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BY EMAIL

May 3, 2019

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

Dear Ms. Walli:

**Re: Algoma Power Inc. and Dubreuil Lumber Inc.
Application for approval for Dubreuil Lumber Inc. to sell its distribution
system to Algoma Power Inc.
OEB Staff Submission on Draft Rate Order**

Ontario Energy Board File Number: EB-2018-0271

In accordance with the Decision and Order, please find attached the OEB Staff Submission for the draft rate order in the above proceeding. This document has been sent to Algoma Power Inc. and Dubreuil Lumber Inc.

Algoma Power Inc. and Dubreuil Lumber Inc. are reminded that their Reply Submissions, if any, are due by May 17, 2019.

Yours truly,

Original Signed By

Valerie Bennett
Project Advisor, Application Policy and Climate Change



OEB Staff Submission on Draft Rate Order

**Application for approval for Dubreuil Lumber Inc.
to sell its distribution system to Algoma Power
Inc.**

Algoma Power Inc. and Dubreuil Lumber Inc.

EB-2018-0271

May 3, 2019

1 INTRODUCTION

The Ontario Energy Board (OEB) issued its Decision and Order on April 4, 2019. In the Decision and Order, the OEB approved the mergers, acquisitions, amalgamations and divestitures (MAADs) transaction, with licensing matters to be dealt with following the completion of the transaction. The OEB approved a time-limited licence condition related to relief from regulatory liability.

The OEB approved classification of customers in the Township of Dubreuilville (Township) to the corresponding Algoma Power Inc. (API) customer classes upon completion of the transaction. The OEB also approved the fixed rate rider applicable to customers in the Township to recover, on an interim basis, the proposed partial disposition of the Interim Licence Deferral Account. The balance of this deferral account was to remain in the account until the OEB made a final determination. For the new Transaction and Integration Costs Deferral Account, the OEB established an effective date of September 24, 2018 (the date of filing of the Application). The OEB did not provide the requested endorsement for the cost allocation methodology, but indicated its expectation that API should propose an approach to mitigate any impacts in the forthcoming rebasing application, expected for 2020 rates. The OEB directed API to file updated and alternative bill impact calculations. Finally, the OEB directed API to file an updated draft Accounting Order reflecting the OEB's Decision and Order.

API filed the Draft Rate Order (DRO) on April 18, 2019. The DRO only relates to rates and accounting matters, as licensing-related matters are dependent upon the completion of the now-approved transaction.

In the DRO, API sought clarification and interpretation of certain aspects of the OEB's Decision and Order, and made a proposal for implementing its understanding of the Decision and Order. API also described potential alternative approaches to the implementation of certain aspects of the OEB's findings. API noted that the interpretation of certain details of the OEB's Decision and Order affect the Rate Order and what is recorded for eventual disposition in the Interim Licence Deferral Account as well as the Transaction and Integration Costs Deferral Account. In addition, there would also be impacts on the rebasing application API intends to file this year.

2 OEB STAFF SUBMISSIONS REGARDING DRAFT RATE ORDER

2.1 Treatment of Transaction Costs

In Section 3 of the DRO, API sets out its understanding of the decision regarding the establishment of the Transaction and Integration Costs Deferral Account effective September 24, 2018. API then discusses the implications of this, in its view, in Section 4 of the DRO. In large part, API's interpretation and discussion on these sections of the DRO are interrelated with the discussion of the transaction costs and the amounts recorded in the deferral accounts, and what may not be recoverable. OEB staff addresses these matters in a combined manner.

In the DRO, API submits that the OEB's establishment of the effective date of the Transaction and Integration Cost Deferral Account as September 24, 2018 (the date that the Application was filed), creates uncertainty about the treatment of the transaction costs for the Application:

This Draft Rate Order also addresses certain concerns that API has with the decision to approve the new Transaction and Integration Costs Deferral Account with an effective date of September 24, 2018, rather than the requested effective date of April 4, 2017. Depending on how this aspect of the Decision is interpreted and applied, it can have significant implications for API's rate proposals, which were otherwise approved in the Decision.¹

API notes that preparation of the Application occurred prior to September 24, 2018. This included not only the Application itself, but the negotiation and drafting of the Asset Purchase Agreement, including legal review and all other due diligence that API and Dubreuil Lumber Inc. (DLI) would have reasonably undertaken as part of negotiating the intended transaction.

