



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

DECISION AND ORDER

EB-2017-0212

ENTEGRUS POWERLINES INC.

ST. THOMAS ENERGY INC.

Application for approvals to effect the amalgamation of Entegrus Powerlines Inc. and St. Thomas Energy Inc.

BEFORE: Ken Quesnelle
Presiding Member

Christine Long
Member

Cathy Spoel
Member

March 15, 2018

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1 INTRODUCTION AND SUMMARY

This is the Decision of the Ontario Energy Board (OEB) regarding an application filed by Entegrus Powerlines Inc. (Entegrus Powerlines) and St. Thomas Energy Inc. (St. Thomas Energy)(collectively, the applicants) requesting approval to amalgamate and to continue as Entegrus Powerlines.

As part of the application, additional approvals are requested to: (a) transfer St. Thomas Energy's rate order to Entegrus Powerlines; (b) cancel St. Thomas Energy's electricity distributor licence; (c) amend Entegrus Powerlines' electricity distributor licence; and (d) continue to track costs to the existing deferral and variance accounts.

Section 86 of the *Ontario Energy Board Act, 1998*¹(the Act) requires that the OEB review applications for a merger, acquisition of shares, divestiture or amalgamation that result in a change of ownership or control of an electricity transmitter or distributor and approve applications which are in the public interest.

The OEB has applied the no harm test in assessing this application, and has concluded that the proposed amalgamation meets that test. The OEB therefore approves the proposed transaction.

The OEB also approves the additional requests made by the applicants. These relate to the transfer of St. Thomas Energy's rate order to Entegrus Powerlines, the cancellation of St. Thomas Energy's electricity distributor licence and amendment of Entegrus Powerlines' electricity distributor licence.

The applicants are further permitted to continue to track costs to the existing deferral and variance accounts.

¹ S.O. 1998, c.15 Schedule B

2 THE APPLICATION

Entegrus Powerlines is a wholly-owned subsidiary of Entegrus Inc. (Entegrus), which is 90% owned by the Corporation of the Municipality of Chatham-Kent and 10% by Corix Energy Inc. St. Thomas Energy is a wholly-owned subsidiary of Ascent Group Inc. (Ascent), which is 100% owned by the Corporation of the City of St. Thomas.

The application filed by Entegrus Powerlines and St. Thomas Energy seeks approval under section 86 of the Act for the amalgamation of the two utilities through the following transactions:

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

The applicants have additionally requested the OEB's 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
- Permit the applicants to continue to track costs to the existing deferral and variance accounts

Process

The OEB issued a Notice of Application and Hearing on August 31, 2017, inviting intervention and comment. Capredoni Enterprises Ltd. (CEL) applied for intervenor status and eligibility for cost awards. The applicants objected to CEL's intervention

request. The OEB requested additional information from CEL but this was not forthcoming, and the OEB subsequently denied CEL's request for intervenor status and cost eligibility.

The OEB provided for interrogatories and submissions on the application.

3 REGULATORY PRINCIPLES

3.1 The No Harm Test

The OEB applies the no harm test in its assessment of consolidation applications.² 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. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

The statutory objectives to be considered are those set out in section 1 of the Act:

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.
- 3 To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario.
- 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.

While the OEB has broad statutory objectives, in applying the no harm test, the OEB has focused on the objectives that are of most direct relevance to the impact of the proposed transaction; namely, price, reliability and quality of electricity service to

² The OEB adopted the no harm test in a combined proceeding (RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257) as the relevant test for determining applications for leave to acquire shares or amalgamate under section 86 of the Act and it has been subsequently applied in applications for consolidation.

customers, and the cost effectiveness, economic efficiency and financial viability of the consolidating utilities.

The OEB considers this an appropriate approach, given the performance-based regulatory framework under which regulated entities are required to operate and the OEB's existing performance monitoring framework.

3.2 OEB Policy on Rate-Making Associated with Consolidation

To encourage consolidations, the OEB has put in place policies on rate-making that provide consolidating distributors with an opportunity to offset transaction costs with savings achieved as a result of the consolidation.

The OEB's 2015 Report³ permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction. The extent of the deferred rebasing period is at the option of the distributor and no supporting evidence is required to justify the selection of the deferred rebasing period. Consolidating entities, must, however, select a definitive timeframe for the deferred rebasing period.

The 2015 Report sets out the rate-setting mechanisms during the deferred rebasing period, requiring 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 increased benefits from consolidation.

The OEB's Handbook⁴ clarifies 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.

The Handbook contains the OEB's expectations with respect to future costs as follows:

In reviewing a transaction the OEB must consider the long term effect of the consolidation on customers and the financial sustainability of the sector.

³ EB-2014-0138 Report of the Board on Rate-making Associated with Distributor Consolidation, March 26, 2015

⁴ Handbook to Electricity Distributor and Transmitter Consolidation, January 19, 2016

To demonstrate “no harm”, applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been.⁵

⁵ Handbook, p.7

4 DECISION ON THE ISSUES

4.1 Application of the No Harm Test

Price, Cost Effectiveness and Economic Efficiency

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 consolidation will be no higher than they would otherwise have been.

