BY EMAIL

May 9, 2022

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Marconi:

Re: Application for the relief necessary to effect the amalgamation of Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. to continue as LDC MergeCo
Ontario Energy Board File Number: EB-2022-0006

In accordance with Procedural Order No. 2, please find attached OEB staff's submission in this proceeding. Kitchener-Wilmot Hydro Inc., Waterloo North Hydro Inc., and all intervenors have been copied on this filing.

Yours truly,

Georgette Vlahos
Digitally signed by Georgette Vlahos
Date: 2022.05.09 16:26:52 -04'00'

Georgette Vlahos
Advisor – Electricity Distribution: Major Rate Applications & Consolidations

Attach.

ONTARIO ENERGY BOARD

Application by Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. for approval to amalgamate and continue operations as a single electricity distribution company

EB-2022-0006

OEB Staff Submission

May 9, 2022

1 INTRODUCTION

Kitchener-Wilmot Hydro Inc. (Kitchener-Wilmot Hydro) and Waterloo North Hydro Inc. (Waterloo North Hydro) (collectively, the Applicants) filed an application with the Ontario Energy Board (OEB) on January 31, 2022,[1] for approval of the following:[2]

- The amalgamation of their parent holding companies, Kitchener Power Corp. and Waterloo North Hydro Holding Corporation, to form a new holding company referred to in the application as Merged Holdco
- For Merged Holdco to acquire control of Kitchener-Wilmot Hydro and Waterloo North Hydro
- The amalgamation of Kitchener-Wilmot Hydro and Waterloo North Hydro to form a new electricity distribution company, referred to in the application as LDC MergeCo
- The issuance of an electricity distribution licence to LDC MergeCo and the cancellation of the electricity distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro upon the issuance of the distribution licence to LDC MergeCo
- The transfer of the current and any future rate orders of Kitchener-Wilmot Hydro and Waterloo North Hydro to LDC MergeCo
- The tracking of costs by LDC MergeCo to existing deferral and variance accounts of Kitchener-Wilmot Hydro and Waterloo North Hydro
- A deferral account to track certain grossed-up Payments in Lieu of tax impacts for Waterloo North Hydro's service area and to track any resulting variances in a related sub-account
- The deferral of LDC MergeCo's rate rebasing application for ten years from the date the transaction is completed (deferred rebasing period)
- The continued maintenance of two separate rate zones, one for the Kitchener-Wilmot Hydro service area and one for the Waterloo North Hydro service area for both the 10-year deferred rebasing period and for an additional ten years after the deferred rebasing period ends (i.e., years 11-20)[3]
- A deferral account to track costs associated with the proposed Earnings Sharing Mechanism (ESM)

[1] Pursuant to sections 18, 60, 77(5), 78, 86(1)(c) and 86(2)(b) of the *Ontario Energy Board Act*, 1998, S.O. 1998, c. 15, Schedule B
[2] EB-2022-0006, Application, pp. 20-22, January 31, 2022
[3] This request was clarified in response to interrogatories from SEC and OEB staff

The proposed transaction is a non-cash transaction involving the issuance of shares. Upon completion of the proposed transaction, the share percentage ownership of Merged Holdco, the holding company of LDC MergeCo, will be as follows: [4]

- City of Kitchener: 53.39%
- Township of Wilmot: 4.49%
- City of Waterloo: 30.83%
- Township of Woolwich 8.51%
- Township of Wellesley 2.78%

The application states that the proposed transaction will benefit and protect customers in the context of the OEB's statutory objectives. The benefits can be summarized as follows: [5]

- Stable distribution rates over the course of the 10-year deferred rebasing period, as provided under the Price Cap Incentive Regulation (IR) methodology
- A larger, local and municipally-owned utility that will deliver cost synergies and operational efficiencies
- A larger utility that will have the capacity to modernize and adapt to future changes in Ontario's electricity sector, with the ability to dedicate resources to invest in innovation and new technologies that address the needs of customers

2 "NO HARM" TEST

The OEB applies the "no harm" test when assessing applications that seek approval for regulated entities to consolidate. As described in the *Handbook to Electricity Distributor and Transmitter Consolidations (*MAADs Handbook),[6] the "no harm" test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB's statutory objectives.[7]

If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.[8]

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[4] EB-2022-0006, Application, p. 20
[5] *Ibid*, p.7, p. 24
[6] OEB *Handbook to Electricity Distributor and Transmitter Consolidations* (MAADs Handbook), pp. 3-4, January 19, 2016
[7] *OEB Act, 1998*, Section 1
[8] MAADs Handbook, pp. 3-4

3 OEB STAFF SUBMISSIONS

In its review of the application, OEB staff has considered the requirements described in the MAADs Handbook and other applicable OEB policies[9] as described herein.

OEB staff supports the proposed amalgamation of Kitchener-Wilmot Hydro and Waterloo North Hydro.

OEB staff supports the Applicants' proposal to maintain two separate rate zones during the 10-year deferred rebasing period. OEB staff's submission is based on the fact that during this time, the current costs of the separate entities will continue to be the basis for the respective rates paid by the current customers of the two utilities. An exception to staff's position on this matter is discussed in section 3.2.5 of this submission related to Group 1 deferral and variance accounts where OEB staff discusses the potential consolidation of Group 1 accounts during the 10-year deferred rebasing period. Section 3.2.6 of this submission related to Accounting Policy Changes also discusses Waterloo North Hydro adopting the accounting policies of Kitchener-Wilmot Hydro.

OEB staff does not support the Applicants' request to maintain two separate rate zones for an additional ten years after the deferred rebasing period ends (i.e., years 11-20) as part of the current application, for reasons discussed further in section 3.2.1 of this submission. OEB staff submits that this request should be addressed in the rebasing application after the 10-year deferred rebasing period.

3.1.1 Impact on Price, Economic Efficiency and Cost Effectiveness

The MAADs Handbook allows for an acquiring or merging utility to elect to defer rebasing for up to a maximum of ten years. The deferral period allows the acquiring or merging utility an opportunity to recover transaction costs, which are not normally allowed to be recovered directly from customers, through operational and capital efficiencies resulting from the transaction over a reasonable period of time.

The Applicants have requested a 10-year deferred rebasing period and have estimated total Operating, Maintenance and Administrative (OM&A) savings, net of transition costs, of approximately $28.8M over that period. The Applicants estimate annual OM&A cost savings of approximately $3.6M by year ten (2032) after the transaction closes.

[9] *Handbook for Utility Rate Applications* (Rate Handbook) and *Accounting Procedures Handbook*

The Applicants provided a detailed account of future OM&A savings that are forecast to result from merger-related efficiency gains in the following OM&A categories: salary and wages, operating services, information technology, professional services and corporate. The Applicants stated that operating savings will benefit customers through lower rates than on a stand-alone basis, as well as provide local and community benefits.[10]

Table 1 shows a summary of the expected OM&A savings and integration and implementation cost projections obtained from the Applicants' interrogatory responses.[11]

Table 1: Projected OM&A Savings and Transition Costs ($000's)

Synergy Savings Projections	**2023 Year 1**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**
Salary and Wages	(2,213)	(2,257)	(2,302)	(2,348)	(2,395)	(2,443)	(2,492)	(2,542)	(2,592)	(2,644)
Operating Services	(298)	(304)	(310)	(317)	(323)	(329)	(336)	(343)	(349)	(356)
Information Technology	(282)	(288)	(293)	(299)	(305)	(311)	(317)	(324)	(330)	(337)
Professional Services	(123)	(125)	(128)	(131)	(133)	(136)	(139)	(141)	(144)	(147)
Corporate	(101)	(103)	(105)	(107)	(109)	(111)	(114)	(116)	(118)	(121)
Total Synergy Savings	**(3,017)**	**(3,077)**	**(3,139)**	**(3,201)**	**(3,265)**	**(3,331)**	**(3,397)**	**(3,465)**	**(3,535)**	**(3,605)**
Integration and Implementation Cost Projections	**2023 Year 1**	**2024**	**2025**	**2026**	**2027**	**2028**	**2029**	**2030**	**2031**	**2032**
Human Resource Costs	375	375	-	-	-	-	-	-	-	-
System Integration	250	860	-	-	-	-	-	-	-	-
Financial, Legal and Regulatory Costs	1,540	-	-	-	-	-	-	-	-	-
Rebranding	400	-	-	-	-	-	-	-	-	-
Facilities	-	300	-	-	-	-	-	-	-	-
Other	150	4	-	-	-	-	-	-	-	-
Total Integration and Implementation Costs	**2,715**	**1,539**	-	-	-	-	-	-	-	-
Net (Costs) / Synergies	**(302)**	**(1,538)**	**(3,139)**	**(3,201)**	**(3,265)**	**(3,331)**	**(3,397)**	**(3,465)**	**(3,535)**	**(3,605)**
Total Synergy Savings	**(28,778)**									

The Applicants have not included net cost savings related to capital investments in the analysis of the proposed transaction over the 10-year deferred rebasing period as they are not expected to be material.[12]

[10] EB-2022-0006, Application, p. 43, January 31, 2022
[11] EB-2022-0006, Interrogatory Response, SEC-5, April 25, 2022
[12] EB-2022-0006, Application, p. 32

The Applicants stated that, over the course of the 10-year deferred rebasing period, customers in the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas will benefit from stable distribution rates, as provided under Price Cap IR. Under this methodology, distribution rates are projected to increase at less than the rate of inflation over the ten years following the merger and are lower than what they would have been on a stand-alone basis.[13] In the absence of the proposed transaction, Kitchener-Wilmot Hydro would rebase their distribution rates in 2025 and 2030, while Waterloo North Hydro would rebase in 2026 and 2031. Without the benefit of the projected costs savings and synergies realized from this proposed merger, projected rate increases under the stand-alone basis are expected to be greater than they would be for customers in each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas under Price Cap IR rate adjustments for the amalgamated LDC MergeCo.[14]

The combined effect of remaining on Price Cap IR and the projected OM&A savings are expected to deliver lower distribution costs to LDC MergeCo customers of approximately 3.1% through the rebasing deferral period and 4.5% following the transfer of the merger benefits to customers, respectively.[15]

The following tables were prepared by OEB staff based on the responses to interrogatories filed by the Applicants.[16] The tables compare the forecasted total distribution revenue requirements and distribution revenue requirements per customer for Kitchener-Wilmot Hydro and Waterloo North Hydro respectively, to LDC MergeCo over the deferred rebasing period, and the first rebasing year (2033).