API notes that, to date, it has recorded the transaction costs in the Interim Licence Deferral Account, and proposed that the costs be transferred to the new Transaction and Integration Cost Deferral Account. This transfer is documented in the Draft Accounting Order in the Application² and updated in the DRO.³

¹ DRO, p. 1

² Exhibit F/Tab 3/Schedule 2/Appendix A

³ DRO/Schedule B

Submission

In MAADs applications, typically, transaction costs are not recoverable from ratepayers. For most MAADs transactions, the parties' shareholders believe that there is an opportunity to exact efficiencies and hence increase the value to shareholders of completing the applied-for transaction. Transaction costs, including any purchase price premium, are recovered through the anticipated efficiencies as the OEB allows a deferred rebasing period. The purpose of the deferred rebasing period is to enable parties to fully realize anticipated efficiency gains from the transaction and retain achieved savings for a period of time to help offset the costs of the transaction.⁴

As was documented in this Application, API's acquisition of DLI's system was in contrast to a more typical, efficiency-driven consolidation proposal as it was driven by a unique range of factors that are a direct consequence of the OEB having appointed API as the interim operator of the DLI system. For instance, API noted that no other licensed electricity distributor had been identified as having any potential interest in acquiring DLI's system, and that API is naturally well-positioned to provide a long-term solution for effective and ongoing distribution service in DLI's service area.⁵ As API has been remediating the DLI system since being appointed interim operator, it has, therefore, helped to improve the quality, safety and reliability of electricity distribution services to customers in the Township. Given the state of DLI's system, and with only 353 customers in the Township (3% of API's customer base), efficiencies from the acquisition will be relatively minor.

OEB staff notes that an allowance for regulatory expenses is typically included in the revenue requirement recoverable from ratepayers. There is a general regulatory expense for staff and for external services associated with a normal level of regulatory activity for licensing, rates (typically Price Cap Incentive Rate-setting (IR) or similar streamlined rate adjustments), policy consultations, regulatory filings and similar activities. Further, for major applications to rebase rates through cost of service applications, or for analogous multi-year rate plans such as Custom IR, the utility forecasts the incremental costs for preparation and processing of the application, and includes estimates of cost awards to eligible intervenors and the OEB's own costs⁶

⁴ *Handbook to Electricity Distributor and Transmitter Consolidations*, pp. 8-9

⁵ Exhibit E/Tab 1/Schedule 1/p. 1

⁶ For the Application, these costs are likely limited to translation of the Notice of Application, as the Application was processed by way of a written proceeding and there were no interventions.

specific to the proceeding, and amortizes the recovery over the term of the IRM or Custom IR plan (currently five years).

The OEB stated in its Decision and Order in this proceeding that:⁷

The MAADs Handbook states that, “Incremental transaction and integration costs are not generally recoverable through rates”. Instead, the OEB allowed for a deferred rebasing period to provide an opportunity for a distributor to offset transaction costs with achieved savings. The OEB agrees with [API] that, as this is a unique circumstance, it is appropriate to allow [API] to recover its reasonable transaction and integration costs, effective the date of this Application.

OEB staff notes that the OEB decided that establishing the new Transaction and Integration Costs Deferral Account with a date prior to the filing of the Application, would constitute a retroactive adjustment that is generally not permitted. The OEB did not further opine on the appropriateness of any transaction costs that were incurred prior to September 24, 2018. In addition, the rate proposals (subject to the mitigation proposals that may be decided as part of this draft rate order process) were approved by the OEB. These rate and deferral account proposals assumed a certain amount of transaction costs that would be recoverable from ratepayers.

