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BY EMAIL

November 27, 2018

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

Dear Ms. Walli:

Re: Veridian Connections Inc. and Whitby Hydro Electric Corporation Application by Veridian Connections Inc. and Whitby Hydro Electric Corporation for approval to amalgamate and continue operations as a single electricity distribution company
OEB Staff Submission

OEB File No. EB-2018-0236

In accordance with Procedural Order No. 3, please find attached the OEB Staff Submission for the above proceeding. This document has been sent to Veridian Connections Inc. and Whitby Hydro Electric Corporation and to all other registered parties to this proceeding.

Veridian Connections Inc. and Whitby Hydro Electric Corporation are reminded that their Reply Submission is due by December 7, 2018, should they choose to file one.

Yours truly,

Original Signed By

Andrew Bishop
Project Advisor, Supply & Infrastructure

Encl.

Application by Veridian Connections Inc. and Whitby Hydro Electric Corporation for approval to amalgamate and continue operations as a single electricity distribution company

EB-2018-0236

OEB Staff Submission

November 27, 2018

1 INTRODUCTION AND SUMMARY

Veridian Connections Inc. (Veridian Connections) and Whitby Hydro Electric Corporation (Whitby Hydro) (collectively, the Applicants) filed an application on July 30, 2018 under Sections 18, 60, 77(5), 86(1)(c), and 86(2)(b) of the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B) (the Act), for approval to amalgamate and continue operations as a single electricity distribution company. To enable the proposed amalgamation, Veridian Connections and Whitby Hydro requested the following Ontario Energy Board (OEB) approvals[1]:

- Leave for a new holding company (referred to as Merged Holdco) to acquire control of Veridian Corporation (the parent company of Veridian Connections) and Whitby Hydro Energy Corporation (the parent company of Whitby Hydro)
- The amalgamation of Veridian Connections and Whitby Hydro to form a new electricity distribution company referred to in the application as LDC Mergeco
- Issuance of a new Electricity Distribution Licence for LDC Mergeco
- Cancellation of the Electricity Distribution Licences of Veridian Connections and Whitby Hydro when the Electricity Distribution Licence for LDC Mergeco is issued
- Transfer of the current and any future rate orders and rate riders of Veridian Connections and Whitby Hydro to LDC Mergeco
- The continued tracking of costs by LDC Mergeco to existing deferral and variance accounts of Veridian Connections and Whitby Hydro
- An accounting order establishing a deferral account to track any material differences between the revenue requirement calculated using pre-merger accounting policies and the revenue requirement calculated using post-merger accounting policies[2]

To facilitate the amalgamation, on July 10, 2018, The Corporation of the Town of Ajax, The Corporation of the City of Belleville, The Corporation of the Municipality of Clarington, The Corporation of the City of Pickering, The Corporation of the Town of Whitby, Veridian Corporation, Veridian Connections, Whitby Hydro Energy Corporation, and Whitby Hydro entered into a merger participation agreement (MPA) which governs all steps of the proposed transactions. As agreed to by the parties, the MPA will become effective following OEB approval of the amalgamation application.

[1] Application, p. 17
[2] Through their response to OEB staff Interrogatory No. 27, the Applicants withdrew their request for an accounting order. OEB staff addresses the Applicants' withdrawal request in Section 3.6.1 of this submission.

Among other matters, the MPA provides that the municipal owners of Veridian Connections and Whitby Hydro will receive the following equity and voting percentage interest in the newly formed Merged Holdco:

- The Corporation of the Town of Ajax: 21.828%
- The Corporation of the City of Belleville: 9.044%
- The Corporation of the Municipality of Clarington: 9.248%
- The Corporation of the City of Pickering: 27.880%
- The Corporation of the Town of Whitby: 32.000%

The above share distribution was based on the fair market value of Veridian Connections and Whitby Hydro as determined by Deloitte LLP (Deloitte) and Henley International Inc. (Henley), respectively. To provide validation, Grant Thornton LLP (GT) was engaged as an independent third party to provide a fairness opinion on the valuations completed by Deloitte and Henley. In their report, provided as Attachment N in the application, GT indicated that, in their opinion, the “Merger Agreement is fair, from a financial point of view, to the Shareholders.”