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[13] *Ibid*, p. 24
[14] EB-2022-0006, Application, p. 25
[15] *Ibid*, p. 35
[16] EB-2022-0006, Interrogatory Response, SEC-9, KWHI_WNHI_IRR_Tables_MAAD_20220426

Table 2: Kitchener-Wilmot Hydro – Distribution Revenue and Distribution Revenue/Customer

	Total Distribution Revenue (Stand-Alone) ($000s)	Total Distribution Revenue (Merged) ($000s)	Distribution Revenue/Customer (Stand-Alone) ($)	Distribution Revenue/Customer (Merged) ($)
2023 (Year 1)	46,991	46,991	465.59	465.59
2024	48,616	48,616	473.13	473.13
2025	51,193	50,297	489.37	480.80
2026	52,963	52,036	497.30	488.59
2027	54,795	53,835	505.36	496.51
2028	56,689	55,697	513.55	504.56
2029	58,650	57,623	521.88	512.74
2030	60,354	59,615	527.50	521.05
2031	62,441	61,677	536.05	529.49
2032	64,600	63,810	544.74	538.07
2033	66,834	62,689	553.57	519.24

Table 3: Waterloo North Hydro – Distribution Revenue and Distribution Revenue/Customer

	Total Distribution Revenue (Stand-Alone) ($000s)	Total Distribution Revenue (Merged) ($000s)	Distribution Revenue/Customer (Stand-Alone) ($)	Distribution Revenue/Customer (Merged) ($)
2023 (Year 1)	39,552	39,552	667.01	667.01
2024	40,672	40,672	676.89	676.89
2025	41,824	41,824	686.91	686.91
2026	45,572	43,009	738.62	697.08
2027	46,863	44,227	749.55	707.39
2028	48,190	45,479	760.65	717.87
2029	49,555	46,767	771.91	728.49
2030	50,958	48,092	783.33	739.28
2031	51,574	49,454	782.38	750.22
2032	53,035	50,855	793.96	761.32
2033	54,537	50,085	805.71	739.94

The Applicants confirmed that they intend to use a combined stretch factor during the deferred rebasing period when setting the rates for both the Kitchener-Wilmot Hydro and Waterloo North Hydro service territories, when the Pacific Economics Group Research (PEG) assessment would permit it.[17] The intention is to file separate regulatory filings for 2022, and combined filings for 2023 and beyond.[18]

[17] The PEG assessment is a statistical cost benchmarking study designed to make inferences on individual distributors' cost efficiency.
[18] EB-2022-0006, Interrogatory Responses, Staff-13

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, 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.[19]

The Applicants stated that some of the OM&A savings will come from the consolidation of two boards of directors into a single board of directors, as well as optimization and reduction of staffing levels through planned retirements and natural attrition.[20] The value of these savings - approximately $33.0M over the 10-year deferred rebasing period - is expected to more than offset the Applicants' forecasted transaction and transition costs of $4.3M, resulting in net savings over the 10-year deferred rebasing of $28.8M.[21] The Applicants also confirmed that transaction and transition costs will not be included in future LDC MergeCo revenue requirements and will not be funded by customers.[22]

Interrogatory SEC-9 requested that the Applicants provide a table that shows a forecast of the Kitchener-Wilmot Hydro, Waterloo North Hydro and LDC MergeCo distribution revenue and distribution revenue per customer, broken down by class for 2022 to 2032. OEB staff has reviewed the Applicants' response to interrogatory SEC-9 and provides the following analysis.[23]

First, as seen in Tables 1 and 2 above, forecasted total distribution revenue for both Kitchener-Wilmot Hydro and Waterloo North Hydro service areas are expected to be lower over the deferred rebasing period on a merged basis as compared to a stand-alone basis. The same can be said with respect to distribution revenue per customer. OEB staff notes that the modelling provided by the Applicants has assumed different stretch factors for Kitchener-Wilmot Hydro (0.15%) and Waterloo North Hydro (0.30%) from 2023 onwards. While this may be appropriate for a comparison on a stand-alone basis, it is inconsistent with the evidence of how the Applicants propose the Price Cap IR will be applied during the 10-year deferred rebasing period. The Applicants' response

[19] MAADs Handbook, pp. 6-7
[20] EB-2022-0006, Application p. 42. Other areas where operating savings are expected to be primarily realized include: reduction in future regulatory costs, elimination of duplicate/overlapping third party services, reduction in IT costs such as hardware and software maintenance fees etc. (p. 43)
[21] EB-2022-0006, Application, p. 45
[22] *Ibid*
[23] EB-2022-0006, KWHI_WNHI_IRR_Tables_MAAD_20220426, SEC-9

to interrogatory Staff-13 confirmed the intention to file separate regulatory filings for 2022 for each of Kitchener-Wilmot Hydro and Waterloo North Hydro, and combined filings for 2023 and beyond (i.e., based on a consolidated stretch factor). Second, in comparing the 2033 forecasted revenue requirement ($112.8M), versus the year prior to rebasing (2032) for the merged utility ($114.7M), OEB staff notes that there only appears to be about a $1.9M difference. In comparison, OEB staff notes that the Applicants have forecasted $28.8M in net OM&A savings alone over the 10-year deferred rebasing period, and that by 2032, the Applicants expect annual OM&A savings of approximately $3.6M.

While it is possible that some of the savings are offset by the effects of inflation and growth[24] on the aggregate revenue requirement, OEB staff notes that it is not clear from the responses to interrogatories what these savings are.[25] OEB staff's concern is whether the LDC MergeCo scenario provided by the Applicants underestimates the achievable savings that should be passed on to the benefit of ratepayers by the time of the next rate rebasing application in 2033. OEB staff believes there are likely ample opportunities for sufficient savings. OEB staff further highlights the apparent underestimation of OM&A savings in section 3.2.7 of this submission.

OEB staff further notes that, while no material capital savings have been forecasted at this time, there should be real opportunities for capital efficiencies that become apparent and realized. OEB staff believes that the commonality of business conditions, operations, and proximity (and indeed integration of operations on regional initiatives) should provide opportunities for realized capital savings over time, beginning during the 10-year deferred rebasing period. The Applicants stated that there are potential synergies with the integration of the software systems in the long-term after software systems rationalization is complete, although the extent of any potential avoided capital expenditures has not been quantified.[26] The Applicants stated that any net capital cost savings achieved during the 10-year deferred rebasing period will ultimately benefit

[24] In response to SEC-9, the Applicants have assumed an annual inflation factor of 1.8%, and growth of 1.81% for Kitchener-Wilmot Hydro and 1.33% for Waterloo North Hydro.
[25] The $112.774M revenue requirement forecasted for LDC MergeCo's cost of service rebasing is modelled outside of the SEC-9 response, and the details are not provided. It is thus unclear how much of an increase in the revenue requirement for the LDC MergeCo in 2033 there would be for the inflation and growth assumptions, and thus what is the amalgamation gross savings to result in a net reduction of $1.9M compared to 2032.
[26] EB-2022-0006, Interrogatory Response, SEC-6

customers through lower depreciation and amortization expense and return on rate base in the years following rebasing.[27]

OEB staff notes that forecasted distribution revenue per customer for Waterloo North Hydro customers is higher than Kitchener-Wilmot Hydro customers, as indicated in Tables 2 and 3 above. In Table 4 below, OEB staff provides a direct comparison between the "Distribution Revenue/Customer (Stand-Alone)" columns provided in Tables 2 and 3.