The applicants submitted that the proposed transaction incorporates benefits to be realized through voluntary consolidation, including cost synergies and economy of scale benefits. The applicants' evidence included a comparison of the status quo versus post consolidation costs (OM&A and capital) over the ten year period (2017-2026) reflecting 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 \$0.3M.⁶

Cost savings are anticipated from reduced management and consulting fees, IT support costs, corporate governance costs, regulatory costs, and combined fleet purchasing, inventory/stock and line deployment efficiencies.⁷ The applicants submitted that these OM&A and capital savings translate into an approximate decrease of 3% - 4% of revenue requirement which will accrue to ratepayers beyond the proposed deferred rebasing period, as well as economies of scale that the merged entity can realize owing to its larger size.⁸

The applicants asserted 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 occurred.⁹

OEB staff submitted that comparing revenues under deferred rebasing relative to the rate-setting plans that the unmerged distributors would otherwise follow is not in itself a

⁶ Application, pp. 29-30

⁷ Application, p. 30

⁸ Application, pp.23, 25

⁹ Application, pp. 22-23

sufficient demonstration of savings and no harm. OEB staff argued that the savings that 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 noted that the degree of certainty regarding forecast savings diminishes over the length of the forecast period.

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

OEB Findings

The OEB has determined that it is reasonable to expect that the underlying cost structures to serve acquired customers following the proposed merger will be no higher than they otherwise would have been. The applicants have satisfied the "no harm" test with respect to price.

It is the OEB's expectation that future rates paid by the acquired customers will be based on the same cost structures used to project the future cost savings in support of this application.

Reliability and Quality of Electricity Service

The applicants submitted that they are committed to maintaining the quality, reliability, and adequacy of electricity service for customers, stating that the existing operational centres will be maintained and that the employment of staff will be guaranteed for a period of three years to ensure continuity of knowledge and experience.¹⁰

In response to OEB staff interrogatories¹¹, 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.

¹⁰ Application, p. 24

¹¹ OEB Staff Interrogatory 7

The applicants expect to maintain and improve upon the five-year average reliability indices, specifically the System Average Interruption Duration Index and the System Average Interruption Frequency Index.¹² The applicants submitted that customers will see reliability benefits from being served by a larger utility that will have an expanded ability to monitor, report on and improve system reliability and power quality, given its greater resources.

OEB staff submitted that the amalgamated entity can meet service quality and reliability standards currently provided by each of the amalgamating distributors. OEB staff also submitted that the OEB is able to monitor the performance of the amalgamated entity on an ongoing basis through performance scorecards as well as the OEB's *Electricity Reporting and Record Keeping Requirements* (RRRs) which constitute the OEB's requirements to maintain and file information under the licence conditions.

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 application¹³ and Entegrus Powerlines recently filed a DSP with its 2016 Cost of Service application.¹⁴

The 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 DSPs every five years, remain in effect. OEB staff noted that the filing of a consolidated DSP in 2021 would be six years after St. Thomas Energy filed its last DSP, but accepted the proposal of the applicants given that the applicants expect to file a consolidated DSP having had an opportunity to operate for a time and thereby identify and prioritize investments for a consolidated planning cycle and given that a consolidated DSP is to be filed in year six.

As part of the interrogatory process, OEB staff requested information relating to Conditions of Service.¹⁵ In response, the applicants identified the material differences in the Conditions of Service documents between the distributors. The applicants indicated

¹² Application, p. 25

¹³ EB-2014-0013

¹⁴ EB-2015-0061

¹⁵ OEB Staff Interrogatory 20

that they intend to review differences between service areas soon after the amalgamation is approved to determine the best practices to address the differences. OEB staff submitted 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 that the consolidated entity should be required to report on this at least once through the deferral period, perhaps in year 4. OEB staff submitted that 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 Requirements](#)¹⁶ where the OEB may require reporting of customer complaint information. OEB staff also suggested that such report should document the applicants' status of the review and any harmonization or integration of Conditions of Service for the legacy service territories.

OEB Findings

The OEB has determined that the applicants have satisfied the “no harm” test with respect to reliability and quality of electricity service. The applicants contend that there may be reliability improvements due to more resources being available to monitor and report on and improve reliability. The OEB’s determination that the “no harm” test has been satisfied is based on the applicants’ plans to maintain the existing operation service centres and staffing compliments for the near future. There is no evidence to suggest that the merged entities will have less capacity to maintain the status quo with respect to reliability and quality of service.

The OEB accepts the applicants’ proposal to file a consolidated (DSP) in 2021, Entegrus’ DSP is a 2016 vintage plan and the OEB finds the time period requested to consider how best to consolidate the merged assets into that plan to be reasonable.