The July 30, 2018 application included a draft version of LDC Mergeco’s Electricity Distribution Licence application, for informational purposes, which the Applicants indicated would be updated and officially filed with the OEB if the amalgamation was approved.[3] OEB staff requested through the interrogatory (IR) process that the Applicants file their Electricity Distribution Licence application as part of their IR responses. The basis for OEB staff’s request was an OEB finding in a previous MAADs proceeding that a request for leave to amalgamate could not be granted in the absence of a related licence application, if the proposed amalgamation involved the issuance of a new licence.[4] In response to the request made through OEB staff IR No. 1, the Applicants filed their Distribution Licence Application on November 9, 2018 and requested that the OEB consider it contemporaneously with the amalgamation request. Given the Applicants’ request, OEB staff has commented on the Applicants’ Electricity Distribution Licence application in this submission.

[3] Application, p. 46
[4] EB-2016-0025, Oral Hearing Transcript Volume 4, p. 65

2 RELEVANT REGULATORY PRINCIPLES

2.1 The "No Harm" Test

The OEB applies the "no harm" test when assessing applications that seek approval for regulated entities to consolidate. The "no harm" test was first established by the OEB in 2005 through its decision in an adjudicative proceeding (the Combined Proceeding),[5] and has been used to guide OEB decision making on merger, acquisition, amalgamation and divestitures (MAADs) applications since then.

The *Handbook to Electricity Distributor and Transmitter Consolidations* (the Handbook), issued by the OEB on January 19, 2016, confirmed that the OEB will continue its practice of applying the "no harm" test when adjudicating utility consolidation requests. 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. Those objectives include[6]:

> **Board objectives, electricity**
> 1 (1) The Board, in carrying out its responsibilities under this or any other Act in relation to electricity, shall be guided by the following objectives:
>
> 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, including having regard to the consumer's economic circumstances.
> 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

[5] RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257
[6] *Ontario Energy Board Act, 1998,* Section 1

> reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities. 2004, c. 23, Sched. B, s. 1; 2009, c. 12, Sched. D, s. 1; 2015, c. 29, s. 7.

If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.[7]

2.2 OEB Policy on Rate-Making Associated with Consolidations

The OEB introduced policies that provide consolidating distributors with an opportunity to offset merger-related transaction costs with any achieved savings through deferral of the rebasing of the consolidated entity.

The OEB's policies on rate-making associated with consolidations are set out in the *Report of the Board – Rate-making Associated with Distributor Consolidation*, issued July 23, 2007 (the 2007 Report) and a further report issued under the same name on March 26, 2015 (the 2015 Report). The 2007 Report permits a deferred rebasing period of five years. The 2015 Report extended the deferred rebasing period, permitting consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

Consolidating distributors are required to select a definitive timeframe for the deferred rebasing period. The OEB's expectation is that when consolidating distributors select a deferred rebasing period, they have committed to a plan based on the circumstances of the consolidation and that if an amendment to the selected deferred rebasing period is requested, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interests of customers.

The OEB requires consolidating entities that propose to defer rebasing beyond five years to implement an earnings sharing mechanism (ESM) 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. In this case, the Applicants have proposed a ten-year rebasing deferral period and will therefore be required to establish an ESM.[8]

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[7] Handbook, pp. 3-4
[8] Application, p. 18

3 OEB STAFF SUBMISSIONS

In its review of the application, OEB staff has considered the requirements described in the Handbook and other applicable OEB policy as described herein.

3.1 Application Performance against the "No Harm" Test

The Handbook provides guidance to applicants and stakeholders on how the OEB reviews consolidation transactions proposed under Section 86 of the Act. As noted above in Section 2.1, the Handbook confirms that the OEB applies the "no harm" test in its assessment consolidation applications. If the proposed transaction has a positive or neutral effect on the attainment of the OEB's statutory objectives, the OEB will approve the application. While the OEB has broad statutory objectives, in applying the "no harm" test the OEB has primarily focused its review on the 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.