Table 4: Comparison of Kitchener-Wilmot Hydro vs. Waterloo North Hydro Distribution Revenue/Customer (Standalone)

	Kitchener-Wilmot Hydro Distribution Revenue/Customer ($) (a)	Waterloo North Hydro Distribution Revenue/Customer ($) (b)	Difference ($) (a-b)
2023	465.59	667.01	-201.42
2024	473.13	676.89	-203.76
2025	489.37	686.91	-197.54
2026	497.30	738.62	-241.32
2027	505.36	749.55	-244.19
2028	513.55	760.65	-247.1
2029	521.88	771.91	-250.03
2030	527.50	783.33	-255.83
2031	536.05	782.38	-246.33
2032	544.74	793.96	-249.22
2033	553.57	805.71	-252.14

As indicated in Table 4 above, the difference in distribution revenue/customer on a standalone basis is estimated to be $252.14 in 2033. On a merged basis, the difference in distribution revenue/customer is estimated to be $220.70 in 2033 at the time of LDC MergeCo's first cost of service rebasing.[28] In any merger scenario, it is understood that one of the merging entities may have a higher distribution revenue per customer than the other, but in some cases the difference is not significant. OEB staff notes that the distribution revenue requirement differential in this case is noteworthy.

OEB staff recognizes that distribution revenue per customer differences between utilities are often indicative of differences in distribution rates, but there can be other factors that contribute to differences in distribution revenues per customer. Differences in the profiles of customers, i.e., the proportion of residential versus general service and

[27] EB-2022-0006, Application, p.34
[28] $739.94 (Distribution Revenue/Customer for Waterloo North Hydro in 2033) – $519.24 (Distribution Revenue/Customer for Kitchener-Wilmot Hydro in 2033) from Tables 2 and 3

large users, and differences in the energy consumption and demand are major factors, as well as, rate design differences between different utilities. OEB staff notes that the significant differences in aggregate distribution revenue per customer data as provided in this application are influenced by these other factors. A comparison of Kitchener-Wilmot Hydro's and Waterloo North Hydro's current (2022) tariffs, and of customer count and consumption (kWh) and demand (kW) data indicates markedly different customer and energy demand data which accounts for some of the higher average distribution revenue for Waterloo North Hydro compared to that for Kitchener-Wilmot Hydro.[29] This is not to say that there are not differences in costs and rates, but these do not account for all of the observed differences in distribution revenue per customer.

While there is no rate harmonization proposal in this proceeding, OEB staff submits that, based on the above analysis of factors (rates and rate design, and customer and energy demand profiles) contributing to differences in distribution revenue per customer between the Applicants, should be a matter that needs to be thoroughly examined in the 2033 rebasing application, and any proposed rate harmonization plan.

OEB staff anticipates that in the first rebasing application following the 10-year 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 *Handbook for Utility Rate Applications*.[30] The Rate Handbook provides that as part of the amalgamated entities' first cost of service or Custom IR application following consolidation, the OEB will scrutinize the specific rate-setting aspects of the amalgamation, including a rate harmonization plan and/or customer rate classifications post consolidation. The OEB will consider, among other things, the savings that have been generated through the amalgamation, as well as, how savings resulting from productivity gains are reflected in harmonized rates.[31] OEB staff submits that the OEB should require the Applicants, as part of the future application to rebase rates for January 1, 2033, to specifically identify how the savings generated through the merger have impacted the distribution revenues per customer in both of the Waterloo North Hydro and Kitchener Wilmot Hydro rate zones and the corresponding impacts of these savings on proposed rates. That is, it will not be sufficient for the Applicants to demonstrate overall savings and apply those savings across a combined rate base. Rather, LDC MergeCo should be required to demonstrate the savings that have

[29] References: EB-2021-0038 (Kitchener-Wilmot Hydro), Decision and Rate Order and IRM Rate Generator Model, EB-2021-0062 (Waterloo North Hydro), Decision and Rate Order and IRM Rate Generator Model, 2020 Electricity Distribution Yearbook
[30] Rate Handbook, p. 21
[31] *Ibid*

accrued to each service territory, the specific actions taken to generate those savings and the effect of those savings on the cost to serve customers in each of the legacy service territories.

If the application to rebase 2033 rates does not satisfactorily address the rate-setting aspects of the amalgamation, as set out in the Rate Handbook, the OEB can address the matter in the rebasing application. For example, the OEB has in some instances disallowed rate harmonization proposals and required merging utilities to continue separate rate zones. This was most recently demonstrated in the OEB's decision on Hydro One's application for 2018-2022 electricity distribution rates.[32] In that decision, the OEB determined that Hydro One's proposed cost allocation to the acquired utilities (Norfolk, Haldimand and Woodstock) did not reflect the OEB's decisions in the related Hydro One acquisition proceedings and the OEB therefore did not approve Hydro One's proposed rates for the acquired utilities.[33] Instead the OEB maintained the then current rate schedules and allowed Hydro One to apply for annual Price Cap IR adjustments following the respective rebasing periods.

Based on the evidence on the record, OEB staff believes that the amalgamation has the potential to deliver benefits to customers of both Kitchener-Wilmot Hydro and Waterloo North Hydro. OEB staff notes that the two utilities have common attributes as they have both urban and rural areas and in some ways are already integrated [34] and have contiguous service areas. However, given the distribution revenue per customer differentials outlined above, OEB staff submits that the Applicants should be required, at the time of rebasing, to clearly articulate how savings have accrued individually to the customers of Waterloo North Hydro and Kitchener Wilmot Hydro in the amalgamated entities' first cost of service or Custom IR application following consolidation in the manner described above. This will allow the OEB to assess progress and consider what measures should be implemented in order to ensure ratepayers are effectively protected.

OEB staff supports the use of a combined stretch factor for LDC MergeCo. OEB staff submits that the synergies and savings resulting from the merger should be taken into

[32] EB-2017-0049
[33] *Ibid*, Decision and Order, March 7, 2019, p. 4, 164
[34] The host/embedded network relationship between Kitchener-Wilmot Hydro and Waterloo North Hydro goes back several decades and predates restructuring. Both utilities serve contiguous service areas that are similar in being urban/rural mixes.

consideration for the PEG assessment. The OEB has also accepted this methodology in an application by Alectra Utilities Corporation.[35]

3.1.2 Adequacy, Reliability and Quality of Electricity Service

The MAADs Handbook requires utilities to indicate the impact that the proposed transaction will have on customers with respect to reliability and quality of electricity service. The MAADs 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.[36]

The Applicants stated that a key objective of the proposed amalgamation will be to ensure levels of customer service, safety, and reliability that either meet or exceed existing levels in each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas.[37] Further, LDC MergeCo will incorporate feedback from customers to set its performance targets. The Applicants also stated that customers will benefit from being served by a larger distributor that will have "expanded resources, including people and technology to improve system reliability and power quality, as well as monitoring and reporting of these performance metrics".[38]

The Applicants stated that LDC MergeCo will continue to have two dedicated operations centers servicing a larger territory - one in Kitchener, and one in Waterloo. Most operations staff will remain in the communities that they currently serve, however, in the event of a large-scale outage in the service area, LDC MergeCo will have the ability to draw on a much larger number of operations staff for restoration efforts.[39] Further, LDC MergeCo's service areas are contiguous and combining resources will lead to improved restoration times in outage situations and improved service quality indicators.

LDC MergeCo also plans on transitioning to a centralized control room. LDC MergeCo expects that with a centralized control room, reliability and quality of service will improve by minimizing the duration of outages.[40] The Applicants project that the transition to a

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[35] EB-2019-0018, Partial Decision and Interim Rate Order, p.6, December 12, 2019
[36] MAADs Handbook, p. 7
[37] EB-2022-0006, Application, p. 26
[38] *Ibid*, p. 27
[39] EB-2022-0006, Application, p. 40
[40] *Ibid*, p. 41

centralized control room will take place within 18-24 months after the approval of the merger.[41]

The Applicants stated that some of the OM&A synergies will come from planned retirements and natural attrition. However, the Applicants stated that LDC MergeCo will maintain or improve existing response times as overall staffing levels are not expected to change in the operations area.[42]

In summary, the Applicants stated that they expect that LDC MergeCo will maintain and/or improve upon the five-year average reliability indices and the OEB Customer Service Standard metrics for its customers.[43]

Submission

Based on the evidence provided by the Applicants, OEB staff agrees that LDC MergeCo can reasonably be expected to maintain the service quality and reliability standards currently provided by each of the amalgamating utilities. There are no anticipated reductions to operations staff and the existing operations centers for each service area will remain unchanged. In addition, customers may see benefits by way of support from neighbouring operations centers during significant outages. OEB staff agrees that the move towards a centralized control room may also streamline operations.

OEB staff believes the contiguous nature of the two utilities, and their mutual long histories of operating combined urban/rural service areas will continue under amalgamation and should provide opportunities for maintaining and enhancing service quality and reliability, and in cost effective manners.

Kitchener-Wilmot Hydro’s current Distribution System Plan (DSP) is in place until 2024 (inclusive) and Waterloo North Hydro’s current DSP is in place until 2025 (inclusive). The Applicants confirmed that they use the same principles for managing their assets, with some differences in the software platform to capture and analyze the asset performance data and develop capital plans. The Applicants will look to utilize a common platform over time.[44] The Applicants plan to file a combined DSP as part of the

[41] EB-2022-0006, Interrogatory Responses, Staff-14(b)(ii)
[42] EB-2022-0006, Application, p. 27
[43] *Ibid*, p. 28
[44] EB-2022-0006, Interrogatory Responses, Staff-16

next cost of service application in 2033. In the interim, current asset management practices will be used.

