May 5, 2014

Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street
P.O. Box 2319
Toronto, Ontario
M4P 1E4

Dear Ms. Walli:

Re: EB-2014-0138 – Service Area Amendments and Rate-Making Associated with Distributor Consolidation

On February 11, 2013, the Ontario Energy Board ("Board") issued a letter announcing an initiative to assess how the Board's regulatory requirements for electricity local distribution companies ("LDCs") may affect the ability of distributors to realize operational or organizational efficiencies. The Board held a stakeholder meeting on February 27, 2013, to discuss a number of issues related to distributor efficiencies and to review a Report by Navigant Consulting Ltd, entitled "Electricity Distribution Efficiency". The Report was the product of a consultation process undertaken by Navigant.

On November 4, 2013, the Board indicated its intent to proceed with a further review of two of its policies – service area amendments and rate-making policies associated with distributor consolidation. On March 31, 2014, the Board posted a Discussion Paper prepared by Board Staff, which addresses these two issues. The Board is seeking comments from stakeholders on the Board Staff Report. These are the comments of the Consumers Council of Canada. The Council is providing some relatively high level comments on these issues at this time. To the extent the Board decides to change its policies regarding these two issues, the Council would support further consultation regarding how these new or revised policies would be put in place (i.e. criteria, filing requirements, changes to legislation etc.).

Service Area Amendments:

Each LDC in the Province is authorized to distribute electricity within the geographic area described in its licence. Each service area has an "Incumbent Distributor". Board Staff has referred to distributors seeking to serve customers outside of its licences service area as "Applicant Distributors". The Board is reviewing its policies regarding applications by Applicant Distributors to obtain service area amendments (SSAs), allowing them to serve customers outside of their service areas.

The current principles and policies were determined through a combined proceeding that was held to consider nine separate SSA applications (RP-2003-0044). In it Decision, the Board noted that economic efficiency should be a primary consideration in assessing an SSA. The Board concluded that SSA should not be resisted where the Applicant Distributor is clearly the most efficient service provider for the prospective customer.

In that Decision the Board also concluded that SAA proposals to align service areas with municipal boundaries are ill-considered unless the Applicant Distributor can provide concrete evidence that the extended area is needed to provide service to actual customers in the area using assets and capacity in a

manner that optimizes existing distribution assets, and does not prejudice existing customers of the Applicant Distributor.

As noted by Board Staff in its Discussion Paper, most of the SSA applications that have come before the Board have been uncontested. They have also resulted in the resolution of many long-term load transfers. The contested applications have arisen in cases where the prospective customer is located in a portion of the Incumbent Distributor's service area where there is no service. These cases dealing with "un-serviced areas" have involved new service to new customers and have been generally approved.

The Council submits that it is not clear as to whether or not the current policy and principles that are applied when considering the SSAs should change. Economic efficiency is currently the primary consideration used in assessing SSAs and should continue to be going forward. It clearly makes sense to allow for SSAs when the Applicant Distributor can demonstrate that it can serve the customer or customers more cost effectively than the Incumbent Distributor. When considering economic efficiency the Board should consider what is in the best interests of the new customers, the customers of the Incumbent Distributor and the customers of the Applicant Distributor. The costs and benefits of the proposed transaction have to be carefully assessed. The Council agrees that the Board should, when assessing SSAs, also look at efficiencies of the overall electricity sector, which may include potential impacts on transmission.

Board Staff has sought input regarding an "open for competition" approach to un-serviced areas. The Council would not be opposed to such an approach as long as there was an assurance that customers in those areas would be served in the most economic way possible.

Board Staff also asked whether or not the Board's policy should facilitate SSAs that have the effect of aligning a distributor's service area with municipal planning boundaries and if so, in what way. The Council submits that aligning an LDC's service area with its municipal boundaries should only be encouraged if it results in increased economic and efficient distribution for ratepayers.

Rate-setting Associated with Distributor Consolidation:

Under current Board policy when a distributor applies for approval of a MADDs transaction it may propose to defer the rebasing of its rates of the consolidated entity for up to five years from the date of the closing of the transaction. The purpose of the policy is to allow the net savings of a consolidation to accrue to the distributor's shareholder for an extended period. This gives the LDC an opportunity to offset the transaction costs incurred (out of pocket costs, acquisition premiums and restructuring costs). The LDCs have expressed a view that the risk of not recovering the transaction costs is a significant impediment to consolidation.

The Council accepts that in LDC consolidations there is an important balance that needs to be addressed. The Board's policies should not discourage consolidation when it will ultimately benefit ratepayers, and result in a more economic and efficient distribution sector. However, the shareholders should not be afforded a windfall at the expense of the ratepayers. The very point of consolidation is to benefit ratepayers and the Board should ensure its MADDs policies maintain this as the primary objective.

As was noted in the consultation, under the current policy a distributor able to reduce its costs can delay rebasing and keep the savings, but a distributor who might experience higher costs could rebase immediately passing those costs on to ratepayers.

The Council is not opposed to allowing a consolidated entity to choose its rebasing deferral period. Depending upon a wide range of factors (transactions costs, age of infrastructure, geography, asset conditions etc.) each utility will be different. It will be incumbent, however, for the new entity to provide a justification for its choice at the time the transaction is being considered by the Board. This would require a forecast of transaction costs and a forecast of projected savings expected to occur before rebasing.

In order to ensure the interests of ratepayers are protected the Council supports the establishment of a deferral account to record actual savings during the period prior to rebasing. To the extent those savings are greater than forecast, or the transaction costs less, the net benefits should be shared with ratepayers upon rebasing. This gives the LDC time to recover its transaction costs, but also ensures that the shareholders are not subject to a windfall to which they are not entitled. Again, the objective of consolidation is to create efficiencies in distribution operations that ultimately benefit the ratepayers of the new entity.

Board Staff has asked the question as to whether once a consolidated entity has proposed a deferral period, should it be required to wait for the entire period before rebasing. The Council submits that this should be considered on a case-by-case basis. There may be circumstances where an early rebasing is required. The Board can consider the evidence at the time the request is made.

With respect to the question regarding distributors on a Custom IR plan at the time of consolidation, the Council submits that, as a part of its Custom IR application, each LDC should be required, in evidence, to address issues around potential consolidation. Given we do not know how those plans are going to be structured it would be premature, now, to prescribe what would happen from a ratemaking perspective, if those LDCs were involved in consolidations.

Board Staff has suggested that merged LDCs apply a price cap with a modified incremental capital module ("ICM") (encompassing normal capital) to set rates during the deferral period. The Council is not clear how this approach would work and accordingly cannot comment, at this time, on the merits or risks of such an approach.

Overall, the Council submits that it is timely for the Board to consider a broader review of its MADDs policies. Distributor consolidation has not been occurring in any great strides despite the fact that opportunities for efficiencies do exist. Hydro One Inc. has become dominant in terms of acquisitions, without its broader policies regarding consolidation clearly articulated. There seem to be barriers to consolidation that the Board needs to better understand and potentially address.

Yours truly,

Julie E. Girvan

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CC: Ken Whitehurst, Consumers Council of Canada