Submission

OEB staff submits that the Applicants have demonstrated, through both their application and IR responses, that the amalgamation will not adversely affect customers with respect to price or quality of service. Further, OEB staff submits that the Applicants have established that the proposed transactions will not have a negative effect on the cost effectiveness, economic efficiency or financial viability of Veridian Connections or Whitby Hydro. OEB staff therefore submits that the amalgamation proposed by the Applicants meets the "no harm" test as described in the Handbook.

The basis for this conclusion is discussed in further detail below.

3.2 Impact on Price, Economic Efficiency and Cost Effectiveness

The Applicants selected a ten-year rate rebasing deferral period from the closing of the proposed transactions, consistent with the 2015 Report and the Handbook. During this time, the Applicants indicate that the pre-existing rate plans for Veridian Connections[9] and Whitby Hydro[10], effective May 1, 2018 and January 1, 2018, respectively, will remain in effect until their expiry. More particularly, Veridian Connections and Whitby

[9] Veridian Connections' May 1, 2018 rates, set in accordance with the Price Cap Incentive Rate option, were approved by the OEB through EB-2017-0078.
[10] Whitby Hydro's January 1, 2018 rates, set in accordance with the Annual Incentive Rate Index (IR) option, were approved by the OEB through EB-2017-0085/EB-2017-0292.

Hydro will continue to have rates adjusted using the Price Cap Incentive Rate Mechanism and Annual Incentive Rate Index mechanisms, respectively, until the end of the ten-year rebasing deferral period.[11] Absent the proposed transactions, the Applicants state that both Veridian Connections and Whitby Hydro would file cost-of-service applications in each of 2019, 2024 and 2029.[12]

The Applicants state that "[i]t is anticipated that at the end of the 10 year deferral period when rate rebasing will take place for both Veridian LDC and Whitby LDC rate zones, distribution rates for these rate zones will be approximately 3% and 11% lower respectively than what would be the case under the status quo. The driver of this reduction is the decrease in the underlying cost structure of LDC Mergeco…."[13] Further, the Applicants also submit that during the ten-year rebasing deferral period, distribution rates for both Veridian Connections and Whitby Hydro are anticipated to be lower than the *status quo*. During this time, distribution rates for customers of Veridian Connections are expected to be 0.8% lower on average while Whitby Hydro distribution rates are expected to be 6.7% lower than the *status quo*.[14]

As identified by the Applicants, the primary drivers of the decreased cost structure are the operating, maintenance and administrative (OM&A) efficiencies anticipated from the proposed amalgamation which the Applicants project will total $48.8 million during the ten-year rebasing period.[15] In response to OEB staff IR No. 12, the Applicants provided a detailed account of projected OM&A savings for the 2019-2029 period. Specifically, the Applicants' response demonstrated that the $48.8 million in savings are forecast to result from merger-related efficiency gains in the following four OM&A categories: general administration[16], customer service[17], operations and maintenance, and labour.[18] The Applicants also state that these savings will result in a lower cost structure for the amalgamated entity at the time of the first rebasing relative to the *status quo* and that these savings will continue after the ten-year rebasing deferral period at a rate of approximately $6.6 million annually.[19] The application specifies that these cost savings will be passed on to customers following the rebasing deferral period.[20]

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[11] Application, p. 20
[12] Application, p. 21
[13] Application, p. 20
[14] Application, p. 20
[15] Application, p. 32
[16] Human Resources, Information Technology, Governance, Insurance, Audit, Other
[17] Billing, Call Centre, Collections
[18] Labour efficiencies represent $33.39 million, or 68% of the projected $48.8 million in OM&A savings. Labour efficiencies result from the Applicants' forecast that 36 positions will be eliminated during the rebasing deferral period due to attrition (Application, p. 33).
[19] Application, p. 32
[20] Application, p. 22

Cost savings related to capital investments are forecast by the Applicants to be non-material and therefore were not included in the forecast of efficiency gains.