At this time, the Applicants do not expect an Incremental Capital Module (ICM) will be filed during the deferred rebasing period.[45] However, the Applicants stated that if LDC MergeCo files an ICM application beginning in 2025, regardless of the service area that the ICM is in, a consolidated DSP will be filed concurrently.[46] The Applicants stated that this is consistent with the OEB's decision in the Brantford Power Inc. and Energy+ Inc. merger application.[47]

OEB staff agrees with the Applicants' proposal and submits that if LDC MergeCo files an ICM in either service area beginning in 2025, it should file a consolidated DSP. From a planning perspective, it is important to understand LDC MergeCo's planning as a combined utility when considering the need and prudence of any proposed ICM.

3.1.3 Impact on Financial Viability

The MAADs 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[48]

Submission

The Applicants indicated that the proposed transaction is predominantly a non-cash transaction involving the issuance of shares. The only consideration which may be necessary will occur in the form of the issuance and redemption of non-voting special shares of Merged Holdco arising from typical post-closing adjustments. Therefore, there is no adverse effect on the financial viability of the Applicants.[49] In response to an interrogatory, the Applicants confirmed that the post-closing adjustments are not

[45] EB-2022-0006, Interrogatory Responses, SEC-10
[46] *Ibid*, PP-6(a)
[47] EB-2021-0280
[48] MAADs Handbook, p. 8
[49] EB-2022-0006, Application, p. 45

expected to be material and will not affect LDC MergeCo's financial liability or financing circumstances.[50]

With respect to the financing of transaction and integration costs to implement the proposed transaction, the Applicants stated that total integration and OM&A implementation costs, which are estimated at approximately $4.3M, will be financed through the anticipated productivity savings expected from the merger during the 10-year deferred rebasing period.[51]

OEB staff notes that the Applicants show that total incremental OM&A integration and implementation costs are estimated to be $4.3M in years one and two. Further, OEB staff notes that the synergies savings for the same period are estimated at $6.1M, which are anticipated to exceed the costs of the merger.[52] Furthermore, OEB staff notes that LDC MergeCo's pro-forma statements in year one show that total comprehensive income is forecasted to be $23.5M.[53]

In addition, both distributors are currently operating at a debt level below the OEB's deemed debt structure. The pro-forma debt-to-total capital ratio for LDC MergeCo at the end of 2020 is 42%. The ratio at the end of year one following the closing of the proposed transaction is 39%. The Applicants stated that they expect to work with a financial institution with respect to the longer-term financing plan for LDC MergeCo, which includes a proposal for a $45M revolving line of credit. The $45M is the combination of the existing lines of credit of Kitchener-Wilmot Hydro and Waterloo North Hydro. The Applicants are targeting a long-term A-range rating for LDC MergeCo.

Considering the above, in OEB staff's opinion, the amalgamation will not negatively impact the financial viability of the Applicants.

3.2 Other Matters

3.2.1 Special Request - Rate Harmonization Period

The Applicants request leave pursuant to Section 78 of the OEB Act to maintain two separate distribution rate zones: one for the Kitchener-Wilmot Hydro service area and

[50] EB-2022-0006, Interrogatory Response, Staff-21
[51] EB-2022-0006, Application, p. 45
[52] EB-2022-0006, Interrogatory Response, Staff-9(d) and SEC-5
[53] EB-2022-0006, Application, Schedule O

one for the Waterloo North Hydro service area for both the 10-year deferred rebasing period and the Rate Harmonization Period, which is described as the ten years following the 10-year deferred rebasing period (i.e., years 11-20).

The special request is made pursuant to section 9.3 of the Merger Participation Agreement (MPA) between the two holding companies (Kitchener Power Corp. and Waterloo North Hydro Holding Corporation). Sections 9.3 of the MPA states, among other things, that if the OEB does not approve the continuation of separate rate zones for a minimum period of 20 years post-closing, either of the holding companies may provide written notice to the other parties of such potential "Adverse Determination". Further, parties to the MPA agreed to cooperate and negotiate a desirable or required amendment to address a potential Adverse Determination.[54]

The Applicants stated that "these are key commercial considerations that were and still are relevant to the municipal shareholders in deciding to approve the transaction and sign the MPA."[55]

OEB staff sought further clarification in its interrogatories with respect to the "special request" in the current application. In response, the Applicants clarified that approval is being sought to maintain two separate rate zones for an additional ten years after the deferred 10-year rebasing period ends, and that no formal proposal with respect to rate harmonization has been made in this application.

Submission

As stated above, OEB staff does not take issue with the request to maintain two separate rate zones during the 10-year deferred rebasing period (years 1-10). The submission that follows is with respect to the special request to maintain two separate rate zones for years 11-20.

The MAADs Handbook states that:

> A consolidated entity is expected to propose rate structures and rate harmonization plans following consolidation at the time it files its rebasing application. Distributors are not required to file details of their rate-setting plans, including any proposals for rate harmonization, as part of the application for consolidation. These issues will be addressed at the time of rate rebasing of the consolidated entity.

[54] EB-2022-0006, Application, Attachment I – MPA, Section 9.3, p. 92
[55] EB-2022-0006, Interrogatory Response, Staff-2(b)

> A rate harmonization plan can propose the approach and timeline for harmonizing rate classes or provide rationale for why certain rate classes should not be harmonized based on underlying differences in cost structures and drivers. For acquisitions, distributors can propose plans that place acquired customers into an existing rate class or into a new rate class. However, the OEB expects that whichever option is adopted, rates will reflect the cost to serve the acquired customers, including the anticipated productivity gains resulting from consolidation.[56]

It is the Applicants' position that this request does not violate any policy position set out in the MAADs Handbook. The Applicants have indicated their intention to propose a 10-year rate harmonization plan at the time of the first rebasing of the consolidated entity. OEB staff takes no issue with this intent and agrees that this intent is not in violation of any policy position in the MAADs Handbook. That said, OEB staff is unclear why a formal approval of a 20-year legacy rate zone period is required as part of this MAADs applications since the Applicants have acknowledged that a future panel of the OEB can approve a shorter (or presumably even a longer) rate harmonization period. The Applicants confirmed that the request is made without prejudice to a future OEB panel making a determination it sees fit with regards to any rate harmonization proposal.

The Applicants also stated that if a future OEB panel denies the Applicants' request for a 10-year rate harmonization period, LDC MergeCo could still implement whatever harmonization plan is approved by the OEB at that time while still maintaining two separate rate zones over the post-deferral ten-year period.[57] OEB staff does not understand this position since a rate harmonization plan covering all customer classes of say, five years, would inherently mean that there would be just one rate zone for years six through 10. The Applicants may wish to clarify this statement in the reply submission.

Subject to that clarification, OEB staff's position is that the request to maintain two separate raze zones for years 11-20 should be a component of LDC MergeCo's future rate harmonization plan, if only because it is unclear what such an approval at this time means. Further, the extent or horizon of the final rate harmonization plan is unclear at this time, OEB staff submits that the current MAADs application is not the appropriate

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[56] MAADs Handbook, pp. 17-18
[57] EB-2022-0006, Interrogatory Response, Staff-2(c)

venue for such a request to be approved. OEB staff notes that, in its findings on this MAADs application, the OEB could acknowledge the Applicants' intent to file a 10-year harmonization plan and that the OEB would be open to reviewing such a plan as part of the first consolidated rebasing application.

3.2.2 Distribution Licence

The application requests that the OEB issue LDC MergeCo a distribution licence and that following issuance of the licence, the distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro be cancelled.

As part of its interrogatories, OEB staff requested that the Applicants confirm that they are requesting that the Licence Application be considered by the OEB concurrently with the amalgamation request as part of this application, why the Applicants consider this Licence Application "draft" as noted in the application[58], and to provide a signed and dated version of the Licence Application. In the response, the Applicants confirmed the proposal that the Licence Application be considered concurrently as part of the amalgamation application. Further, the Applicants provided a signed and dated version of the Licence Application and noted that it is considered "draft" since certain information[59] will not be available until approval of this Application. A revised application with these factual details included will be filed once the information is known.[60]

The Licence Application confirms that LDC MergeCo's service area will consist of the current service areas of Kitchener-Wilmot Hydro and Waterloo North Hydro. With respect to the ongoing operational elements of the merged entity, OEB staff notes that the Licence Application states that the proposed transaction:[61]

- 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, and that the consolidation proposed in the MAADs application will create opportunities for the improvement of existing reliability and quality of supply
- Will create opportunities for improved economic and energy efficiency in the

[58] EB-2022-0006, Application, p. 54,
[59] The Applicants provided examples such as Full Legal Name of Applicant, Ontario Corporation Number and Date of Formation
[60] EB-2022-0006, Interrogatory Responses, Staff-19
[61] *Ibid*, Attachment B – Proposed Distribution Licence Application, p. 12

distribution of electricity in the predecessor distributors' service areas

The Licence Application also indicates that the key individuals in LDC MergeCo will include executives from the two amalgamating utilities, who have many years of experience in the electricity sector and, more particularly, with the operations of the amalgamating utilities.

