54]

Throughout the proceeding, the Applicant maintained that the Proposed Rate Framework is an integral and non-severable component of the proposed two-phase

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[51] Application, p. 12
[52] In EB-2017-0127, the OEB approved ICM treatment for a new $2,062,500 municipal substation on the basis of a 2014 in-service date.
[53] Application, p. 12
[54] Applicant Argument-in-Chief, p. 3

transaction and that if the OEB determines that it will deny the Proposed Rate Framework, the balance of the Application must also be denied.[55]

OEB staff supported the Proposed Rate Framework and noted that it could possibly address some elements of Espanola Hydro's financial performance as the cost of service application can assist in ensuring that Espanola Hydro's rates are more reflective of its current circumstances. However, OEB staff highlighted that there is no guarantee that the OEB will treat the cost of service applications filed by both North Bay Hydro and New Espanola Hydro in an isolated context (i.e., as if they do not have a common owner).[56] As such, there would be no guarantee as to whether North Bay Hydro and New Espanola Hydro's rates would not be adjusted to reflect synergies in response to developments.[57]

Similarly, SEC also noted in its submission that the Applicant may want the OEB's assurance that in the North Bay Hydro and New Espanola Hydro cost of service applications each utility would be allowed to present their costs as if there was no common ownership.[58] SEC submitted that the OEB should not allow this and provided two reasons:

1. The panel adjudicating the Application cannot make any determination on what costs should be included in the revenue requirement of the cost of service applications as it has no evidence before it regarding just and reasonable rates in 2020 or 2021.

2. Whether there are cost efficiencies in 2020 or 2021 will be a matter of fact, which will be determined based on the evidence in the cost of service proceedings.

An additional element that SEC addressed in its submission pertained to the OEB approving the Proposed Rate Framework. SEC submitted that the OEB is not in a position to "approve" the Proposed Rate Framework.[59] Instead, SEC submitted that the OEB can confirm its current policies would allow North Bay Hydro and New Espanola Hydro to rebase rates and continue to operate independently.[60] SEC submitted that there is no rate application before the OEB at this time, and the OEB is unable to make procedural determinations in one case with respect to possible future applications.

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[55] Applicant Argument-in-Chief, p. 3
[56] OEB Staff Submission, p. 19
[57] *Ibid.*
[58] SEC Submission, p. 4
[59] SEC Submission, p. 3
[60] SEC Submission, p. 5

Further, SEC highlighted that it would be unwise for the OEB to initiate a new practice in which utility-specific future procedural rules are established or permitted by an OEB panel hearing a different matter.

The Applicant did not agree with SEC's submission of the OEB not being in a position to "approve" the Proposed Rate Framework and highlighted that it had applied under Section 78 of the OEB Act for approval of the Proposed Rate Framework. The Applicant also provided several reasons for why it did not agree with SEC's submission including:

- Ignoring the Applicant's request for approval of the Proposed Rate Framework would be directly contrary to the rules of natural justice.[61]
- The request for approval of the Proposed Rate Framework combined together with the request for MAADs approval is not without precedent. The MAADs application between Union Gas Limited (Union Gas) and Enbridge Gas Distribution Inc. (Enbridge Gas)[62] was noted by the Applicant as a proceeding in which the OEB approved both a MAADs application and a rate-setting framework.
- The Proposed Rate Framework falls within the spirit of the OEB's policies for MAADs as set out in both the 2007 Report and the 2015 Report.

OEB staff also highlighted in its submission that the OEB can acknowledge that both North Bay Hydro and New Espanola Hydro intend to file cost of service applications prior to the Phase 2 application. However, these applications are not currently before the OEB and that they will be considered on their merits by the OEB panels assigned to them. SEC also provided context for what the OEB could address when rendering its decision by stating:

> What the Applicants really want to know, we believe, is that with the change of control of [Espanola Hydro], but before [New Espanola Hydro] and [North Bay Hydro] merge, the Applicants are not obligated under the Board's MAADs policy to freeze rates and commence a rebasing deferral period. What they want the Board to say, in this proceeding, is that they can continue to operate as separate entities, despite common ownership, following the normal rules for those separate [local distribution companies].[63]