Figure 1, extracted from the Applicants' IR response to School Energy Coalition (SEC) IR No. 2, visually illustrates the projected financial impact of the amalgamation on the revenue requirements of each utility. Figure 1 shows that beginning in 2019 and continuing throughout the rebasing deferral period, the revenue requirement of the which are rate based. amalgamated entity is forecast to be between approximately $1.5 million and $7.9 million lower than under the *status quo* scenario. Figure 1 also reflects the Applicants' claim that the efficiency gains will continue to benefit customers after the ten-year rebasing deferral period. As shown, in 2029, the year of the consolidated entity's first cost-of-service review following amalgamation, the Applicants' forecast a total savings of approximately $6.7 million that will directly benefit customers. The Applicants submit that these savings will continue after the ten-year deferral period by providing an annual savings to customers of approximately $6.6 million.[21]

Figure 1: Applicant Merged versus Standalone Revenue Requirement

Comparision LDC MergeCo and Standalone Distribution Revenue / Forecasted Revenue Requirement

(in 000's)

	Historic					Forecast	Deferred Rebasing Period Forecast										Deferred Rebasing Period Forecast
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
Distribution Revenue / Forecasted Revenue Requirement																	
Veridian LDC	51,899	51,981	53,436	52,023	52,337	55,052	57,265	59,724	62,212	63,918	65,485	67,596	69,499	71,457	73,470	75,541	78,736
Whitby LDC	23,905	22,515	23,001	22,067	22,804	22,606	23,262	23,959	24,678	25,394	26,105	26,836	27,587	28,360	29,154	29,970	30,258
Total	75,804	74,496	76,437	74,090	75,141	77,658	80,527	83,684	86,890	89,311	91,590	94,431	97,086	99,816	102,624	105,511	108,994
Standalone Revenue Requirement																	
Veridian LDC	-	-	-	-	-	55,052	57,295	64,800	67,418	69,185	70,799	72,069	74,392	76,487	78,641	80,857	81,619
Whitby LDC	-	-	-	-	-	22,606	24,732	25,554	26,404	27,256	28,107	28,749	29,647	30,574	31,529	32,513	34,056
Total	-	-	-	-	-	77,658	82,026	90,355	93,823	96,441	98,907	100,819	104,039	107,060	110,170	113,370	115,675
Total Forecast Savings	-	-	-	-	-	-	1,500	6,671	6,933	7,130	7,317	6,387	6,953	7,244	7,546	7,860	6,681

* Distribution Revenue 2013 to 2017 sourced from annual OEB Year Book

In further support of their claim that the amalgamation will facilitate lower cost structures, and in response to SEC IR No. 6, the Applicants compared the forecast OM&A per customer of the amalgamated entity over the rebasing deferral period to that of the *status quo* scenario. Figure 2, extracted from the Applicants' SEC IR No. 6 response, demonstrates the results of this comparison.

[21] Application, p. 32

Figure 2: Applicant Forecast OM&A per Customer (2019 to 2028)

	Veridian			Whitby			Mergeco		
	OM&A ($000's)	Customers	OM&A per Customer	OM&A ($000's)	Customers	OM&A per Customer	OM&A ($000's)	Customers	OM&A per Customer
2019	31,848	126,435	$ 251.89	14,504	44,341	$ 327.11	50,225	170,776	$ 294.10
2020	32,922	129,842	$ 253.56	14,903	45,095	$ 330.49	48,271	174,937	$ 275.93
2021	34,009	133,173	$ 255.37	15,313	45,861	$ 333.90	44,587	179,034	$ 249.04
2022	34,862	134,693	$ 258.83	15,727	46,595	$ 337.52	45,165	181,288	$ 249.13
2023	35,682	135,841	$ 262.67	16,143	47,294	$ 341.34	46,297	183,136	$ 252.80
2024	36,672	138,045	$ 265.65	16,571	48,004	$ 345.21	47,611	186,049	$ 255.91
2025	37,607	139,724	$ 269.15	17,010	48,724	$ 349.12	48,524	188,448	$ 257.49
2026	38,566	141,424	$ 272.70	17,461	49,455	$ 353.07	49,818	190,879	$ 260.99
2027	39,549	143,146	$ 276.29	17,924	50,196	$ 357.07	51,146	193,343	$ 264.54
2028	40,558	144,890	$ 279.92	18,399	50,949	$ 361.12	52,510	195,839	$ 268.13

As shown to begin in 2021 and continue throughout the rebasing deferral period, OM&A costs per customer for both current Veridian Connections and Whitby Hydro customers are forecasted to be lower under the amalgamated scenario, thereby leading to reduced cost structures and lower rates in the longer term for all customers impacted by the proposed amalgamation.[22]