The applicants intend to compare the respective Conditions of Service practices subsequent to approval of the proposed merger with a view to adopt best practices in consolidating the legacy approaches. The OEB accepts this plan as being a routine post-merger endeavor and expects that the exercise will be conducted in the spirit of determining best practices from a customer service perspective.

¹⁶ Issued May 3, 2016

The 2105 Report describes the OEB's reliance on its ongoing monitoring of key performance indicators in the context of its post-merger rate setting policies. The OEB does not consider any of the features of this particular proposed merger to warrant the special report suggested by OEB staff. The merged entity will have no less ability to maintain its existing service levels at existing costs than the separate entities do now. The report suggested by OEB staff may serve to provide an indication of progress and improvement beyond the base service requirements of the separate entities. While the OEB anticipates progress and customer service improvements will result from mergers in general, it does not consider any particular level of progress to be a determinative factor in its consideration of a merger application.

The most significant and enduring anticipated benefit to customers should be the lower cost structures achieved through the deferred rate-setting period resulting in lower rates upon rebasing than would otherwise have been achievable.

Financial Viability

According to the application, the consideration for the proposed amalgamation transaction is non-cash, as it involves an exchange of shares between the parties. The valuation of the shares is based on the fair market value of the consolidating distributors. The application 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.

The applicants 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.

OEB staff submitted that the applicants' evidence demonstrates that no adverse impact on the applicants' financial viability is anticipated.

OEB Findings

Given the non-cash nature of the transaction, the OEB does not consider there to be any inherent risk to the financial liability of the amalgamated entity. The OEB does not

consider the incremental transaction costs, financed through productivity gains, to be a significant risk to the financial viability of the amalgamated entity.

4.2 Rate-making Considerations

Deferred Rate Rebasing and Earnings Sharing Mechanism

The 2015 Report permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction and OEB approval is not required for the selected deferral period. However, as set out in the Handbook, consolidating distributors are required to identify in their consolidation application the specific number of years for which they choose to defer as this allows the OEB to assess any proposed departure from this stated plan.

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

The applicants have proposed an ESM 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 submitted that approval for a new deferral account for the ESM will be requested in a later rate application and that the ratepayer share of earnings will be credited to this account.

OEB staff submitted that the proposed ESM is consistent with the OEB's policy, noting that the applicants have not provided details of how the ESM will be calculated. OEB staff submitted 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.

OEB Findings

The OEB agrees with OEB staff and approves the applicants' proposals regarding deferred rate rebasing and ESM due to their consistency with the OEB's related policies contained in the 2015 Report.

4.3 Other Requests

The applicants have requested the OEB's 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

OEB staff supported these requests.

OEB Findings

The OEB grants approval of these requests intended to complete the proposed overall transaction and facilitate the creation of a new amalgamated entity.

5 CONCLUSION

The OEB concludes that the proposed amalgamation of Entegrus Powerlines and St. Thomas Energy Inc. meets the no harm test and therefore the OEB approves this transaction.

The OEB also approves the applicants' additional requests as set out in this Decision and Order relating to:

- a) Transfer of St. Thomas Energy's rate order to Entegrus Powerlines
- b) Cancellation of St. Thomas Energy's electricity distribution licence
- c) Amendment of Entegrus Powerlines' electricity distribution licence
- d) Continued tracking of costs to the existing deferral and variance accounts

6 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. St. Thomas Energy Inc. is granted leave to amalgamate with Ascent Group Inc. to continue as STE Amalco.
2. Entegrus Inc. is granted leave to acquire all the shares of STE Amalco from the City of St. Thomas in exchange for shares of Entegrus Inc.
3. Entegrus Powerlines Inc. and STE Amalco are granted leave to amalgamate and continue as Entegrus Powerlines Inc.
4. The leave granted in paragraphs 1-3 above shall expire 18 months from the date of this Decision and Order. If the transaction has not been completed by that date, a new application will be required in order for the transaction to proceed.
5. The applicants shall promptly notify the OEB of the completion of the transactions referred to in paragraphs 1-3 above.
6. Once the notice referred to in paragraph 5 is provided to the OEB, the OEB will transfer the rate order of St. Thomas Energy Inc. to Entegrus Powerlines Inc.
7. Once the notice referred to in paragraph 5 has been provided to the OEB, the OEB will amend the electricity distribution licence of Entegrus Powerlines Inc. (ED-2002-0563) to include the service area formerly served by St. Thomas Energy Inc. and to include St. Thomas Energy Inc.'s CDM targets.
8. When the OEB amends the electricity distribution licence of Entegrus Powerlines Inc., it will cancel the electricity distribution licence of St. Thomas Energy Inc. (ED-2002-0523).
9. The applicants are granted approval to continue to track costs to the deferral and variance accounts currently approved by the OEB for each of the applicants.
10. The applicants shall pay the OEB's costs of and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

DATED at Toronto March 15, 2018

ONTARIO ENERGY BOARD

Original signed by

Kirsten Walli
Board Secretary