May 5, 2014

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto, ON M4P 1E4

Via web portal and by post

Dear Ms. Walli:

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

The Electricity Distributors Association (EDA) is the voice of Ontario's local distribution companies (LDCs). The EDA represents the interests of 75 publicly and privately owned LDCs in Ontario.

The EDA welcomes the opportunity to provide input on the Board's review of policies to facilitate electricity distributor efficiency through amendments to policies on service area amendments and rate-making associated with distributor consolidation.

The EDA's submission offers preliminary comments given the early stages of the OEB's consultation and the fact that further details are needed for the industry to develop a comprehensive response.

Sincerely,

"Original Signed"

Teresa Sarkesian
Vice President, Policy and Government Affairs

Attached:/submission

Electricity Distributors Association
3700 Steeles Ave. W., Suite 1100, Vaughan, Ontario L4L 8K8 Tel 905.265.5300 1.800.668.9979 Fax 905.265.5301 email@eda-on.ca www.eda-on.ca

Service Area Amendments

The EDA acknowledges that the review of service area amendments is integral to the new requirements under the RRFE for distributors to be involved in regional planning, to integrate the regional plan with the distributor's planning processes, and to improve operational effectiveness. The current service area amendment process under review may also be made more efficient.

As noted in the Board staff's discussion paper of March 31, 2014, the service area amendment policies were established in the February 2004 Decision with Reasons. At that time, the Board noted that it chose a middle course where it issued licences with non-overlapping service areas, but would receive and consider applications for service area amendments that promote optimal use of distribution resources and overall economic efficiency. Subject to the proposed connection being in the public interest, customers will be able to exercise a choice of distributor.

The Board had noted that in its consideration of the economic efficiency of any given amendment proposal, an important factor will be the extent to which a proposal builds upon existing, well-developed electricity distribution assets from high or medium density systems. The Board noted that this will likely favour proposals that represent the extension of an existing local distribution system into a contiguous area. In general, the decisions on the service area amendment applications (SAA) filed since 2004 have been consistent with this direction. At issue is the current process under contested applications, where the applicant distributor must make the case that the service area amendment is in the public interest.

The EDA would like to raise the following concerns with the current process:

1. Distributors have noted that because "time is money" for developers, developers may feel pressure to accept the initial incumbent offer rather than wait for the decision on the applicant distributor proceeding.
2. The process may unintentionally give the incumbent distributor the incentive to further delay the proceedings in order to put additional pressure on developers to sign the connection offers before the applicant distributor's SAA application is decided. The EDA believes this could be curtailed by expediting the process, for example, by setting timeline~~s~~ for the review of SAA applications and in addition, setting a timeline such as 60 days for the applicant distributor to provide a responding Offer to Connect. It may be further expedited by providing greater delegation to OEB staff to review the applications.
3. Proceeding delays may be caused when Offers to Connect by the proponents are not comparable. When the incumbent and applicant distributors both are required to give Offers to Connect, the costs included in the offers should be comparable as far as possible. This could be achieved by defining the costs to be included (e.g., should distribution losses be included?) and the basis for calculating the costs (e.g., should the time horizon be 25 years?). We note that an initial Offer to Connect may offer to provide different service levels such as higher reliability through redundant lines or underground connections. At a minimum, customers should be required to indicate the level of service desired to facilitate comparability between Offers to Connect where more than one distributor is involved.

In 2004 many distributors argued that aligning the service areas with municipal boundaries advances distribution system planning. The 2004 Decision argued that because distributors would be pursuing efficiencies through continuing consolidation, any alignment of service areas to specific municipalities would become increasingly irrelevant. Although there has been considerable consolidation, many distributors today are still seeking to align their service territories with municipal boundaries. This has been further supported by the need to carry out regional plans with local government.

Conceptually, the regional planning process may serve as a reasonable framework to addressing service area amendments. Once further details are known about the regional planning exercises in practice rather than in theory we will be able to provide a more comprehensive response. Where distributors are identified in municipal and regional long term plans as the provider of facilities, they may be treated as the pending incumbent distributor. As the pending incumbent in this situation, they would seek an expedited SAA for areas where new facilities are required and would make the initial Offer to Connect. Distributors need a better understanding of their role in future planning in order to carry out integrated long term planning which involves establishing corridors for future lines and making trade-offs among local generation, local load control, and new facilities.