Submission

As part of its review of consolidation proposals, the OEB examines the underlying cost structures of the consolidating utilities. As distribution rates are based on a distributor's current and projected costs, the OEB has stated that it is important for the OEB to consider the impact of a transaction on the cost structure of consolidating entities both now and in the future, particularly if there appear to be significant differences in the size or demographics of consolidating distributors.[23]

OEB staff accepts the Applicants' claim that the amalgamation will generate OM&A savings that will benefit customers through reduced cost structures. The value of these savings, approximately $48.8 million during the ten-year deferral period, is expected to more than offset the Applicants' amalgamation transaction and transition cost forecast of $6.7 million.[24] The Applicants also confirmed, through their response to OEB staff IR No. 5, that transition costs will not be funded by ratepayers. Based on the evidence on the record, OEB staff is satisfied that the amalgamation will not result in the customers

[22] Application, p. 22
[23] Handbook, p. 6
[24] Application, p. 36

of Veridian Connections or Whitby Hydro experiencing negative price implications in the near-term.

OEB staff anticipates that in their first cost-of-service application following the selected ten-year rebasing deferral period, the Applicants will demonstrate the savings and efficiencies that have resulted from the amalgamation.

This anticipated area of inquiry is consistent with the provisions of the OEB's October 13, 2016 *Handbook for Utility Rate Applications*, which states, in part:

> "***In the first cost of service or Custom IR application following the consolidation the OEB will scrutinize specific rate-setting aspects of the MAADs transaction*** [emphasis added], including a rate harmonization plan and/or customer rate classifications post consolidation.

This will include consideration of:

- The treatment of any premium above book value paid as part of a consolidation (no premium is to be recovered from customers).
- ***The savings that have been generated through the consolidation*** [*emphasis added*].
- Whether there were any inducements or incentives beyond the purchase price to encourage a shareholder to agree to the consolidation and if so whether there is any intent to recover the costs of those inducements or incentives from customers. Any costs incurred will be reviewed to ensure that the costs incurred are delivering the best value to customers.
- Whether the rate harmonization plan includes a detailed explanation and justification for the implementation plan, and an impact analysis. For acquisitions, distributors can propose plans that place acquired customers into an existing rate class or into a new rate class. ***Regardless of the option adopted, the OEB will assess whether the proposed harmonized rates will reflect the cost to serve the acquired customers, including the anticipated productivity gains resulting from consolidation*** [emphasis added]."[25]

3.3 Impact on Service Quality and Reliability

The Handbook requires consolidating utilities to indicate the impact that the proposed transaction will have on consumers with respect to reliability and quality of electricity

[25] Handbook for Utility Rate Applications, p. 21

service. The Handbook also provides that in considering the impact of a proposed transaction on the quality and reliability of electricity service, and whether the "no harm" test has been met, the OEB will be informed by the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard.[26]

OEB staff reviewed the Applicants' 2016 Electricity Utility Scorecards, provided as Attachments K and L of the application, as well as the Applicants' 2017 Electricity Utility Scorecards[27] and identified that the current and historical reliability metrics of both utilities are reasonable. The reliability metrics of both utilities are shown in Table 1, below:

Table 1: Historical SAIDI and SAIFI Performance

Description	2012	2013	2014	2015	2016	2017
SAIDI						
Veridian Connections	1.19	1.45	1.97	1.62	1.24	1.07
Whitby Hydro	0.96	0.93	1.89	1.40	0.99	0.69
SAIFI						
Veridian Connections	2.07	2.09	1.72	2.13	1.29	1.07
Whitby Hydro	1.29	0.87	2.32	1.65	1.23	1.23

In addition to reliability metrics, OEB staff reviewed the Applicants' plans related to ensuring that the current reliability performance of both utilities is not compromised by the amalgamation.