OEB staff notes that the pre-September 24, 2018 transaction costs are approximately \$71k.⁸ The OEB established that this is a unique case and that transaction costs may be recoverable from ratepayers. The OEB did not undertake a prudence review of these costs as part of this Application nor did the OEB make a finding that the transaction costs recorded in the Interim Licence Deferral Account are beyond the scope of the purpose of that account.

By establishing the effective date on September 24th and knowing that there were transaction costs that were incurred prior to this date, the OEB was well aware, in OEB staff’s view, that it was denying the subject amounts. But, because the OEB was responding to a request from API to commence to separately track the transaction and integration costs now that the acquisition of DLI is nearing completion, there is an argument to be made that this was more of an accounting and tracking exercise than it was a prudence review of the transaction costs.

⁷ EB-2018-0271, Decision and Order, April 4, 2019, p. 23

⁸ DRO, p. 11

Given that API has recorded its transaction costs in the existing Interim Licence Deferral Account, and that the OEB did not address the prudence of the transaction costs, OEB staff understands why API is seeking clarification on the status of the pre-September 24, 2018 transaction costs.

In OEB staff's view, in the absence of a motion on the part of API for the OEB to review and vary its decision, there are three paths that could be taken to address this matter. First, the OEB could confirm its finding on this matter as part of the final Rate Order process and API would remove the transaction costs in finalizing this Rate Order in order to abide by the OEB's finding on the effective date of the new account. API's shareholders would assume the \$71k costs to the extent that any of these costs are not already captured by API's approved annual regulatory budget.

Second, the OEB could seek further submissions from parties as to the nature and scope of the Interim Licence Deferral Account, and the nature and scope of the operational and transaction costs that were incurred in 2017 and 2018. The OEB could then issue a supplemental decision before issuing the final rate order for this case. OEB staff will not make submissions on the substance of these matters at this time but notes that as an example of what could be further explored by parties is the fact that the matter of distinguishing between operational and transaction costs during the 2018 year is not a straightforward exercise. There was certain work performed and costs incurred that served both functions.

For example, in the April 4, 2017 Order⁹ that appointed API as the interim operator of DLI's system, the OEB directed API to file a written report with the OEB advising on the status of the electricity distribution system in the Township including a detailed analysis of the assets and capabilities. Two external contractors were retained to provide third-party assessments, which likely make up some of the costs that were one-time in nature. There were seven reports accompanying the status report. Many of these reports could have served a dual purpose in that they allowed API to assess the status of DLI's system upon assumption of operation of DLI's system in accordance with the April 4, 2017 Order; and they may have formed part of the "due diligence" that an acquiring distributor would be expected to do in considering a possible acquisition. However, these also allowed API to assume operations pursuant to the Interim Licence Order and to comply with bullets 1 (d) and (f) of the Order.

⁹ EB-2017-0153

API noted in its DRO filing that the matter of whether it is appropriate for API to record transaction costs in the Interim Licence Deferral Account was not identified as a specific issue in this proceeding.

Third, all transaction-related costs incurred prior to September 24, 2018 could be treated similarly to operation and maintenance costs that API incurred as part of operating DLI's system per the April 4, 2017 Order, for purposes of finalizing this Rate Order, and this matter be tested and determined in API's subsequent 2020 cost of service rate case.

API pointed out that:

“the incurrence of transaction costs occurred beginning in April 2017, as API started to incur transaction costs in April 2017 as a result of having been appointed by the OEB as the interim operator of the DLI system, that the OEB was aware that API had been engaged in commercial discussions with DLI since that time, and that the OEB was supportive of and encouraged these efforts to achieve a long term solution to the public interest objective of having a viable and committed owner and operator of the DLI system.”¹⁰

OEB staff submits that a finding that pre-September 24, 2018 costs would be non-recoverable based on the fact that API did not request a dedicated account for transaction costs effective April 4, 2017, imposes these costs on API's shareholder and perhaps its legacy ratepayers even though these are not the parties that “caused” or “benefit” (in any material way) from the incurrence of these costs. This matter could be tested in API's subsequent rate case to determine whether or not it is contrary to the spirit of the OEB appointing API as an interim operator and to the fact that no other utility has had an interest in acquiring DLI.