Board Staff Questions

Question: *What are the benefits of an "open for competition" approach to un-serviced areas? How would the Board implement such an approach in light of section 28 of the Electricity Act, 1998 and existing licence conditions? Under an "open for competition" approach: (i) how will the Board ensure that all prospective new customers will receive an offer to connect on fair and reasonable terms; and (ii) how should the interests of Incumbent Distributors and their ratepayers be taken into consideration?*

The EDA questions how the "open for competition" approach would work in practice. Definitions for 'end-use customer' and un-serviced area need to be developed. For example, is the end-use customer the developer or the customer, and will an un-serviced area within the incumbent distributor's service area be "open for competition"? An "open for competition" approach may unnecessarily complicate distributor system planning and delay the SAA process. Distributors are interested in serving growth near their own current borders in order to have smooth, contiguous, well-defined boundaries which will facilitate future planning processes. Where growth occurs in the areas contiguous to existing urbanized zones currently served by well-developed electricity distribution systems, the distributors may be considered as the pending incumbent and the SAA could be expedited.

Question: *Should the Board's SAA policy facilitate SAAs that have the effect of aligning a distributor's service area with municipal planning boundaries and, if so, in what way? What are the benefits and risks of such an approach for Incumbent Distributors, Applicant Distributors and their respective ratepayers? What role should municipal planning, community energy plans and regional planning have in the SAA process?*

As noted above distributors believe they may be treated as the pending incumbent distributor for the new facilities in local long term plans where they are identified in municipal and regional long term plans as the provider of facilities in the plan. The benefit is clarity in their role in future planning which will promote a more unified, timely and cost-effective municipal and regional infrastructure plan.

Question: *For either proposed change to the Board's current policy: (i) How should the Board approach its analysis? (ii) What criteria should be used by the Board and what type of evidence would be necessary? (iii) How can the Board ensure that the proposed change would not adversely affect overall economic efficiency in the sector? (iv) How should the Board assess the impact on existing and future customers in terms of cost and the reliability and quality of electricity service? (v) How can the Board be satisfied that the process will ensure that the connection of new customers proceeds in a timely manner?*

For new growth which is included in regional plans and in the distributor's system planning, the OEB may treat the distributor as the pending incumbent who will have the ability to make the initial connection offer following an expedited SAA. The applicant incumbent would have the option to provide an alternative offer and make the case for the competing offer.

Overall efficiency may be improved as this approach may facilitate new connections that are reasonably contiguous to existing, well-developed electricity distribution systems. Efficiency would also be achieved in reducing the number of proceedings for contested applications.

Rate Setting Associated with MAADs

Duration of the deferral period for rebasing after a MAADs transaction

The risk of not being able to recover the costs of a MAAD transaction is a significant impediment for distributors' shareholders to consider a consolidation initiative. It is therefore essential to provide a reasonable opportunity to offset the costs of a MAAD transaction as a prerequisite for distributors to consider the merits of a consolidation initiative.

A main incentive for distributors to engage in a consolidation is the expectation that their share of efficiency savings will exceed the costs. The shareholders of consolidating distributors expect that they will be able to retain the efficiency savings for some time before being passed on to ratepayers in the form of lower rates to the extent that these savings exceed transaction, transition and integration costs.

Specifically, in the case of acquisitions, the shareholders of a selling LDC will usually require some strong commitments from the purchasing utility to provide a local presence in their community and to provide job guarantees. As a result, many of the staff changes or reductions are expected to occur as a part of normal attrition resulting in more time to "right size" the selling LDC. In addition, labour costs may escalate at the time of consolidation due to different unions in the consolidating utilities.

Once the acquisition transaction is complete and the companies are consolidated, the newly formed company goes through a transition period during which operational and financial systems are consolidated. The transaction costs associated with a consolidation, such as integrating customer information systems, fleet operations and severance packages for employees, lead to an increase in overall costs of the combined entity in the short term. The process of technical, financial and cultural integration of the two companies will cost money and is usually time consuming and difficult.

Financial benefits of consolidation can normally be expected after two or more years from the date the consolidation is executed. Larger transactions will require more time to produce synergies.

With acquisitions, there is considerable risk to the purchasing distributor. The efficiency savings from consolidation are not certain, may be lower or may be achieved later than expected. Operational savings start at low levels and generally increase over time to reach a "steady state" seven to ten years following consolidation.

Given the nature and timing of these costs and savings, annual net financial benefits (operational savings less transition/integration costs) are likely to be negative during the first two to four years following consolidation. The level of costs and savings and their respective timing, will vary by transaction but in general, it is expected to take four to six years to reach a break-even point when the cumulative savings exceed the cumulative transition/integration costs.

Any purchase premiums provided by the purchaser to the seller, in order to secure the deal, represent an additional cost and will further delay the "break even" point when the purchaser's share of cumulative savings exceed their overall costs.

In view of the above, distributors should be given the option of choosing when to rebase, within 10 years of the consolidation transaction. If within that timeframe the Regulated Rate of Return threshold test of 300 basis points for the consolidated entity is exceeded, rebasing could be required earlier.