The Applicants state that "ensuring levels of customer service and reliability after the merger that either meet or exceed existing customer service levels for both LDCs was identified early in the process as a key objective from the Proposed Transaction."[28] To achieve this goal, the Applicants indicate that all existing Veridian Connections and Whitby Hydro operations centres will be maintained following amalgamation. Among other benefits, the Applicants state that maintaining these centres will provide continuity of access and service for customers and is expected to enhance response times for outages and emergencies in some areas of their service territory.[29]

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[26] Handbook, p. 7
[27] https://www.oeb.ca/documents/scorecard/2017/Scorecard%20-%20Veridian%20Connections%20Inc..pdf; and https://www.oeb.ca/documents/scorecard/2017/Scorecard%20-%20Whitby%20Hydro%20Electric%20Corporation.pdf
[28] Application, p. 24
[29] Application, p. 29

The Applicants also indicated that Whitby Hydro's service area is contiguous with Veridian Hydro's current Ajax and Pickering service areas.[30] Combined, approximately 70% of LDC Mergeco's customers will reside in one of these three regional centres.[31] The Applicants anticipate that combining the resources of these contiguous service areas will have a positive impact on response times and service quality.

The Applicants did note that the lease on Veridian Connections' current Belleville operations centre (located in the City of Belleville) would expire in 2021. As a result, given LDC Mergeco will have a continued need for an operations centre in the City of Belleville, a new facility is required. The Applicants are currently investigating the alternatives of leasing or building a new operations centre. In response to SEC IR No. 5, the Applicants noted that no formal decision has been made regarding this matter.

Given the large reduction in staff anticipated to occur in the near-term following amalgamation[32], OEB staff asked the Applicants how the staff directly responsible for the maintenance of the distribution system would be affected by the amalgamation.[33] In response, the Applicants indicated that the majority of the anticipated staff reductions are related to non-operational roles such as senior leadership, management and back office staff. The Applicants highlighted that impacts to staff directly responsible for maintenance of the distribution system are expected to be nominal. Further, the Applicants referenced the report prepared by Navigant Consulting Ltd. (Navigant) which assessed the risk of negative service quality impacts stemming from the amalgamation. In response to OEB staff IR No. 4, the Applicants noted that the Navigant report concluded that negative service quality impacts in the areas of lines, construction and operations will be very low.

Additionally, the Applicants state that transition planning is taking place in order to ensure the retention of "institutional and specialized knowledge."[34] Such planning is critical given the level of staff reductions forecast to occur.

Submission

Based on the evidence provided by the Applicants, OEB staff submits that LDC Mergeco can reasonably be expected to maintain the service quality and reliability standards currently provided by each of the amalgamating utilities.

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[30] Application, p. 29
[31] *Ibid.*
[32] The Applicants' response to the Power Workers' Union IR No. 4 indicates that the amalgamated entity's workforce will be reduced by 30 staff by 2022.
[33] Response to OEB staff IR No. 4
[34] Application, p. 30

OEB staff also submits that the OEB is able to monitor the performance of LDC Mergeco on an ongoing basis through performance scorecards as well as the OEB's *Electricity Reporting and Record Keeping Requirements*.

3.4 Impact on Financial Viability

The Handbook provides that the impact of a proposed transaction on the acquiring utility's financial viability for an acquisition, or on the financial viability of the consolidated entity in the case of a merger will be assessed. The OEB's primary considerations in this regard are:

- The effect of the purchase price, including any premium paid above the historic (book) value of the assets involved
- The financing of incremental costs (transaction and integration costs) to implement the consolidation transaction[35]

Submission

The proposed transaction involves the issuance of shares in the amalgamated entity and is substantially non-cash in nature. To facilitate the amalgamation, the Applicants will carry out the transactions as described in the MPA and outlined in Section 1 of this submission. The Applicants have indicated that transition and transaction costs incurred will be financed through existing borrowing facilities and synergies generated as a result of the amalgamation and not by ratepayers. OEB staff is of the view that these costs, anticipated by the Applicants to total $6.7 million, are not prohibitive given the projected savings forecast to result from the merger.

A review of the Applicants' *pro forma* financial statements further supports that the financial viability of the amalgamated entity will not be adversely affected by the transaction. Consequently, in OEB staff's opinion, the amalgamation will not negatively impact the financially viability of the Applicants.

