

**Ontario Energy
OEB**
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4
Telephone: 416- 481-1967
Facsimile: 416- 440-7656
Toll free: 1-888-632-6273

**Commission de l'énergie
de l'Ontario**
C.P. 2319
27e étage
2300, rue Yonge
Toronto ON M4P 1E4
Téléphone: 416- 481-1967
Télécopieur: 416- 440-7656
Numéro sans frais: 1-888-632-6273



BY E-MAIL

November 30, 2017

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

Dear Ms. Walli:

**RE: OEB STAFF SUBMISSION
APPLICATION FOR APPROVALS TO EFFECT THE AMALGAMATION
OF ENTEGRUS POWERLINES INC. AND ST. THOMAS ENERGY INC.
EB-2017-0212**

In accordance with the OEB's directions, please find attached OEB staff's submission with respect to the above referenced application.

Yours truly,

Original Signed by

Judith Fernandes
Project Advisor
Applications Division

Attachment



ONTARIO ENERGY BOARD

OEB Staff Submission

EB-2017-0212

November 30, 2017

1 INTRODUCTION

Entegrus Powerlines Inc. (Entegrus Powerlines) and St. Thomas Energy Inc. (St. Thomas Energy) (collectively, the applicants) filed an application with the Ontario Energy Board (OEB) on July 21, 2017 under section 86 of the Ontario Energy Board Act, 1998, S.O. 1998, c. 15, (Schedule B) (the Act) seeking approval of the following:

- Amalgamation of St. Thomas Energy with Ascent Group Inc. and to continue as STE Amalco
- Acquisition of all shares of STE Amalco by Entegrus Inc. from the City of St. Thomas in exchange for shares of Entegrus Inc.
- Amalgamation of Entegrus Powerlines and STE Amalco and to continue as Entegrus Powerlines

The applicants also seek approval to:

- Transfer St. Thomas Energy's rate order to Entegrus Powerlines, under section 18 of the Act
- Cancel St. Thomas Energy's electricity distribution licence, under section 77(5) of the Act
- Amend Entegrus Powerlines' electricity distribution licence, under section 74 of the Act
- Continue to track costs to the existing deferral and variance accounts

The applicants have selected an eight year deferred rebasing period. OEB approval is not required for the selected deferral period as the OEB's 2015 Report¹ permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction. The OEB's Handbook² clarified, however, that consolidating distributors are required to identify in their consolidation application the specific number of years for which they choose to defer as this will allow the OEB to assess any proposed departure from this stated plan.

¹ Report of the Board on Rate-making Associated with Distributor Consolidation, March 26, 2015

² Handbook to Electricity Distributor and Transmitter Consolidation, January 19, 2016

2 RELEVANT REGULATORY PRINCIPLES

2.1 The No Harm Test

In its assessment of applications relating to consolidation transactions, the OEB has applied the no harm test. The no harm test was first established by the OEB in 2005 in the Combined Decision³, and has been considered in detail in several OEB decisions. The Handbook confirmed that the OEB will continue to apply the no harm test.

The Handbook states that 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. The statutory objectives considered are those set out in section 1 of the Act. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

The OEB recognizes in the Handbook, that while it has broad statutory objectives, in applying the no harm test, the OEB has primarily focused its review on impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and the financial viability of the consolidating utilities.

2.2 OEB Policy on Rate-Making Associated with Consolidation

To encourage consolidations, the OEB has introduced policies that provide consolidating distributors with an opportunity to offset transaction costs with any achieved savings. As set out earlier, consolidating distributors are permitted to defer rebasing for up to ten years from the closing of the transaction but distributors must select a definitive timeframe for the deferred rebasing period. The Handbook sets out that when a consolidated entity has opted for a deferred rebasing period, it has committed to a plan based on the circumstances of the consolidation and that if the consolidated entity seeks to amend the deferred rebasing period, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interest of customers⁴.

The OEB requires consolidating entities that propose to defer rebasing beyond five years to implement an earnings sharing mechanism 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.

³ RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257

⁴ Handbook, p. 13

The Handbook sets out that rate-setting following a consolidation will not be addressed in an application for approval of a consolidation transaction unless there is a rate proposal that is an integral aspect of the consolidation, e.g. a temporary rate reduction. Rate-setting for a consolidated entity will be addressed in a separate rate application, in accordance with the rate setting policies established by the OEB.