Submission

OEB staff supports the Applicants' request that the Licence Application be considered by the OEB concurrently with the request for leave to amalgamate. OEB staff's position is based on the OEB's findings in a previous MAADs proceeding, which noted the OEB's concerns are with the ongoing operation elements of the new licence and a request for leave to amalgamate cannot be granted in the absence of a related licence application.[62]

OEB staff has reviewed the Licence Application and is satisfied that it addresses the ongoing operation elements of LDC MergeCo. OEB staff supports the Applicants' request for approval of a new distribution licence for LDC MergeCo. OEB staff's position is based on how the merger will impact the ongoing operational elements of LDC MergeCo, which, as stated in the Licence Application, will not have an adverse impact on competition, access to distribution services, reliability and quality of supply and will create opportunities for improved economic and energy efficiency.

OEB staff notes that the Licence Application does not contain any requests for licence conditions that would depart from those found in the typical form of an Electricity Distribution Licence.

OEB staff agrees that the key individuals indicated in the Licence Application have the appropriate industry experience and qualifications necessary to lead the LDC MergeCo, and as such, LDC MergeCo can reasonably be expected to carry out the obligations of an OEB electricity distributor licensee.

As stated above, the Applicants have also requested that the existing electricity distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro be cancelled when the new electricity distribution licence for LDC MergeCo is issued. Further, the Applicants requested that the current and any future rate orders (received prior to the OEB's approval for this application) of Kitchener-Wilmot Hydro and Waterloo North

[62] EB-2016-0025, Enersource Hydro Mississauga Inc., Horizon Utilities Corporation & Powerstream Inc. MAADs Application, Oral Hearing Transcript Volume 4, p. 65

Hydro be transferred to LDC MergeCo.[63] OEB staff supports the Applicants' requests in this regard as they are required to facilitate the proposed amalgamation, and complementary to the Applicants' request for a new distribution licence for LDC MergeCo.

3.2.3 Earnings Sharing Mechanism (ESM)

The Applicants proposed an ESM with customers for years six through ten of the deferred rebasing period following the merger of Kitchener-Wilmot Hydro and Waterloo North Hydro.[64] A draft accounting order was provided with respect to the ESM, as part of the interrogatory responses.[65] The proposed ESM will share excess earnings beyond 300 basis points above the regulated return on equity (ROE) for the consolidated entity on a 50:50 basis between LDC MergeCo and its customers.[66]

Submission

The MAADs Handbook requires that consolidating utilities that propose to defer rebasing beyond a five-year period, implement an ESM for the period beyond five years. Excess earnings are shared with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the consolidated entity's annual ROE.[67] OEB staff submits that the Applicants' ESM framework proposal as noted above is consistent with this aspect of the OEB policy, however stub period(s) may need to be taken into consideration, as discussed further below.

The Applicants confirmed that the regulatory net income and regulated ROE will be computed based on LDC MergeCo's annual audited financial results, adjusted for any revenue and expenses that are not otherwise included for regulatory purposes, consistent with the OEB's established regulated ROE model.[68] The Applicants provided a list of revenues and expenses that would be excluded in the ROE calculation.[69] OEB staff does not take issue with the list of adjustments the Applicants have proposed. OEB staff submits that any further adjustments to revenues and expenses should be reviewed at the time of disposition.

[63] EB-2022-0006, Application, p. 54
[64] EB-2022-0006, Application, p. 50
[65] EB-2022-0006, Interrogatory Responses, Staff–29, Attachment C, Draft Accounting Order, Account 2435 – Accrued Rate-Payer Benefit
[66] EB-2022-0006, Application, p. 50
[67] Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016, pp. 16-17
[68] EB-2022-0006, Interrogatory Responses, Staff-26
[69] EB-2022-0006, Application, p.51

The Applicants agreed with OEB staff's calculations showing a consolidated deemed/ approved ROE of 8.43%, based on the approved rate base and approved ROE of each legacy distributor.[70] OEB staff submits that the consolidated deemed/approved ROE of 8.43% is appropriate, as a similar computation was approved by the OEB in a prior proceeding.[71]

ESM Disposition

The Applicants noted that they would be amenable to filing the results of the ESM annually, with the detailed review and disposition of the ESM account balance being considered in the cost of service rate proceeding at the end of the 10-year Deferred Rebasing Period.[72] OEB staff would not object to this sequencing of the reporting and disposition of the ESM account balance. OEB staff notes that there have been past precedents where the ESM is disposed at the end of the deferred rebasing period.[73]

ESM Stub Period

The Applicants confirmed that if the date of closing is January 1, 2023, the ESM will be in effect for the periods commencing January 1, 2028 (i.e., year 6), and ending December 31, 2032, (5 years or 60 months), as the planned cost of service proceeding has rates expected to be effective January 1, 2033.[74] In the event that the closing date of the transaction is different than January 1, 2023, the Applicants noted that they did not consider a stub period for the ESM mechanism and that in the recent decision for Brantford Power and Energy+, no stub period was contemplated, considered or offered.[75] The Applicants did not agree that the term of the ESM may be in effect longer than a 60-month period, depending on whether the closing of the transaction is different than January 1, 2023.

The Applicants noted that Kitchener-Wilmot Hydro and Waterloo North Hydro will be filing two separate *Reporting and Record Keeping Requirements* (RRRs) for the year

[70] EB-2022-0006, Interrogatory Responses, Staff–26
[71] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, page 13
[72] EB-2022-0006, Interrogatory Responses, Staff–27
[73] MAADs for the former Orillia Power Distribution Corporation and Hydro One Networks Inc. (EB-2018-0270) and MAADs for former Peterborough Distribution Inc. and Hydro One Networks Inc. (EB-2018-0242)
[74] EB-2022-0006, Interrogatory Responses, Staff-25
[75] EB-2021-0280

2022, and combined RRRs for the year 2023, and that a full year of earnings is easier to calculate and more transparent. The Applicants stated that in order to calculate an ESM for a stub period, an ROE would have to be calculated for the before and after stub period. During a financial year many estimates, such as taxes and depreciation are made, that are trued up at year-end during the year-end audit. In addition, construction season would continue over the stub period resulting in lower rate base than would be calculated at year-end. The Applicants further noted that this could lead to an ESM that is not accurate.

In contrast to the Applicants' position, OEB staff submits that the ESM should be implemented starting in year six of the deferred rebasing following the amalgamation (i.e., the anniversary of when the transaction closes), which may not necessarily coincide with the start of a calendar year. OEB staff is of the view that this is consistent with OEB policy. OEB policy does not require the five year period to exactly align with a calendar year period. The OEB has specifically stated the following:

- Consolidating entities that propose to defer rebasing beyond five years, must implement an ESM for the period beyond five years.[76]
- The ESM should operate during the term of the extended deferred rebasing period. (i.e. – for any extended periods beyond the initial five year deferral period).[77]

A similar ESM stub period was approved by the OEB in a prior proceeding.[78] The OEB required the implementation of a proportional calculation of any overearnings during the stub periods, based on the calendar year earnings in which the stub period occurs.

Therefore, OEB staff submits that if the transaction closes on a date earlier than January 1, 2023 (for example October 1, 2022), a proportional calculation should be implemented of any overearnings during the start of the stub period (i.e., October 1, 2027 to December 31, 2027), based on the calendar year earnings in which the stub period occurs. OEB staff is of the view that performing a proportional calculation reflects the true underlying nature of the transaction and that OEB policy does not require the five year period to exactly align with a calendar year period.

[76] Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016, p.16
[77] EB-2014-0138, Report of the Board Rate-Making Associated with Distributor Consolidation, March 26, 2015, p. 6
[78] EB-2021-0312, North Bay Hydro Distribution Limited, Espanola Regional Hydro Distribution Corporation, Decision and Order, March 17, 2022, p.17

The Applicants stated that its merger closing date is targeted for no later than January 1, 2023.[79] However, in the event that the transaction closes on a date later than January 1, 2023 (for example April 1, 2023), OEB staff submits that a symmetrical approach to that proposed by OEB staff would be appropriate. OEB staff submits that a proportional calculation should also be made to exclude any overearnings from being subject to sharing with customers during the start of the stub period (i.e., January 1, 2028 to March 31, 2028), based on the calendar year earnings in which the stub period occurs.

OEB staff notes that the Applicants did not take issue with the ESM ending on December 31, 2032. OEB staff submits that this end-date of the ESM is appropriate, given that the Applicants' next rebasing application will have rates expected to be effective January 1, 2033.

ESM Draft Accounting Order

In its interrogatory responses, the Applicants filed a draft accounting order regarding the ESM.[80] In the event that the OEB finds that stub period earnings are to be included in the ESM framework, and that disposition will occur in the Applicants' next cost of service rate proceeding (and not shared annually), as OEB staff has suggested, OEB staff submits that the OEB should also direct the Applicants to re-file the ESM draft accounting order to incorporate this. Parties can comment on the ESM draft accounting order at that time.