3.5 LDC Mergeco Distribution Licence Application

As previously discussed, in response to OEB staff IR No. 1, the Applicants filed LDC Mergeco's Electricity Distribution Licence application on November 9, 2018. At that

[35] Handbook, p. 8

time, the Applicants requested that the OEB consider the licence request contemporaneously with their amalgamation application.

The licence application confirmed that LDC Mergeco is "the distributor that will be created by the consolidation of Veridian [LDC] and Whitby [LDC]"[36] and that its service area will consist of the current service areas of Veridian Connections and Whitby Hydro, as described in the amalgamation application.

Further, the licence application stated that the proposed amalgamation[37]:

- Will have no adverse impact on competition, nor will it have an adverse impact on access to distribution services.
- Will have no adverse impact on reliability and quality of supply. Moreover, the consolidation proposed in the MAADs application will create opportunities for the improvement of existing reliability and quality of supply.
- Will promote economic and energy efficiency. The consolidation of the two existing distributors will create opportunities for improved efficiency in the distribution of electricity in the predecessor distributors' service areas, and more opportunities for the promotion of energy efficiency and conservation in those areas.

The Application indicates that the key individuals in LDC Mergeco will include executives from the two amalgamating utilities. As indicated in the Application, these individuals have many years of experience in the electricity sector and, more particularly, with the operations of the Applicants.

Submission

OEB staff has reviewed the distribution licence application and considers it complete. OEB staff notes that the application does not contain any requests for licence conditions that would depart from those found in the typical form of Electricity Distribution Licence.

OEB staff submits that the key individuals proposed to lead LDC Mergeco have appropriate industry experience and qualifications necessary to lead the utility. OEB staff submits that LDC Mergeco can reasonably be expected to carry out the obligations of an OEB Electricity Distributor Licensee.

OEB staff supports the Applicants' request for approval of a new distribution licence for LDC Mergeco. OEB staff also supports the Applicants' request that the licence application be considered by the OEB concurrently with their amalgamation request.

[36] LDC Mergeco Distribution Licence Application, p. 9
[37] LDC Mergeco Distribution Licence Application, p. 12

The joint consideration of an applicant's amalgamation and licence request is consistent with OEB practice. Specifically, during the Thunder Bay Hydro and Kenora Hydro amalgamation proceeding[38], through Procedural Order No. 2, the OEB established that the Applicants' amalgamation application would be combined and adjudicated concurrently with its distribution licence application.

3.6 Other Matters

3.6.1 Deferral Account for Accounting Policy Changes

The Applicants have advised that the amalgamation will require Whitby Hydro to transition to Veridian Connections' accounting policies.[39] As a result, and as proposed in Section 4.2.1 of the application, the Applicants requested that the OEB approve an Accounting Order "to track any material differences between the revenue requirement calculated using the pre-merger accounting policies and the revenue requirement calculated using post-merger accounting policies."

In response to OEB staff IR No. 27, the Applicants stated that they had reviewed the accounting policies of both organizations and identified the types of transactions they believed would likely be impacted by the accounting policy change. Further, the Applicants estimated that the difference in revenue requirement associated with the accounting policy change would be lower by approximately $50,949 annually.[40] The Applicants asserted that this amount is immaterial and based on this determination withdrew their request for an Accounting Order.

Submission

OEB staff is of the view that until the OEB addresses this matter on a generic basis, it is appropriate for the OEB to deal with this matter on a case by case basis.

OEB staff is of the view that the OEB should establish a variance account to track the revenue requirement impact of the actual differences arising from the harmonization of accounting policies. While the Applicants have provided information on materiality for the change in accounting policies, the amounts have not been tested sufficiently to determine if in fact the amounts are likely to be immaterial.

In OEB staff's view, the establishment of this account is consistent with the OEB's decision on a previous MAADs application filed by Thunder Bay Hydro and Kenora

[38] EB-2018-0124
[39] The Applicants indicate that LDC Mergeco will adopt International Financial Reporting Standards
[40] Response to SEC IR No. 10

Hydro [41] that dealt with the revenue requirement impacts arising from post consolidation changes to accounting policies. In that Decision, the OEB ordered the applicants to establish a deferral account in order to track the annual differences in revenue requirement arising from Kenora Hydro's transition to Thunder Bay Hydro's accounting policies. The OEB did not opine on the materiality of the differences created by the accounting policy change in their Decision.