2.2 Bill Impacts

As requested in the Decision and Order, API provided bill impact information comparing 2018 average bills to bills at the rates proposed by API. Further, if rate impacts exceeded 10%, API was required to file a rate mitigation plan. API explained in the DRO that DLI's historical billing practice was to calculate a rate to pass-through total costs of

¹⁰ DRO, p. 9, referencing Exhibit F/Tab 3/Schedule 2/pp. 1-2

the Delivery line of its bulk-metered bill to individual customers, on a monthly basis, inherently including any rate riders.¹¹

This rate experienced significant volatility over the past five years as a result of changes to Global Adjustment rate riders, including negative pass-through rates for 2018. In this context, using the average 2018 bills as a baseline results in the highest possible bill impact in the 2015 to 2019 period. For this reason, API provided three calculations of bill impacts¹² (keeping commodity costs and regulatory charges constant at current levels) based on the following scenarios:

- The 2018 average bill (average pass-through delivery rate of $-\$0.0079/\text{kWh}$) – bill impacts of 42.70% to 28.85% for residential customers, and 40.27% for commercial customers
- The May to December 2017 average bill, i.e. the portion of 2017 during which API was the interim operator (average pass through of $\$0.250/\text{kWh}$) – bill impacts of 2.41% to 17.92% for residential customers, and 9.20% for commercial customers
- The average March 2019 bill, i.e., the most recent month (average pass through delivery rate of $\$0.0064/\text{kWh}$) – bill impacts of 15.85% to 30.76% for residential customers, and 24.83% for commercial customers

API notes that the average 2018 bill impacts that API was ordered to calculate, result in the largest bill impacts.¹³ It has provided its various options in order to provide the OEB with alternatives for the OEB's consideration.

In light of potential mitigation measures that API was directed to address by the OEB in the Decision and Order,¹⁴ API has also provided additional bill impact comparisons¹⁵ with the proposed fixed monthly rate rider, and alternatives of a variable (per kWh) rate rider, or no rate rider. However, as discussed later in this submission, API's preference is for the fixed rate rider of $\$11.16/\text{month}$ for six years, as proposed.

Submission

OEB staff submits that it was reasonable for API to provide three different bill impact scenarios given the volatility of API's pass-through rate. First, it is standard practice that

¹¹ *Ibid.*, p. 13

¹² *Ibid.*, p. 16/Table 2

¹³ *Ibid.*, p. 14

¹⁴ EB-2018-0271, Decision and Order, April 4, 2019, p. 22, Bullet 3

¹⁵ DRO, p. 19/Table 4

bill impacts are calculated on the average annual bill for a customer (i.e. seasonal volatility is ignored by the annual averaging). Considering an average annual (or longer) period is more important here because DLI's existing rates were not unbundled (separated by commodity, transmission and distribution) as is the case for rate-regulated electricity distributors in Ontario.

OEB staff submits that API has complied with the OEB's directions in this regard in the Decision and Order. OEB staff also considers that API's provision of the alternative bill impacts for consideration by the OEB are appropriate based on API's explanations for the rate volatility – variations in consumption and in Global Adjustment amounts are known and are beyond the utility's ability to control. OEB staff notes that, in all three scenarios, at least some customers have a bill impact of more than 10%. As directed by the OEB in the Decision and Order, API has filed a rate mitigation plan. OEB staff's submissions on that plan are described below.