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[61] Applicant Reply Submission, p. 4
[62] EB-2017-0306/EB-2017-0307
[63] SEC Submission, p. 4

The Applicant noted in its reply submission that it seeks certainty on the North Bay Hydro cost of service application being treated as a separate and stand-alone application from the New Espanola Hydro cost of service application, despite the common ownership. Further, the Applicant identified that it is seeking clarity that the two applications will not be joined or heard together due solely to common ownership. Instead, each cost of service application will be heard independently of the other and on its own merits.[64] The Applicant highlighted that this request is not without precedent. Specifically, the Applicant cited the example of FortisOntario Inc. which owns and operates Canadian Niagara Power Inc., Cornwall Street Railway Light & Power Company Ltd., and Algoma Power Inc. The Applicant noted that the OEB has never combined the stand-alone rate applications of Algoma Power Inc. with Canadian Niagara Power Inc. as a result of the common ownership.[65]

The Applicant highlighted that it is making this request for a specific reason as the PUC Services Agreement includes a severe liquidated damages clause in the event the agreement is terminated prior to its expiry.[66] The Applicant noted that the commercial transaction that is before the OEB in the Application is uneconomic if the OEB expects the parties to terminate the PUC Services Agreement before its expiry.

In its submission, OEB staff also provided three examples of previous MAADs applications that the OEB could consider when making a decision on the Proposed Rate Framework.

1. The application[67] filed by Hydro One Inc. for approval to purchase Great Lakes Power Transmission Inc. (GLPT).

   The OEB accepted the requested ten-year rebasing deferral period and customized ESM, but denied the request that the rates of GLPT be reset at the beginning of the rebasing deferral period.[68]

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[64] Applicant Reply Submission, p. 9
[65] *Ibid.*
[66] Applicant Reply Submission, p. 10
[67] EB-2016-0050
[68] OEB Staff Submission, pp. 15-16

2. The MAADs application[69] filed by Alectra Utilities Corporation (Alectra Utilities)[70] and Guelph Hydro Electric Systems Inc. (Guelph Hydro).

   Alectra Utilities and Guelph Hydro proposed to maintain separate rate zones – one for legacy Alectra Utilities customers in the Enersource, Horizon, PowerStream and Brampton service territories, and one for Guelph Hydro – and to rebase the Guelph Hydro rate zone and legacy Alectra Utilities customer rates separately following the ten year deferral periods prior to rates being harmonized. The OEB's Decision and Order on the Alectra Utilities and Guelph Hydro MAADs application allowed for the independent rebasing of utilities prior to the harmonizing of rate zones.[71]

3. The rebasing of ERTH Power Corporation (ERTH)[72] during its MAADs application[73] with West Coast Huron Energy Inc. (West Coast Huron).

   The OEB considered ERTH's rate application without regard for the MAADs application between ERTH and West Coast Huron. In its reply submission, the Applicant submitted that the Proposed Rate Framework is similar to what the OEB permitted in the ERTH example.

SEC noted that under the OEB's current policies, the utilities would be able to request a deferred rebasing period of up to ten years as part of the Phase 2 transaction. It appeared to SEC that the utilities being on Price Cap IR from 2022 to 2026, as proposed by the Applicant, would be a better result for customers. However, SEC submitted that the OEB cannot and should not provide any assurances as to what Incentive Rate Mechanism rules will apply after rebasing.

OEB staff noted that allowing both utilities to file cost of service applications to rebase their rates prior to the Phase 2 transaction could result in overearnings for North Bay Hydro and New Espanola Hydro. However, there are mechanisms that could be put in place to remedy such a scenario. OEB staff highlighted the example of implementing an ESM following either the Phase 1 or Phase 2 transaction, similar to the ESM for

[69] EB-2018-0014
[70] Alectra Utilities was formed on January 1, 2017 through the amalgamation of Enersource Hydro Mississauga Inc. (Enersource), Horizon Utilities Corporation (Horizon), PowerStream Inc. (PowerStream), and Hydro One Brampton Networks Inc. (Brampton).
[71] OEB Staff Submission, pp. 16-17
[72] On June 19, 2018, Erie Thames Powerlines Corporation became ERTH Power Corporation.
[73] EB-2018-0082

Enbridge Gas.[74] The ESM for Enbridge Gas shares all earnings in excess of 150 basis points with customers on a 50:50 basis from year one of the deferred rebasing period.