Furthermore, at the time that the account is brought forward for disposition by LDC Mergeco, parties will have an opportunity to validate the calculation of the revenue requirement differences on an actuals basis. If the OEB determines at that time that the actual amounts recorded in the account are immaterial, it may order that the account not be disposed.

OEB staff submits that the Applicants should be ordered to establish a variance account that captures the annual difference over the deferred rebasing period between the revenue requirement calculated using the pre-amalgamation accounting policies and the revenue requirement calculated using the new accounting policies.

The balance in the proposed account should be brought forward for disposition at a later date and will be subject to an OEB review at that time. OEB staff further submits that the establishment of this account should be approved as part of this current proceeding and that the Applicants should be directed to prepare and submit to the OEB a draft accounting order for this proposed account.

3.6.2 Earnings Sharing Mechanism (ESM)

OEB staff IR No. 25 requested clarification on how the Applicants propose to calculate the amounts to be recorded in the ESM account during the deferred rebasing period.

In response, the Applicants indicated that they have not determined a methodology or proposal for this calculation at this time. The Applicants further stated that prior to year six of the proposed ten-year deferral period, the OEB will have received and considered ESM proposals from other merged distributors, and that this will likely inform the amalgamated entity's approach. The Applicants also cited the OEB's Decision and Order issued on December 8, 2016 on the application for approval to amalgamate filed by Enersource Hydro Mississauga Inc., Horizon Utilities Corporation and Powersteam Inc.[42], whereby those applicants were ordered by the OEB to file plans for the ESM by

[41] EB-2017-0124/EB-2018-0233
[42] EB-2016-0025/EB-2016-0360

December 31, 2019. Finally, the Applicants confirmed that their ESM proposal follows the form set out in the 2015 Report.[43]

Submission

OEB staff agrees that the Applicants should have an opportunity to provide a more detailed ESM plan at a future date, during the deferred rebasing period.

In the December 8, 2016 Decision and Order cited above, the applicants were given until the end of year three of the deferred rebasing period to provide their ESM plans. OEB staff is of the view that the same timelines should apply in this case (i.e. to December 31, 2021).

OEB staff agrees that both the OEB and the Applicants will be in a better position to propose an appropriate calculation for the purposes of the ESM after considering the proposals of other merged entities. OEB staff expects that the Applicants will consider the principles and methodologies of other approved ESM proposals, as well as the impact of having two separate rate years, if that situation still applies, in their future proposed ESM.

4 CONCLUSION

The Applicants have requested the OEB’s approval for:

- Leave for a new holding company (referred to as Merged Holdco) to acquire control of Veridian Corporation (the parent company of Veridian Connections) and Whitby Hydro Energy Corporation (the parent company of Whitby Hydro)
- The amalgamation of Veridian Connections and Whitby Hydro to form a new electricity distribution company referred to in the application as LDC Mergeco
- The issuance of an Electricity Distribution Licence for LDC Mergeco
- The cancellation of the Electricity Distribution Licences of Veridian Connections and Whitby Hydro when the Electricity Distribution Licence for LDC Mergeco is issued
- The transfer of the current and any future rate orders and rate riders of Veridian Connections and Whitby Hydro to LDC Mergeco
- The continued tracking of costs by LDC Mergeco to existing deferral and variance accounts of Veridian Connections and Whitby Hydro

[43] EB-2014-0138

Initially, the Applicants' application requested the following OEB approval:

- A deferral account to track any material differences between the revenue requirement calculated using pre-merger accounting policies and the revenue requirement calculated using post-merger accounting policies

However, this request was subsequently withdrawn by the Applicants through their response to OEB staff IR No. 27. As discussed in Section 3.6.1 of this submission, OEB staff supports the establishment of a variance account to track revenue requirement impacts arising from accounting policy changes.

OEB staff submits that the amalgamation proposed by the Applicants reasonably meets the "no harm" test as described in the Handbook. Therefore, OEB staff does not have any concerns with the approval of these requests.

As described in Section 3.6.2, OEB staff recommends that the OEB require the Applicants to file their plans for the ESM by December 31, 2021.

All of which is respectfully submitted.