3.2.4 Account 1592, Payments in Lieu of Taxes (PILs) and Tax Variances, sub-Account CCA Changes

The Applicants confirmed that the continued use by Waterloo North Hydro of Account 1592, PILs and Tax Variances, sub-account CCA Changes, will capture the impact of differences that result from the phasing out of accelerated CCA that underpins the OEB-approved rates in Waterloo North Hydro's 2021 cost of service rate proceeding.[81] The Applicants also noted that Account 1592 should continue to be available to Kitchener-

[79] EB-2022-0006, Application, p. 49
[80] EB-2022-0006, Interrogatory Responses, Staff-29, Attachment C, Draft Accounting Order, Account 2435 – Accrued Rate-Payer Benefit
[81] EB-2022-0006, Interrogatory Responses, Staff-30

Wilmot Hydro to record the differences between the PILs in rates and the PILs with the phasing out of accelerated CCA.[82]

OEB staff notes that Waterloo North Hydro's Account 1592, PILs and Tax Variances, sub-account CCA Changes balance as at December 31, 2020 was disposed as a credit to customers in its 2021 cost of service proceeding.[83]

OEB staff notes that the phase-out of accelerated CCA rules that are expected to occur starting in 2024 is expected to be complete by 2028.

Submission

OEB staff submits that the continued use by Waterloo North Hydro of Account 1592, PILs and Tax Variances, sub-account CCA Changes, to capture the impact of differences that result from the phasing out of accelerated CCA that underpins the OEB-approved rates in Waterloo North Hydro's 2021 cost of service rate proceeding is appropriate. OEB staff also submits that Account 1592 should continue to be available to Kitchener-Wilmot Hydro to record the differences between the PILs in rates and the PILs with the phasing out of accelerated CCA.

Breakdown of Sub-Account and Disposition

OEB staff agrees with the Applicants' proposal to report a combined Account 1592 with the following sub-accounts:[84]

a) Sub-Account 1 – New balances arising for future PILs differences that will affect LDC MergeCo and are not specific to historical LDCs
b) Sub-Account 2 – Waterloo North Hydro Account 1592 balances relating to the wind-down of the AIIP as described in response to SEC-11 and Staff-30.
c) Sub-Account 3 – Historical Account 1592 balances relating to historical Kitchener-Wilmot Hydro balances as described in response to Staff-31(b).

However, OEB staff is of the view that the Applicants should clarify in their reply submission the expected timelines of reporting the three sub-accounts to the OEB.

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[82] *Ibid*, Staff-31
[83] EB-2020-0059, Waterloo North Hydro Inc., OEB staff Submission on the Settlement Proposal, November 23, 2020, p. 7
[84] EB-2022-0006, Interrogatory Responses, Staff-31

OEB staff also requires further clarification as to which sub-account Kitchener-Wilmot Hydro is proposing to record the differences between the PILs in rates and the PILs with the phasing out of accelerated CCA. The Applicants' description of Sub-Account 3 (relating to the response to interrogatory Staff-31b) only applies to balances accumulated during the 2019 calendar year. OEB staff invites the Applicants to clarify this item in their reply submission.

OEB staff also submits that any stub period(s) should also be taken into consideration when calculating Account 1592 balances.

Given the nature of the balances in sub-accounts 2 and 3, LDC MergeCo proposed that these sub-accounts may be requested for disposition in future annual IRM applications. Sub-Account 1 will not be requested for disposition until LDC MergeCo's next cost of service application.[85] OEB policy is that generally Group 2 balances are disposed in cost of service proceedings, given that they require a prudence review.[86] That said, OEB staff notes that there have been some exceptions in the past. OEB staff submits that it may be more efficient, and certainly timely, to dispose of Group 2 balances in one application at the mid-point of the deferred rebasing period, rather than in any future IRM application (as per the Applicants' proposal regarding certain sub-accounts of Account 1592).

OEB staff notes that the disposition of Group 2 balances is not a mechanistic exercise and so OEB staff recommends that the Applicants not file for disposition of Account 1592, PILs and Tax Variances, sub-account CCA Changes, or any other Group 2 balances, in multiple years of the deferred rebasing period. Unless an urgent matter arises or there is an ICM or Z factor request for any particular year (which also require a prudence review), the Applicants should concentrate their Group 2 reviews at the mid-point of the deferred rebasing period, and then again at the first consolidated rebasing application, with one exception that will be discussed below regarding accounting policy changes.

The Applicants stated that there is a credit balance of $554,594 recorded in Kitchener-Wilmot Hydro's Account 1592, PILs and Tax Variances, sub-account CCA Changes, pertaining to balances accumulated during the 2019 calendar year.[87] This balance is

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[85] *Ibid*
[86] EB-2008-0046, Report of the Board on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR), July 31, 2009, p. 6
[87] EB-2022-0006, Interrogatory Responses, Staff-31

expected to be returned to Kitchener-Wilmot Hydro's customers at the next cost of service application. OEB staff is of the view that this credit balance of $554,594 (or any different balance approved by the OEB) should be returned to Kitchener-Wilmot Hydro's customers sooner than at rebasing. As discussed above and later in this submission, OEB staff submits that the Applicants should file their Group 2 balances (including Account 1592) with the first rate application after year five of the deferred rebasing period, together with a proposal for disposition.

Mechanics of Sub-Account

OEB staff is of the view that the 1592 sub-account should continue to be available to LDC MergeCo to December 31, 2032, as LDC MergeCo is expected to rebase for 2033 rates.

OEB staff submits that the mechanics of the calculation of amounts recorded in Account 1592, PILs and Tax Variances, sub-account CCA Changes (i.e., the three sub-accounts described above), should be reviewed in the proceeding when the sub-account is brought forth for disposition, and not in the current proceeding.

OEB staff submits that there are many unknown factors at this time that may impact how the 1592 sub-account balance should be calculated. OEB staff notes that there are alternative methodologies in calculating the Account 1592 balances. For 1592 sub-account balances that have been disposed to date, the balances have been calculated using either the approved capital additions embedded in a distributor's last rebasing rate application,[88] or actual capital additions.[89]

OEB staff submits that there has not been sufficient opportunity for testing the proposed calculations in this proceeding. In addition, it is not clear to OEB staff whether the Applicants would still record amounts in the 1592 sub-account if the accelerated CCA rules are, for example, extended beyond their currently projected phase-out timelines. OEB staff submits that the OEB would be assisted in making its decision on the appropriate 1592 sub-account balance at the time the balance is brought forth for disposition when all relevant factors are known (i.e., actual CCA rules in place and the actual in-service capital additions).

[88] For example, Waterloo North Hydro Inc. (EB-2020-0059)
[89] For example, Enbridge Gas Inc. (EB-2020-013), Canadian Niagara Power Inc. (EB-2021-0011), Brantford Power (EB-2021-0009), Burlington Hydro Inc. (EB-2020-0007)

3.2.5 Group 1 and 2 Deferral and Variance Accounts

The Applicants request that LDC MergeCo be granted approval to continue to track costs to the existing regulatory and deferral and variance accounts (DVAs) currently approved for Waterloo North Hydro and Kitchener-Wilmot Hydro.[90] In their pre-filed evidence, the Applicants stated that all of Kitchener-Wilmot Hydro's DVAs will be held separately from that of Waterloo North Hydro's for the 10-year deferred rebasing period and that the Applicants will seek disposition at a later date. The Applicants confirmed that the above statements made in their pre-filed evidence apply to both Group 1 and Group 2 accounts.[91]

Submission

Group 1 DVAs

In their responses to interrogatories, the Applicants noted that they would be amenable to combining their Group 1 accounts sooner, if required, after consideration is given to the different grid connections and settlement practices.[92] OEB staff supports the consolidation of Group 1 accounts as soon as it is practical for the Applicants to do so, as this would result in increased regulatory efficiencies and synergies, and that this aligns with the approach directed by the OEB in a prior proceeding.[93] It also directionally aligns with the Applicants' intent to file RRRs on a consolidated basis, commencing with year one of the deferred rebasing period.

OEB staff notes that both Kitchener-Wilmot Hydro's and Waterloo North Hydro's rate years begin on January 1 (as opposed to May 1). OEB staff submits that the Applicants should provide their plan for consolidating Group 1 balances and their settlement processes, as well as discuss any implications in doing so, in the IRM rate application that sets rates for the rate year that coincides with the effective date of the proposed consolidation of the balances. If the effective date of the proposed consolidation of the balances does not coincide with the start of the rate year (i.e., January 1), OEB staff submits that the Applicants may propose an alternative in the IRM rate application that discusses their plan for consolidating Group 1 balances.

[90] EB-2022-0006, Application, p.55
[91] EB-2022-0006, Interrogatory Responses, Staff-32
[92] *Ibid*
[93] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, p.16

On a final point, the Applicants noted that they will address the host/embedded relationship between the Kitchener-Wilmot Hydro and Waterloo North Hydro rate zones as part of the cost allocation evidence filed as part of the first rebasing application following the deferred rebasing period.[94] The Applicants should clarify this statement, given the Applicants' intent to consolidate the Group 1 balances during the 10-year deferred rebasing period.

