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By electronic filing

May 5, 2014

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
27th floor
Toronto, ON M4P 1E4

Dear Ms. Walli,

Review of the Board's Policies and Processes to Facilitate Electricity Distributor Efficiency: Service Area Amendments and Rate-Making Associated with Distributor Consolidation
Board File No.: EB-2014-0138
Our File No.: 339583-000150

Please consider this correspondence as the comments by Canadian Manufacturers & Exporters ("CME") with respect to the potential changes that the Board may make to its policies related to service area amendments ("SAA") and ratemaking associated with merger, amalgamation, acquisition and divestiture ("MAAD") transactions.

Service Area Amendments

The principles and policies currently applied by the Board in considering SAAs are set out in the February 2004 Decision with Reasons (RP-2003-0044) (hereinafter referred to as the "Combined Proceeding").

As recognized by Board Staff, the majority of SAA applications since the Combined Proceeding have been uncontested. These uncontested applications have generally involved new subdivisions that need immediate connection in circumstances where the applicant distributor has the capacity to provide the service and the incumbent distributor does not. In such circumstances, the existing policies and procedures have been sufficient.

By contrast, contested SAA applications have generally only arisen in circumstances where the prospective customer is located in a portion of the incumbent distributor service area where service is not currently provided by that distributor (an "Unserviced Area"). During the previous consultations, a number of distributors expressed the view that the Board's current SAA policy gives preference to the incumbent distributor and questions why this should be the case in relation to Unserviced Areas. These concerns were described by Navigant Consultant Inc. in the *Electricity Distribution Efficiency Summary of Consultation Process* as follows:

> A number of distributors also expressed concerns over rules around service area amendments. Distributors see opportunities to increase scale through growing to serve all end-use customers within the boundaries of the municipalities they serve. A number expressed concerns that the current practice treats HONI as the incumbent supplier of customers even in cases where the area being developed is currently not serviced but lies within the municipality served by the distributor. Service area amendments were also raised as an issue with respect to long term load transfers. Several distributors commented that the requirement to eliminate long term load transfers is resulting in inefficient service arrangements in some situations.

CME questions why an incumbent distributor should be assigned to an Unserviced Area on the basis of geography, rather than on the basis of the distributor's ability to provide service in the area in the most economically efficient manner. For the reasons set out below, the more efficient approach to determining how best to service an Unserviced Area would be the approach described by Board Staff as "open for competition".

In the Combined Proceeding, the Board recognized that economic efficiency is of primary consideration in assessing an SAA application. As a starting point, CME urges the Board to conclude that, regardless of the modifications made to the existing principles and policy arising from the Combined Proceeding, economic efficiency remain a primary consideration.

In assessing the economic efficiency of the SAA, the Board should consider all related elements including the cost impact on the existing customers of the incumbent distributor and on the existing customers of the applicant distributor, the costs on the customers within the Unserviced Area, and whether it is appropriate to extend the SAA to include existing customers where they are near a boundary that is being amended for the purpose of serving new customers. Such an analysis will necessitate a balancing of interests by the Board. At the Stakeholder Meeting of February 27, 2013 (EB-2012-0397), Mr. Cohen of HONI described this balancing process as follows:

> One of the things we always have to remember: To the extent that one utility loses customers, the rates of their existing customer base are going up. So anything to do with service area amendments is going to be a balancing act. Where SAA amendments have made sense in the past, Hydro One has certainly consented to SAAs and in other cases they have not. It is just a case of what is in the best interests of the consumers at the end of the day, of both the utilities, that makes sense.

CME questions whether placing the onus on applicant distributors to displace the assumption that the incumbent distributor should service an Unserviced Area will necessarily result in an assignment that is in the best interests of the consumers of both utilities.

In undertaking an "open for competition" SAA assessment, a primary focus should be on the costs that will result on all consumers. This includes the existing customers of the applicant and incumbent distributors, as well as the new customers in the Unserviced Area.