OEB staff was of the view that implementing the ESM, as described above, following the Phase 1 transaction until the end of the deferred rebasing period following Phase 2 would ensure that ratepayers would be protected from any unforeseen consequences of the proposed atypical two-phase transaction.[75] However, if the OEB were to determine that OEB staff's proposed ESM should not be implemented following the Phase 1 transaction, OEB staff submitted that the OEB should recommend, in its Decision and Order on the Application, that a future panel consider implementing the ESM following the Phase 2 transaction.

The Applicant submitted that it did not agree with OEB staff's submission regarding the implementation of an ESM as, according to the Applicant, it does not align with the spirit of the OEB's policy to encourage and incent electricity distributor consolidations as established in the 2007 Report and 2015 Report.[76] The Applicant stated that the policy objective of encouraging and incenting electricity distributor consolidation was not applicable to the amalgamation of Union Gas and Enbridge Gas.

The Applicant did not agree with OEB staff's proposed ESM beginning in year one of the deferred rebasing period. The Applicant submitted that the proposed ESM would limit its ability to recover upfront transaction costs in the years after the PUC Services Agreement expires when financial efficiencies become achievable.[77] However, the Applicant did submit that it would be willing to accept a modification to its Proposed Rate Framework to include an ESM that would share overearnings 300 basis points above the OEB-approved ROE on a 50:50 basis with ratepayers beginning in year six following the closing of the Phase 1 transaction.[78]

The Applicant stated that this ESM would supersede and replace any ESM during the Phase 2 transaction, ensuring that customers benefit from the ESM in year six after the Phase 1 transaction. However, the Applicant did further submit that the Proposed Rate Framework is the best option available to address the unique circumstances of the Application.

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[74] EB-2017-0306/EB-2017-0307
[75] OEB Staff Submission, p. 20
[76] Applicant Reply Submission, p. 6
[77] *Ibid.*
[78] Applicant Reply Submission, pp. 6-7

Findings

The OEB finds that it is consistent with the OEB's policies for one utility to acquire another utility and operate it on a stand-alone basis. In addition to the examples of utilities operating separately under common ownership cited by OEB staff and the Applicant, the OEB notes that Hydro One Networks Inc. acquired Brampton Hydro Networks Inc. and operated it as a separate company, Hydro One Brampton Networks Inc., for many years. It is not unreasonable for a company incorporated under the *Ontario Business Corporations Act* to seek to grow its business through acquisitions.

Remaining as stand-alone utilities would mean keeping separate licences, filing and maintaining separate reporting and record-keeping requirements, keeping separate scorecards and filing separate rate applications. On this basis, the OEB finds the Applicant's proposal to file separate cost of service rate applications for 2021 rates for North Bay Hydro and New Espanola Hydro reasonable.

It is a separate matter to determine now what costs should be considered in these future rate applications. This OEB panel cannot bind the future OEB panel that would hear those rate applications. As noted by SEC, there may be some near term efficiencies and improvements that the future OEB panel may want to explore. This OEB panel cannot preclude the future OEB panel from considering these efficiencies in a rate application. The Applicant acknowledged that it is a natural component of any cost of service rate application for the OEB or the parties to explore the evidence of actual costs or efficiencies.

As to the PUC Services Agreement, the OEB acknowledges the concerns raised by the Applicant about the "severe liquidated damages clause in the event the agreement is terminated prior to its expiry". The Applicant's evidence is that this contract was effective June 1, 2016 and it will end February 28, 2022. Espanola Hydro last rebased for 2012 rates. As a result, the OEB has not had an opportunity to assess the PUC Services Agreement. This OEB panel is not making any findings with respect to the PUC Service Agreement. The OEB panel hearing the future rate application may review the details of this agreement, however, it is expected that both the OEB's policies developed to encourage consolidation of electricity distributors, and the implications of any termination clause in the PUC Services Agreement, would be taken into consideration.