2.3 Fixed Rate Rider and Other Alternatives to Mitigate Bill Impacts

API had proposed a monthly fixed rate rider to recover, on an interim basis, the partial disposition of the Interim Licence Deferral Account from customers in the Township. The fixed rate rider would be an amount of \$11.16/month for a period of six years. API noted that it had considered the bill impacts on customers in the Township of the partial disposition Interim Licence Deferral Account on an interim basis. API submitted that its proposed fixed rate rider includes the following mitigation measures:

- Only the return of (depreciation) and return on capital is being recovered for the 2017-2019 period, with the undepreciated capital cost to form part of API's 2020 rate base
- A significant portion of non-capital costs currently in the Interim Licence Deferral Account were proposed to be transferred to the Transaction and Integration Costs Deferral Account, to be recovered as part of API's 2020 revenue requirement
- The proposed 6-year recovery period reduces the level of the rate rider for most residential and General Service (GS) customers in the Township¹⁶

¹⁶ *Ibid.*, pp. 16-17

API has also advised that the fixed rate rider was presented at a town hall meeting in the Township.¹⁷ Customers were informed of the proposal, and there were no interventions or letters of comment in this proceeding.

API proposed an alternative calculation for recovery of the amount via a variable (per kWh) rate rider, over the same term. This would lessen the bill impact on low volume customers, but API stated that GS and higher-volume residential customers may be upset by this change in API's proposal from what was communicated during meetings in the community.¹⁸

API has also provided the bill impact with no rate rider (i.e. no partial disposition of the Interim Licence Deferral Account balance).

API does not support delaying recovery of the interim partial disposition of the Interim Licence Deferral Account as approved by the OEB, in order to mitigate bill impacts in the immediate future. Nor does API propose to lengthen the recovery period for the interim rate rider. API notes that either option would result in larger amounts ultimately recovered from customers in the Township, due to higher carrying charges.

Submission

OEB staff supports API's proposal for the fixed rate rider of \$11.16/month for six years and does not support the alternative of a variable (per kWh) rate rider. In OEB staff's view, a variable rate rider would be inconsistent with the OEB's general rate policies, whereby:

- Group 2 Deferral and Variance Accounts, including API's Interim Licence Deferral Account and the new Transaction and Integration Costs Deferral Account, are now recoverable through fixed rate riders except where deviations are warranted
- The OEB's rate-setting policies overall are for fixed monthly distribution rates for residential customers,¹⁹ and the possibility of moving toward fixed monthly rates for low volume GS (i.e. commercial and industrial) is being considered under another policy initiative²⁰ of the OEB. Except for street lighting, the Township's 353 customers are residential or GS < 50 kW.

¹⁷ *Ibid.*, p. 20

¹⁸ *Ibid.*

¹⁹ [Board Policy on a New Distribution Rate Design for Residential Electricity Customers](#) (EB-2012-0410), April 2, 2015

²⁰ EB-2015-0043

OEB staff also notes that the costs in respect of which API is seeking interim disposition and recovery, through the rate rider, largely relate to incremental capital and operating costs for remediation of DLI's system, to bring it into compliance with the OEB's Codes and the requirements of other agencies (e.g. the Electrical Safety Authority and Measurement Canada). API has had to repair and replace poles, wires, transformers and meters, the costs of which are not dependent on the level of electricity consumption (kWh) for the Township's customers.

OEB staff notes that, through additional carrying charges, ultimately the amounts to be recovered with respect to the Interim Licence Deferral Account would increase if the recovery period were lengthened or if no rider were implemented at this time, relative to the current option of a fixed rate rider of \$11.16/month for six years.

OEB staff does not support API's option of no rate rider. The OEB approved API's requested partial disposition, on an interim basis, of certain costs in the Interim Licence Deferral Account.²¹ Eliminating the rate rider would be inconsistent with the OEB's Decision and Order.

OEB staff submits that lengthening the recovery period would be a possible option if the OEB finds that additional mitigation is warranted, but it is not preferred over the current proposal of the fixed rate rider of \$11.16/month for six years.

OEB staff submits that the current proposed fixed rate rider is the most reasonable approach, balancing the time for recovery and the cost relative to the impacts on most customers. It appears to OEB staff that API has made reasonable efforts to mitigate the impact on residential and GS customers in the Township, and to explain the impacts.