Group 2 DVAs

The Applicants stated that neither Kitchener-Wilmot Hydro nor Waterloo North Hydro have (or expect to have) material Group 2 balances, with the exception of Account 1592[95] and Account 1508, sub-account Pole Attachment Revenue Variance. Kitchener-Wilmot Hydro and Waterloo North Hydro would be receptive to disposing of Account 1508, sub-account Pole Attachment Revenue Variance after year five of the deferred rebasing period, if the balance is material.

As noted earlier, typically the Applicants would be expected to dispose of their Group 2 accounts in their next cost of service rate application, which in this case would be after a 10-year deferred rebasing period. Given the lengthy amount of time in which Waterloo North Hydro and Kitchener-Wilmot Hydro's Group 2 accounts will accumulate, OEB staff submits that the Applicants should file their Group 2 balances with the first rate application after year five of the deferred rebasing period, together with a proposal for disposition. This treatment of Group 2 balances is consistent with the OEB findings of a prior proceeding.[96] OEB staff also notes that there have been instances where the OEB has required that Group 2 accounts be brought forth for disposition during the deferred rebasing period.[97] OEB staff addresses one exception to filing the Group 2 balances with the first rate application after year five of the deferred rebasing period later in this submission, with respect to the harmonization of accounting policies.

The Applicants stated that Group 2 balances that relate to the former customers of Kitchener-Wilmot Hydro and Waterloo North Hydro would be disposed at the end of the 10-year deferred rebasing period to the respective customers of the legacy territory.[98]

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[94] EB-2022-0006, Interrogatory Responses, Staff-4
[95] *Ibid*, Staff-32
[96] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, page 16
[97] MAADs for the former Orillia Power Distribution Corporation and Hydro One Networks Inc. (EB-2018-0270) and MAADs for former Peterborough Distribution Inc. and Hydro One Networks Inc. (EB-2018-0242)
[98] EB-2022-0006, Interrogatory Responses, Staff-33

OEB staff submits that the Group 2 accounts should be held separately by rate zone during the ten-year deferred rebasing period, consistent with the OEB findings of a prior proceeding.[99] OEB staff agrees that Group 2 balances that relate to the former customers of Kitchener-Wilmot Hydro and Waterloo North Hydro should be disposed to the respective customers of the legacy territory, to maintain the cost causality of the accounts, regardless of the year in which they are disposed during the deferred rebasing period.

The Applicants stated that whether LDC MergeCo will continue to track Group 2 balances separately during the Rate Harmonization Period will be determined as part of a future rate harmonization plan.[100] At this time, the Applicants anticipate that Group 2 balances arising during the 10-year Rate Harmonization Period would be combined. OEB staff supports the consolidation of Group 2 accounts effective with the first rebasing year of the consolidated entity.

3.2.6 Accounting Policy Changes

The Applicants noted that Waterloo North Hydro and Kitchener-Wilmot Hydro both use Modified International Financial Reporting (MIFRS) for regulatory reporting purposes, and LDC MergeCo will also use MIFRS.[101]

The Applicants confirmed that Waterloo North Hydro (the acquiree) will adopt the accounting policies of Kitchener-Wilmot Hydro (the acquirer), given IFRS consolidation rules, such that LDC MergeCo will maintain the accounting policies of Kitchener-Wilmot Hydro.[102] The Applicants have reviewed the accounting policies for Kitchener-Wilmot Hydro and Waterloo North Hydro to determine what changes in accounting policy the acquiree may be required to make to align to that of the acquirer. No material policy differences have been identified by the Applicants.

However, the Applicants noted that the rates of depreciation differ slightly in some areas, as shown in the table below that has been re-produced by OEB staff.[103]

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[99] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, p.16
[100] EB-2022-0006, Interrogatory Responses, Staff-33
[101] EB-2022-0006, Application, January 31, 2022 p.56
[102] EB-2022-0006, Interrogatory Responses, Staff-34
[103] *Ibid*, SEC-14

Table 5: Difference in Depreciation Rates – Kitchener-Wilmot Hydro and Waterloo North Hydro

	Kitchener-Wilmot Hydro	Waterloo North Hydro
Buildings	20-50 Years	15-60 Years
Transformer and Substation Equipment	15-50 Years	15-50 Years
Supervisory Control and Data Acquisition Equipment	15 Years	15 Years
Distribution System	25-60 Years	15-50 Years
Meters	15-25 Years	15-25 Years
General Equipment	3-10 Years	5-15 Years
Computer Software	3-10 Years	5-10 Years
Land Rights	100 Years	No amortization period

Submission

OEB staff submits that a deferral account should be established to track the rate base impact over the deferred rebasing period of actual differences arising from the alignment of Waterloo North Hydro's accounting policies to that of Kitchener-Wilmot Hydro's, particularly with respect to the rates of depreciation. The rate base over the deferred rebasing period is underpinned by the pre-amalgamation accounting policies of each utility. Accounting policy changes made by the Applicants may lead to a disconnect in the continuity of rate base from each utility's last rebasing application to their next rebasing application after consolidating. The new deferral account should apply the same methodology and mechanics as Account 1576 (including a return component applied to the balance).

OEB staff notes that Account 1576 was established generically for electricity distributors subsequent to a consultation involving industry participants.[104] The account is intended to capture impacts of capitalization and depreciation policy changes from those embedded in rates at last rebasing, made during the incentive rate-setting term. In OEB

[104] EB-2008-0408, Report of the Board: Transition to International Financial Reporting Standards, July 29, 2009 and Addendum to Report of the Board: Implementing International Financial Reporting Standards in an Incentive Rate Mechanism Environment, June 13, 2011

staff's view, the purpose and principles for Account 1576 would be appropriate for the Applicants' current circumstances.

Impact of Changes in Depreciation Rates

The Applicants stated that under IFRS reporting, depreciation rates are estimates that are reviewed by management each year.[105] LDC MergeCo will review depreciation rates in 2022 and will apply any changes in estimate, if necessary, on a prospective basis. OEB staff notes that it is normal course for distributors to review deprecation rates annually under IFRS and that such rates are estimates and are subject to change. However, OEB staff is unable to conclude at this time that there would be an immaterial impact on LDC MergeCo from Waterloo North Hydro adopting the depreciation rates of Kitchener-Wilmot Hydro.

The Applicants suggested that LDC MergeCo's materiality threshold is $465k.[106] OEB staff notes that the impact alone of changing Waterloo North Hydro's depreciation rate applicable to Account 1611, Computer Software, by two years (from five years to three years) in order to potentially align with Kitchener-Wilmot Hydro's depreciation rates could be approximately $421k. OEB staff notes that adding the impacts of further changes in depreciation rates in other property, plant and equipment accounts could, in aggregate, likely surpass LDC MergeCo's materiality threshold of $465k.

Table 6 below shows OEB staff's analysis of the impacts of changing Waterloo North Hydro's depreciation rate applicable to Account 1611, Computer Software. This analysis was based on Waterloo North Hydro's Appendix 2-C for 2021, filed as part of its 2021 cost of service settlement proposal.[107]

[105] EB-2022-0006, Interrogatory Responses, SEC–14; Staff–34
[106] *Ibid*, Staff-34, Attachment C, Draft Accounting Order, Account 1508 – Other Regulatory Assets, Sub Account Impact of Post-Merger Accounting Policy Changes
[107] EB-2020-0059, Waterloo North Hydro Inc., 2021 Cost of Service Settlement Proposal, November 16, 2020, Excel Chapter 2 Appendices, Appendix 2-C

Table 6: Analysis of Change in Depreciation Rates

Account	Description	Life of Assets (Years)	Depreciation Expense on Assets	Depreciation Expense on Current Year Additions	Total Current Year Depreciation Expense
1611	Computer Software	5.00	569,801	61,153	630,954
1611	Computer Software	3.00	949,668	101,922	1,051,590
Difference					420,636

Impact of Other Mechanisms

The Applicants stated that they would be willing to track the differences (such as rate base impacts) in a deferral account, if so ordered by the OEB.[108] A draft accounting order was provided in their response to interrogatories. However, in the Applicants' view, it is not appropriate to track such differences, as:

- This could result in a duplication of results between the ESM mechanism and the Account 1576 mechanism.
- The Applicants have already agreed to an ESM to compensate stakeholders as necessary.

OEB staff disagrees with the Applicants that there would be a duplication of results between the ESM mechanism and the Account 1576 mechanism. OEB staff notes that Account 1576 captures the full rate base differential impact, while an ESM recognizes only part of this impact (50%) and only when a threshold is reached. Sharing factors and earnings levels do not impact the Account 1576 calculation. OEB staff submits that if the Applicants believe it is appropriate, they may propose to incorporate any adjustments to the ESM calculation when it is brought forth for disposition for amounts that are being captured in other accounts (such as this one).

[108] EB-2022-0006, Interrogatory Responses, Staff-34

Prior OEB Precedents

In OEB staff's view, the establishment of this account is consistent with the OEB's establishment of deferral accounts relating to accounting policy changes stemming from MAADs proceedings for Brantford Power Inc. and Energy+ Inc.[109], Synergy North Corporation,[110] as well as Alectra Utilities Corporation,[111] as described further below.