Mechanism to reflect capital investments in rates during the rebasing deferral period

The longer period between rebasing after a consolidation means the merging distributors could have a challenge in financing capital expenditures during the deferral period as the Board does not permit the recovery of capital expenditures during the period. Disallowing the recovery of capital expenditures during the deferral period works as a disincentive to consolidation in the sector.

Currently, the distributors that have chosen the Price Cap rate setting methodology can potentially apply for an Incremental Capital Module (ICM) to incorporate extraordinary capital expenditures in rates between rebasing periods, while distributors who chose one of the other two rate setting options (i.e., Custom IR or Annual IR Index) do not have access to the ICM.

We recommend that the eligibility criteria for the ICM be expanded to include normal capital investments between the rebasing periods after a MAAD transaction and to allow merged distributors the use of the same ICM model during a deferral period, no matter their choice of rate setting methodology.

Board Staff Questions

Question: *What are the merits and risks of allowing a consolidated entity to set its own rebasing deferral period? Should the Board establish a "default" minimum deferral period and, if so, what should the length of that deferral period be?*

The Board should establish a "default" minimum deferral period of up to 10 years as opposed to the current 5 year period. As explained above, the 5 year period is not sufficient to recover the transaction, integration and transition costs of a MAAD transaction and therefore acts a disincentive to shareholders considering a MAAD transaction.

The amount of costs and savings of a MAAD transaction and their respective timings vary by each transaction and it is therefore difficult to quantify or generalize them for the industry as a whole. It is recommended that a deferral period of up to 10 years be established with the expectation that the merged utility would rebase within the 10 year time frame depending on its own experience with costs and savings.

Question: *Should the consolidated entity be required to elect its rebasing deferral period at the time of the MAADs application (as is the case under the 2007 Policy), or should the entity be allowed to address* *this at a later date and, if so, when? What information should a consolidated entity provide to support its proposed rebasing deferral period?*

The prospective merging utilities should not be required to elect their rebasing deferral period at the time of the MAADs application because the efficiency savings and the merger costs are not certain at that point in time. Further, the savings may be lower, or may be achieved later than expected. The operational savings start at low levels and generally increase over time to reach a "steady state" some seven to ten years following consolidation. Therefore, the consolidated distributors should be allowed up to 10 years for rebasing with the expectation that the consolidated entity would elect to rebase any time during the period depending on its experience.

Question: *Once a consolidated entity has proposed a rebasing deferral period, should it be required to wait for the entire period before applying for a rebasing of its rates, or should it be allowed to apply for rebasing at any time within the proposed period? What are the merits and risks of each approach?*

As explained above, the consolidated distributors should not be expected to propose the rebasing deferral period at the time of the MAADs application as the merger costs and the estimated efficiency savings are not certain at that point in time.

Question: *In the case of a distributor that is on Custom IR at the time of consolidation, how should its rates be set for the duration of the rebasing deferral period following completion of the Custom IR period?*

The distributor that is on Custom IR at the time of consolidation should be allowed to choose either the Price Cap option or the Annual Index IR option once its Custom IR period is complete until rebasing of the consolidated entity.

Question: *What are the merits and risks of the suggestion that a newly consolidated entity apply for new rates under the Custom IR option that recognize both costs and projected efficiency savings, (e.g. an efficiency carryover to allow the distributor to recoup transaction costs)? Is this complimentary to or a substitute for an approach that allows the deferral of rebasing?*

The newly consolidated entity would not be in a position to apply for new rates under the Custom IR option as the costs and savings of the MADD transaction are not certain at the time of MAAD application. Once the MAAD transaction is approved by the Board and the companies are consolidated, the newly formed company goes through a transition period during which operational and financial systems are consolidated.

The transaction costs associated with a consolidation, such as integrating customer information systems, fleet operations, and severance packages for employees, lead to an increase in overall costs of the consolidated entity in the short term. The process of technical, financial and cultural integration of the two companies will cost money and is usually time consuming and difficult. Therefore, it is not appropriate for the consolidating distributors to apply for new rates under the Custom IR option immediately following the MAAD transaction due to the uncertainty.

Question: *What are the merits and risks of using a modified ICM (which allows broader eligibility of expenditures) to address the recovery of capital investments during any rebasing deferral period? How* *should the Board evaluate an ICM request under this scenario to ensure that any financing is for investments that are incremental to the capital amount built into rates?*

Since disallowing the recovery of capital expenditures during the rebasing deferral period works as a disincentive to consolidation in the distribution sector, consolidating distributors under any of the three rate setting methodologies should be permitted to use a modified ICM model during the deferral period for rebasing. All incremental capital expenditures by the consolidated entity (i.e., capital expenditures that are over and above what is already embedded in the rates), should be recoverable through rates by making an ICM application to the Board.