For the 353 residential and GS customers in the Township, DLI's existing rates, which were never approved by the OEB or, earlier, by Ontario Hydro, were not fully compensatory for the remediated system invested in and operated by API since April 4, 2017, and for the improved quality, safety and reliability of service they are now receiving.²²

OEB staff notes that customers in the Township were implicitly receiving Rural or Remote Electricity Rate Protection (RRRP) treatment through the manner in which DLI, as an R2 customer of API, was passing on API's charges to it.²³ Upon the completion of the transaction, when the residential and GS customers in the Township are reclassified

²¹ EB-2018-0271, Decision and Order, April 4, 2019, pp. 20-21

²² OEB Staff Submission, February 21, 2019, p. 21

²³ *Ibid.*

as R1(i) and R1(ii) customers of API, they will explicitly be receiving RRRP treatment. Customers in the Township have received, and will continue to receive, subsidized rates in accordance with regulations. However, not all costs can, or should, be passed on to be borne by all Ontario ratepayers (through RRRP and/or Distribution Rate Protection). In OEB staff's view, customers in the Township receive materially improved services under API's operation, and they should reasonably bear the costs for this benefit.

OEB staff submits that API has addressed the OEB's direction in the Decision and Order to address mitigation. Existing subsidization through the RRRP and the DRP, and the insufficiency of DLI's existing rates, are significant factors that exacerbate the bill impacts of API's proposed fixed rate rider. OEB staff submits that the proposed fixed rate rider of \$11.16/month for six years is reasonable²⁴ in mitigating the bill impacts for most of the 353 residential and GS customers in the Township.

2.4 Proposed Tariff Schedule

API has included a proposed Tariff of Rates and Charges as Schedule A of the DRO. The proposed Tariff of Rates and Charges is based on API's approved Tariff of Rates and Charges for 2019.²⁵ API has included the proposed Rate Rider for Partial Disposition of Interim Licence Deferral Account as the following for the R1 (covering both R1(i) and R1(ii) customers) and R2 (should improved metering data require reclassification of any GS customers in the Township into this class):

| | |
|--|----------|
| Rate Rider for Partial Disposition of Interim Licence Deferral Account | |
| - effective until December 31, 2024 | |
| Applicable only for customers in the Township of Dubreuilville | \$ 11.16 |

Submission

OEB staff has reviewed the proposed Tariff of Rates and Charges, and submits that it is consistent with the 2019 Decision and Rate Order and with the OEB's findings in this

²⁴ In the *Report of the Board on the 2006 Electricity Distribution Rate Handbook* (EB-2004-0188), May 11, 2005, the OEB stated:

The Board considers that diligence respecting rate increases is a core responsibility of the distributor. It is a fundamental element of customer relations to manage the expectations of consumers and to remedy, where possible, and to the extent reasonable, hardship occasioned by material increases in rates. [p. 89]

²⁵ EB-2018-0017

proceeding, subject to any further changes the OEB decides on the Interim Licence Deferral Account rate rider.

The only change that OEB staff would recommend is that the final approved Tariff of Rates and Charges should include references to both EB-2018-0017 and EB-2018-0271 in the header on the right, as the OEB's decisions and rate orders in both of those proceedings are the basis for the revised Tariff of Rates and Charges.

2.5 Draft Accounting Order

API has included a revised Draft Accounting Order for the Transaction and Integration Costs Deferral Account.²⁶ The only change made relative to the Draft Accounting Order in the Application²⁷ was to change the effective date from April 4, 2017 to September 24, 2018, in accordance with the OEB's Decision and Order.

Submission

Subject to the OEB's findings on API's proposals in the DRO with regard to the Interim Licence Deferral Account and the Transaction and Integration Costs Deferral Account, OEB staff submits that the Draft Accounting Order is reasonable and compliant with the OEB's Decision and Order.

All of which is respectfully submitted.

²⁶ DRO/Appendix B

²⁷ Exhibit F/Tab 3/Schedule 2/Appendix A