The OEB will not establish an ESM at this time. The OEB concludes that this issue is best considered by the OEB panel hearing the future cost of service rate applications.

Deferral Account for Accounting Policy Changes

The Application provided context that the proposed two-phase transaction would ultimately result in North Bay Hydro and New Espanola Hydro amalgamating in 2022 upon the completion of the Phase 2 transaction. Although the Application pertains to approvals specific to Phase 1, OEB staff noted implications regarding accounting policies in its submission that could affect the Phase 2 transaction.

Currently, both North Bay Hydro and Espanola Hydro report under International Financial Reporting Standards (IFRS) for external reporting purposes and Modified IFRS for ratemaking purposes. The expectation is that following the Phase 2 transaction, New North Bay Hydro will report under IFRS. The Applicant noted that it does not propose the use of any different accounting standards following the closing of the Phase 1 transaction.[79] The Applicant noted through interrogatory responses that it had not undertaken any studies of the types of transactions that may be impacted as a result of an accounting policy change.

OEB staff submitted that there are potential material differences between the rates that are underpinned by Espanola Hydro's existing accounting policies, and those that would result if New Espanola Hydro adopts North Bay Hydro's policies.

OEB staff proposed two options to remedy the potential for a material difference:

1. Require New Espanola Hydro to adopt the accounting policies of North Bay Hydro effective fiscal 2021 and incorporate those accounting policies into its cost of service application.
2. New Espanola Hydro would remain on its existing accounting policies until 2022, but would be required to establish a deferral account to track differences in revenue requirement using New Espanola Hydro's and North Bay Hydro's accounting policies, and then seek disposition of the deferral account at a later time.

OEB staff submitted that the first option would be the most efficient from an administrative standpoint as it would eliminate the need to track revenue requirement variances between two sets of accounting policies. In addition, the first option would eliminate the need for the Applicant to establish a deferral account and request disposition of the deferral account at a later date.

[79] Response to Interrogatory OEB Staff-6

In the Applicant's reply submission, it highlighted that it had undertaken initial steps to review the accounting policies of Espanola Hydro and North Bay Hydro. From the initial review, the Applicant submitted that the bulk of Espanola Hydro's and North Bay Hydro's accounting policies are very comparable and there does not seem to be any material difference.[80] Further, the Applicant noted that if there are material differences in underlying accounting policies, it does not object to either of the two options submitted by OEB staff. However, the Applicant proposed that, rather than creating a new, and potentially unnecessary, deferral account now, it would be willing to conduct further analysis of the accounting policies following approval of the Phase 1 transaction. The Applicant submitted that after completion of the further analysis, it would be able to come forward with a more detailed proposal as part of New Espanola Hydro's cost of service application (i.e., before the Phase 2 transaction).[81]

Findings

The OEB finds the proposal provided by the Applicant in its reply submission reasonable. The Applicant's preliminary review has not identified material differences in the underlying accounting policies between North Bay Hydro and Espanola Hydro. The Applicant is ordered to complete its analysis of accounting policies and bring forward a detailed proposal as part of its cost of service rate application.

[80] Applicant Reply Submission, pp. 16-17
[81] Applicant Reply Submission, p. 17

5 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. North Bay (Espanola) Acquisition Inc. is granted leave to acquire 100% of the issued and outstanding shares of Espanola Regional Hydro Holdings Corporation and 100% of the special shares of Espanola Regional Hydro Distribution Corporation.

2. North Bay (Espanola) Acquisition Inc. is granted leave to amalgamate with Espanola Regional Hydro Holdings Corporation and Espanola Regional Hydro Distribution Corporation into the New Espanola Hydro.

3. The leave granted in paragraphs 1 and 2 above shall expire 18 months from the date of this Decision and Order.

4. North Bay (Espanola) Acquisition Inc. shall promptly notify the OEB of the completion of the transactions referred to in paragraphs 1 and 2 above.

5. North Bay (Espanola) Acquisition Inc. shall complete its analysis of accounting policies, as described in this Decision, and bring forward a detailed proposal as part of Espanola Regional Hydro Distribution Corporation's cost of service rate application.