The Board should also consider whether rationalization would result in improving the efficient use of distribution assets since the distribution costs, including capital costs, operating maintenance costs and settlement costs with IESO could potentially decrease as a result of fewer wholesale metering points, fewer substations and the reduction of non-distribution assets. In so doing, the Board could assess whether optimization of existing and future distribution assets could be achieved.

To be clear, the Board should assess all costs and benefits that can arise from an expansion into an Unserviced Area (for both the incumbent distributor and the non-incumbent distributor), as well as other benefits that could arise from such an expansion, including efficiencies that may flow from the supply and costs related to transmission and IESO.

Such an "open for competition" approach would permit the Board to ensure that all prospective new customers receive an offer to connect on fair and reasonable terms. The elimination of the existing onus on applicant distributors to displace the incumbent distributor would also permit the Board to fully consider and balance the interests of both applicant and incumbent distributors and their respective ratepayers.

Board staff has also asked intervenors to comment on whether the Board's SAA policy should facilitate SAAs that have the effect of aligning a distributor service area with municipal planning boundaries. CME submits that the alignment of a distributor's service area with municipal planning boundaries should be a secondary consideration. Alignment between a distributor service area and municipal planning boundaries should not be undertaken if the overall effect is to unnecessarily increase the overall costs for ratepayers.

Merger, Amalgamation, Acquisition and Divestiture Transactions

CME supports undertakings that result in efficiency improvements and cost savings in the electricity sector. Consolidation among distributors can be a positive occurrence when it results in operating cost reductions, as well as a reduction in the cost of borrowing.

At page 13 of the Staff Discussion Paper, Board Staff accurately sets out the concerns of ratepayers with respect to MAAD transactions. CME reiterates its view that efficiency improvements and cost savings that result from a MAAD transaction should be shared equitably between the ratepayers of the distributors involved and the distributors' shareholders. While distributors should recover the transaction costs, efficiency improvements and cost savings that result from economies of scale should not represent a shareholder windfall. It is within this context that CME addresses the questions asked by Board Staff beginning at page 15 of the Staff Discussion Paper.

First, CME is concerned that allowing a consolidated entity to set its own rebasing deferral period may not benefit consumers. As described by Board Staff, a distributor able to cut costs could delay rebasing to keep its savings while a distributor who experiences higher costs could rebase immediately in order to pass those incremental costs on to ratepayers. To this end, if the Board permits consolidated entities to set their own rebasing deferral period, CME then urges the Board to establish a ratepayer protection mechanism that will provide for and ensure a sharing of cost reductions.

Second, CME believes that the consolidated entity should be required to elect its rebasing deferral period at the time of the MAAD application. This is a requirement under the 2007 policy which CME sees no reason to alter. Moreover, the extent to which cost efficiencies will be achieved and the manner in which those efficiencies will be shared with ratepayers is something that the Board should consider during the MAAD application.

Third, Board Staff has asked whether a consolidated entity that has proposed a rebasing deferral period should be required to wait for the entire period before applying for a rebasing of its rates. While in the majority of situations consolidated entities should wait for the entire period before applying for a rebasing of its rates, CME appreciates that there may be unique circumstances which warrant early rebasing. In this regard, the Board may wish to allow for such situations but only where the consolidated entity can demonstrate a material change in circumstances that justifies early rebasing.

Finally, Board Staff has considered how rates should be set for consolidated entities that are currently on Custom IR. In particular, Board Staff have raised the possibility of using a modified ICM to address the recovery of capital investments during any rebasing deferral period. In considering the options set out by Board Staff, CME urges the Board to also consider introducing a ratepayer protection mechanism that will expressly provide for an equitable sharing of the cost savings. Such a mechanism would ensure that the consolidated entity appropriately recovers transaction costs while ratepayers appropriately receive a portion of the cost savings for a pre-established period of time.

Yours very truly,

per Vincent J. DeRose
VJD/kt

c. Paul Clipsham and Ian Shaw (CME)
All Interested Parties

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