3 SUBMISSIONS

3.1 The No Harm Test

OEB staff submits that the evidence in this proceeding reasonably demonstrates that the amalgamation of Entegrus Powerlines and St. Thomas Energy meets the no harm test.

Price, Economic Efficiency and Cost Effectiveness

The applicants identified a number of savings that will accrue from the transaction.

The applicants provided a comparison of the status quo versus post consolidation costs (OM&A and capital) over the ten year period (2017-2026) which reflects lower costs for the amalgamated entity. The applicants estimated annual OM&A cost savings of \$1.2M to \$1.4M and reductions in capital expenditures of \$0.2M to \$0.3M⁵.

The cost savings arise from reduced management and consulting fees, IT support costs, corporate governance costs, regulatory costs, and combined fleet purchasing, inventory/stock and line deployment efficiencies. These OM&A and capital savings translate into an approximate decrease of 3% - 4% of revenue requirement versus what it otherwise would have been at the end of the proposed deferred rebasing period.

The applicants submitted that projected savings, which translate into the decreased revenue requirement, include ongoing synergies as of 2026 that will persist beyond the proposed deferred rebasing period as well as economies of scale that the merged entity can realize due to its larger size.

The applicants also submitted that under the status quo, Entegrus Powerlines and St. Thomas Energy would have filed multiple rebasing applications during the deferred rebasing period and that as a result of the transaction, the ratepayer enjoys a period of distribution rate stability, including lower distribution rates throughout the eight year period than otherwise would have occurred⁶.

In OEB staff's view, comparing revenues under deferred rebasing relative to the rate-setting plans that the unmerged distributors would otherwise follow is not in itself a sufficient demonstration of savings and no harm. OEB staff believes that the savings that

⁵ Application, pp. 29-30

⁶ Application, pp. 22-23

are most relevant to demonstrating no harm are the estimated annual OM&A cost savings of \$1.2M to \$1.4M and reductions in capital expenditures of \$0.2M to \$0.3M although OEB staff notes that the degree of certainty regarding forecast savings diminishes over the length of the forecast period.

OEB staff submits that the evidence provided by the applicants supports the claim that the proposed amalgamation can reasonably be expected to result in cost savings and operational efficiencies.

Rates for the amalgamated entity during the deferral period are to be set under the Price Cap IR adjustment mechanism and will require the OEB's approval annually before they are implemented.

Service Quality and Reliability

The applicants are committed to the maintenance and improvement of service quality and reliability for customers. The applicants stated that existing operational centres will be maintained. The applicants will guarantee the employment of staff for a period of three years to ensure continuity of knowledge and experience⁷.

In response to OEB staff interrogatories⁸, the applicants confirmed that there are no plans to reduce local staff or to eliminate functions but that a redeployment of existing positions, particularly in billing and certain IT functions is expected to enhance customer service capabilities. The applicants anticipate the elimination of duplicative back office administrative support positions to occur through normal attrition. The applicants estimated cost savings from staff attrition of \$165K in 2018, increasing to \$311K in 2022 and remaining at this level for each of the years to 2026⁹.

The applicants expect to file a consolidated distribution system plan (DSP) in 2021, having had an opportunity to operate for a time and thereby identify and prioritize investments for a consolidated planning cycle. St. Thomas Energy filed a DSP with its 2015 Cost of Service application (EB-2014-0013) and Entegrus Powerlines recently filed a DSP with its 2016 Cost of Service application (EB-2015-0061).

The OEB 2015 Report states that despite the ability for consolidating entities to extend the rate re-basing period, all other regulatory requirements, including the requirement to file

⁷ Application, p. 24

⁸ OEB Staff Interrogatory 7

⁹ OEB Staff Interrogatory 8

DSPs every five years remain in effect. OEB staff notes that the filing of a consolidated DSP in 2021 would be six years after St. Thomas Energy filed its last DSP but accepts the proposal of the applicants for the reason noted above and given that a consolidated DSP will be filed in year six.

In response to interrogatories¹⁰ relating to Conditions of Service, the applicants identified the material differences in the Conditions of Service documents between the distributors. The applicants indicated that they intend to review differences between service areas soon after amalgamation is approved to determine the best practices to address the differences noted.