6. The School Energy Coalition and Mr. Donald Rennick shall file with the OEB and forward to North Bay (Espanola) Acquisition Inc. their respective cost claims no later than **August 29, 2019**.

7. North Bay (Espanola) Acquisition Inc. shall file with the OEB and forward to the School Energy Coalition and Mr. Donald Rennick any objections to the claimed costs of the School Energy Coalition and Mr. Donald Rennick by **September 9, 2019**.

8. The School Energy Coalition and Mr. Donald Rennick shall file with the OEB and forward to North Bay (Espanola) Acquisition Inc. any responses to any objections for their cost claims by **September 16, 2019**.

9. North Bay (Espanola) Acquisition Inc. shall pay the OEB's costs of, and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

DATED at Toronto August 22, 2019

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary

SCHEDULE A

DECISION AND ORDER

NORTH BAY (ESPANOLA) ACQUISITION INC.

EB-2019-0015

AUGUST 22, 2019

Figure 1: Existing North Bay Hydro ownership structure

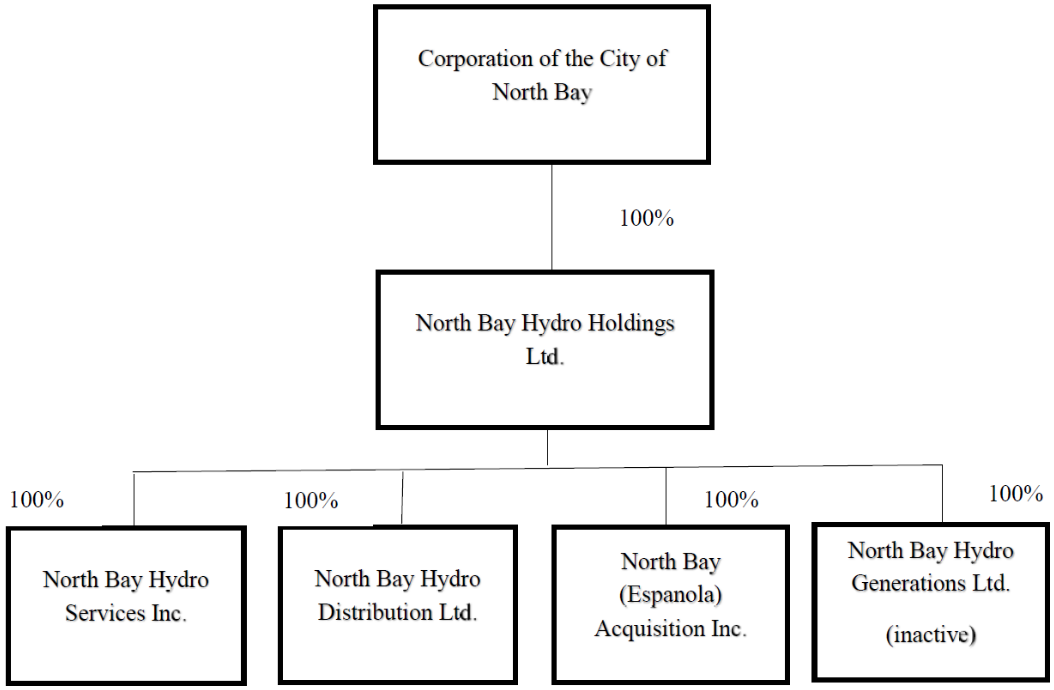

Figure 2: Existing Espanola Hydro ownership structure

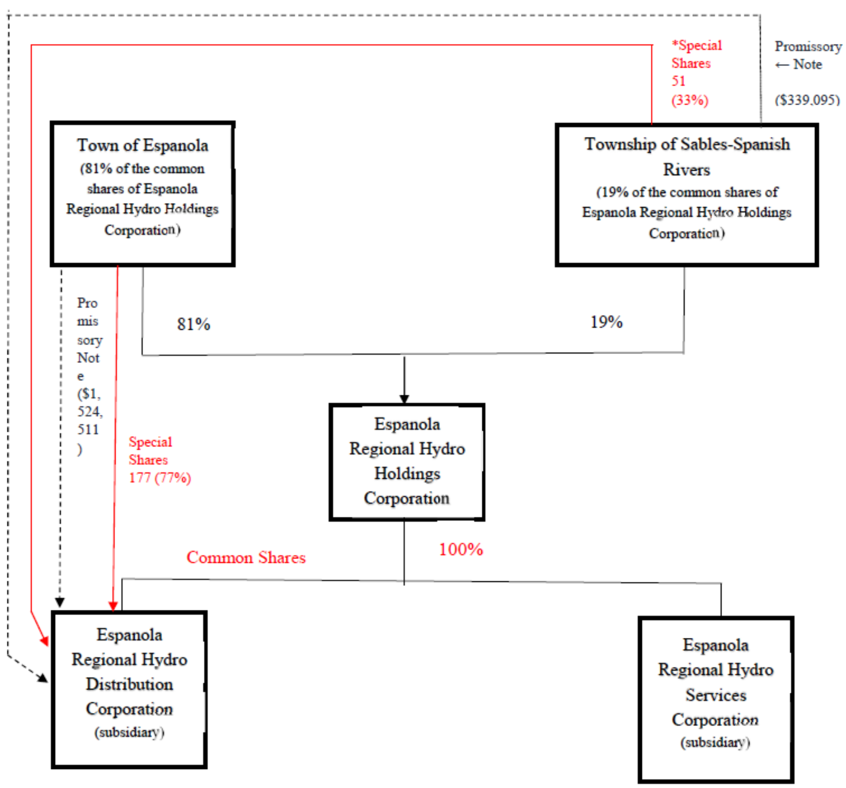

Figure 3: Corporate ownership structure upon the closing date of the Phase 1 transaction.

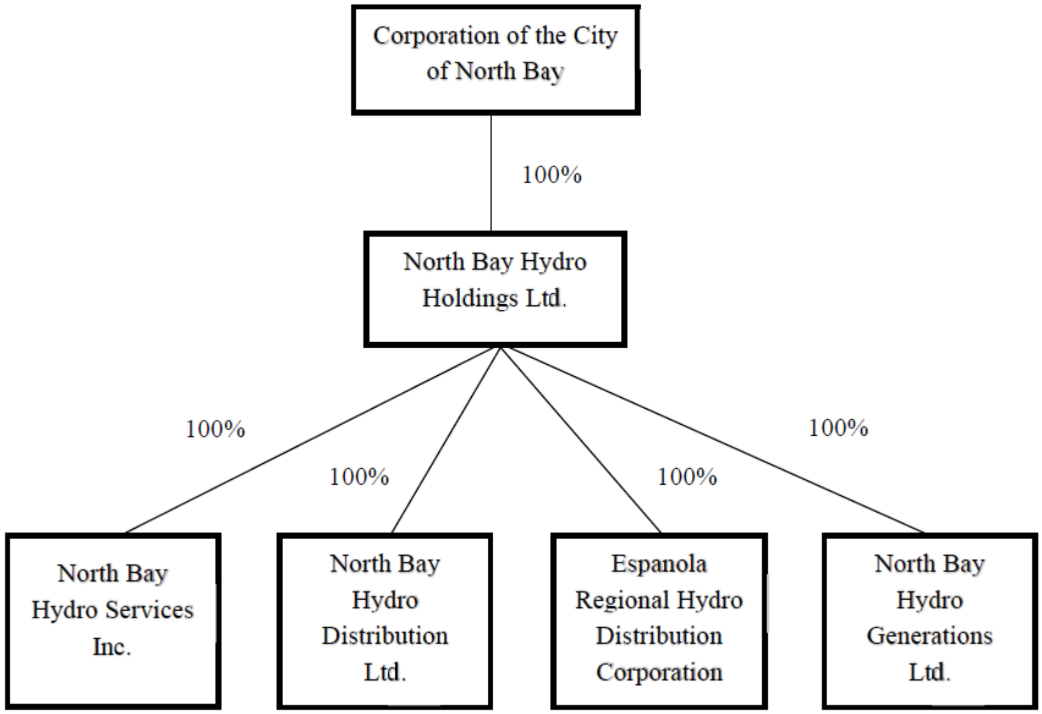

Figure 4: Corporate ownership structure upon the completion of the Phase 2 transaction.