- For Brantford Power Inc. and Energy+ Inc., the OEB established a deferral account to track the rate base impact, using the methodology established for Account 1576, arising from Brantford Power's adoption of Energy+'s accounting policies.[112]
- For Synergy North Corporation, the OEB ordered the applicants to establish a deferral account to track the annual differences in revenue requirement arising from the former Kenora Hydro Electricity Corporation Ltd.'s transition to the former Thunder Bay Hydro Electricity Distribution's accounting policies. The OEB did not opine on the materiality of the differences created by the accounting policy change in its decision.
- For Alectra Utilities Corporation, the OEB ordered Alectra Utilities Corporation to adopt the Account 1576 approach to deferral accounts for the impact of changes in capitalization policies of certain former utilities to conform to the acquirer's capitalization policy.[113]

Draft Accounting Order

In OEB staff's view, the draft accounting order filed by the Applicants with respect to Account 1508 – Other Regulatory Assets, Sub Account Impact of Post-Merger Accounting Policy Changes,[114] should be subject to the following modifications.[115]

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[109] EB-2021-0280
[110] Formed from the former Thunder Bay Hydro and Kenora Hydro in EB-2017-0124/EB-2018-0233
[111] Formed from the former Enersource Hydro Mississauga Inc., PowerStream Inc., Hydro One Brampton Networks Inc., and Horizon Utilities Corporation in EB-2017-0024
[112] EB-2021-0280, MAADs Brantford Power Inc. Energy+ Inc., Decision and Order, March 17, 2022, p.17
[113] EB-2019-0018, Alectra Utilities Corporation, Partial Decision and Order, January 30, 2020, p.20
[114] Staff - 34, Attachment C, Draft Accounting Order, Account 1508 – Other Regulatory Assets, Sub Account Impact of Post-Merger Accounting Policy Changes
[115] OEB staff notes that these changes generally align with the approach taken in another proceeding: EB-2021-0280, Brantford Power Inc. and Energy+ Inc., Accounting Order, April 21, 2022

1. The draft accounting order states that the account will record “the cumulative difference between Kitchener-Wilmot Hydro Inc. (“KWHI”) net property, plant and equipment (“PP&E”) under the pre-merger capitalization policy and its net PP&E under the post-merger capitalization policy plus or minus the cumulative difference between Waterloo North Hydro Inc. (“WNHI”) net property, plant and equipment (“PP&E”) under the pre-merger capitalization policy and its net PP&E under the post-merger capitalization policy.” OEB staff suggests the following changes:

a) OEB staff notes that the approved account should use the methodology established for Account 1576. Account 1576 is to record the financial differences arising as a result of changes to capitalization or depreciation policies.[116] Therefore, OEB staff submits the accounting order should be revised to include references to changes to depreciation policy, as well as changes to capitalization policy.

b) OEB staff notes that the account should capture differences caused by changes to the depreciation and capitalization policies of Waterloo North Hydro to Kitchener-Wilmot Hydro’s policies. Therefore, no reference should be made to Kitchener-Wilmot Hydro also changing its own policies. OEB staff submits that the draft accounting order and associated illustrative example should be revised to reflect only changes of Waterloo North Hydro adopting Kitchener-Wilmot Hydro’s policies. OEB staff is of the view that since LDC MergeCo will be maintaining Kitchener-Wilmot Hydro’s policies, there should be no impact on Kitchener-Wilmot Hydro – there will only be an impact on the former Waterloo North Hydro.

2. OEB staff submits that the phrase in the draft accounting order that “the cumulative difference recorded in this account will be reviewed at LDC MergeCo’s 2024 IRM Application for materiality” should be revised to reflect that the cumulative difference will be initially reviewed as part of either the 2023 or 2024 IRM application.

3. The draft accounting order states that “the cumulative variance will be recovered from, or refunded to, customers in both of LDC MergeCo’s rate zones.” OEB staff submits the draft accounting order should be revised to state that the cumulative

[116] Accounting Procedures Handbook, July 2012 Frequently Asked Questions #1 and 2

variance will be recovered from, or refunded to, customers in Waterloo North Hydro's rate zone and not both rate zones. OEB staff is of the view that since LDC MergeCo will be maintaining Kitchener-Wilmot Hydro's policies, there should be no impact on Kitchener-Wilmot Hydro or its customers.

4. OEB staff notes that the draft accounting order does not include an effective date for the account. In the event that the OEB finds that stub period earnings are to be included in the ESM framework, OEB staff submits that an effective date of the account, coinciding with the date of the closing of the merger, should be included in the draft accounting order and the associated illustrative example for clarity. If the OEB does not make such findings about stub period earnings, then OEB staff submits that the effective date of the account should be January 1, 2023.

5. The draft accounting order references a "rate of return component" in two instances. OEB staff interprets the "rate of return component" to mean the dollar value return equaling the cumulative account balance multiplied by the weighted average cost of capital, in accordance with the Account 1576 approach; and not a reference to the rate itself (i.e., weighted average cost of capital). For clarity, OEB staff submits that the reference to the "rate of return component" should be replaced with "return component" instead.

6. The descriptions associated with the two sample journal entries listed in the draft accounting order state that the account is "to record differences arising from capitalization policies." OEB staff submits these descriptions should be revised to include references to the differences arising from the adoption of Kitchener-Wilmot Hydro's accounting policies.

7. The illustrative example associated with the draft accounting order should reference "Current Depreciation Policy" instead of solely "Depreciation".

Disposition Considerations

OEB staff submits that if an account is not established at this time and accounting policy differences result in material amounts to be recovered from or refunded to customers, this may constitute retroactive ratemaking. OEB staff notes that at the time that the account is brought forth for review if the amount in the account is immaterial, the OEB may order that no disposition is required.

If the accounting policy changes deferral account is established by the OEB, OEB staff further submits that the account balance should be reviewed as part of the IRM application for either 2023 or 2024 rates, as opposed to waiting until the first rate application after year five of the deferred rebasing period, as per OEB staff's recommendations for the remaining Group 2 accounts. If the balance is lower than the materiality threshold for LDC MergeCo of $465k, OEB staff submits that the account should be closed without disposition and no further entries should be required. This would avoid binding LDC MergeCo with the onerous process of tracking immaterial differences over the ten-year deferred rebasing period, if the account is not required. Otherwise, if material, the balance should be disposed in the 2023 or 2024 IRM, then again at the first rate application after year five of the deferred rebasing period, and finally again at the end of the deferred rebasing period to customers of the former Waterloo North Hydro.

3.2.7 Audited and Pro-Forma Financial Statements

The 2019 and 2020 audited financial statements were filed for Kitchener-Wilmot Hydro and Waterloo North Hydro in the application.[117] Pro-forma financial statements for LDC MergeCo were also filed, representing the first full year following the completion of the proposed transaction, for the period January 1, 2023 to December 31, 2023.[118]

Submission

OEB staff submits that some of the responses to Staff-24 suggest that the Applicants may be under-estimating their projected 2023 OM&A synergies of $0.3 million presented elsewhere in the Applicants' evidence (e.g., Staff – 9 and the Excel file,[119] tab "SEC-3 - Tables 6-7"). These impacts are shown below in Table 7 which shows an analysis of 2023 OM&A synergies, which range from $4.3 million to $6.7 million.

[117] Application, Attachment M and N
[118] Application, p. 47; Attachment O, Staff - 23
[119] Excel Tables with Formulas, April 25, 2022; Staff – 9

Table 7: Analysis of 2023 OM&A Synergies ($000s)

	Staff-9 2023 values	Staff-24b Preliminary Kitchener-Wilmot Hydro/ Waterloo North Hydro December 31, 2021 audited financial statements uplifted to 2023	Staff-24d Kitchener-Wilmot Hydro/ Waterloo North Hydro prior cost of service proceeding values uplifted to 2023
Stand-alone Operating Expenses	37,259	42,437	40,055
LDC MergeCo Operating Expenses	36,957	35,720[120]	35,720[121]
Difference – 2023 OM&A synergies	(302)	(6,717)	(4,335)

OEB staff further reiterates the concern noted earlier in this submission that the LDC MergeCo scenario provided by the Applicants may underestimate the achievable savings. OEB staff submits that this is further highlighted in the apparent underestimation of OM&A savings in Table 7. In the reply submission, OEB staff invites the Applicants to provide their views on this matter.

3.3 Conclusion

OEB staff supports the application being approved by the OEB, subject to some exceptions noted in this submission. The key areas that OEB staff does not support are described in the paragraphs below.

OEB staff does not support the Applicants' request to maintain two separate rate zones for an additional ten years after the deferred rebasing period ends (i.e., years 11-20) as part of the current application. This request should be addressed in the rebasing application after the 10-year deferred rebasing period.

[120] EB-2022-0006 Application, Attachment O (LDC MergeCo Pro Forma Year 1 Statements – December 31, 2023)
[121] *Ibid.*

In contrast to the Applicants’ position, OEB staff submits that the ESM should be implemented starting in year six of the deferred rebasing following the amalgamation (i.e., the anniversary of when the transaction closes), which may not necessarily coincide with the start of a calendar year. OEB staff submits that stub period(s) should be taken into consideration.

All of which is respectfully submitted