OEB staff submits that the consolidated entity should monitor customer issues regarding Conditions of Service and rate matters, particularly as they relate to differences between the legacy service areas and should be required to report on this at least once through the deferral period, perhaps in year 4. While this report is intended to address all customer issues that the consolidated entity believes are important to monitor, the spirit of this requirement is consistent with existing reporting requirements such as section 2.3.1 of the Electricity Reporting and Record Keeping Requirements¹¹ where the OEB may require reporting of customer complaint information. OEB staff also suggests that such report also document the applicants' status of the review and any harmonization or integration of Conditions of Service for the legacy service territories.

Based on the evidence and interrogatory responses provided, OEB staff submits that the amalgamated entity can meet service quality and reliability standards currently provided by each of the amalgamating distributors. OEB staff also submits that the OEB is able to monitor performance of the amalgamated entity through performance scorecards as well as the OEB's Electricity Reporting and Record Keeping Requirements (RRR).

Financial Viability

The application states that the consideration for the proposed transaction is non-cash, based on an exchange of shares between the parties and that valuation of the shares is based on fair market value of the consolidating distributors. The application also states that rate base of the consolidated entity will not be set to include the premium attributed to the value of the distributors through the transaction/share allotment.

¹⁰ OEB Staff Interrogatory 20

¹¹ Issued May 3, 2016

The applicants have confirmed that incremental transaction costs will be financed through productivity gains and are not to be included in the amalgamated entity's revenue requirement and will not be funded by ratepayers.

The applicants also provided pro-forma statements. In response to interrogatories¹², the applicants confirmed that Entegrus Powerlines management and St. Thomas Energy management both independently prepared 2018 forecasts on a status quo basis and that subsequently, the forecasts were consolidated and then transition costs and projected synergies for 2018 were factored into the consolidated proforma financial statements. The applicants also clarified that the transition costs will be financed through existing working capital until expected productivity gains materialize in 2018.

OEB staff submits that the applicants' evidence¹³ noted above demonstrates that no adverse impact on the applicants' financial viability is anticipated.

3.2 Rate-related Matters

Deferral of Rate Rebasing

The applicants have chosen to defer the rebasing of rates of the amalgamating utilities for eight years from the date of closing of the proposed transaction. During this time, the rates of Entegrus Powerlines and St. Thomas Energy will be set through the Price Cap IR adjustment mechanism.

OEB staff submits that the deferred rebasing period chosen by the applicants aligns with the OEB's policy regarding consolidations.

Earnings Sharing Mechanism

The applicants have proposed an ESM consistent with the 2015 Report whereby earnings in excess of 300 basis points above the OEB's established regulatory ROE for the consolidated entity would be shared on a 50:50 basis between the consolidated entity and its ratepayers.

The applicants submit that they will request approval for a new deferral account in a later rate application and that the ratepayer share of earnings will be credited to this account.

¹² OEB Staff Interrogatories 11 and 12

¹³ Application, pp. 31, 32

According to the application, the consolidated entity would begin reporting on the year 6 Regulated ROE outcome for ESM purposes commencing in year 7 post-merger (when audited results for year 6 become available). The ratepayer share of earnings will be credited to a newly proposed deferral account, for clearance at the next applicable annual IRM application filing. For example, if the consolidated entity earned above 300 basis points in year 6 post-merger, it would record 50% of the excess balance in the proposed deferral account, which would be disposed of for each rate zone as follows:

- St. Thomas Energy Rate Zone (Jan 1 rate year): over a 12 month period commencing on Jan 1 of year 8
- Entegrus Powerlines Rate Zone (May 1 rate year): over a 12 month period commencing on May 1 of year 8

OEB staff submits that the proposed ESM is consistent with the OEB's policy. The applicants have not provided details of how the ESM will be calculated. OEB staff notes that while this is not an explicit requirement for a consolidation application, it is expected that the consolidated entity will provide evidence in support of its detailed ESM proposal at the time any balance may be brought forward for disposition.

3.3 Other Requested Approvals

As part of the amalgamation proposed, the applicants have requested the OEB's approval to:

- Transfer St. Thomas Energy's rate order to Entegrus Powerlines
- Cancel St. Thomas Energy's electricity distribution licence and to amend Entegrus Powerlines' electricity distribution licence to enable Entegrus Powerlines to serve the customers of St. Thomas Energy
- Continue to track costs to the existing deferral and variance accounts

OEB staff supports the approval of these requests.

3.4 Conclusion

OEB staff submits that the evidence provided by the applicants reasonably demonstrates that the proposed transaction to effect the amalgamation of Entegrus Powerlines and St. Thomas Energy meets the no harm test.

All of which is respectfully submitted