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

DECISION AND ORDER

EB-2022-0006

KITCHENER-WILMOT HYDRO INC. AND

WATERLOO NORTH HYDRO INC.

Application for approval to amalgamate and continue operations as a single electricity distribution company

BEFORE: Patrick Moran
Presiding Commissioner

Robert Dodds
Commissioner

Michael Janigan
Commissioner

June 28, 2022

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1 OVERVIEW

This is the Decision and Order of the Ontario Energy Board (OEB) regarding an Application filed by Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. (collectively, the Applicants). The Applicants seek approval of an amalgamation of Kitchener-Wilmot Hydro and Waterloo North Hydro (the Transaction).

The OEB has applied the “no harm” test in assessing the Application and has concluded that the proposed Transaction meets this test. The OEB approves the amalgamation of Kitchener-Wilmot Hydro and Waterloo North Hydro into a single electricity distribution company (LDC MergeCo), subject to certain conditions. The OEB also approves certain additional requests made by the Applicants as further described in this Decision. The OEB defers the decision on the Applicants’ request to maintain two separate rate zones for LDC MergeCo for an additional 10 years after the 10-year deferred rebasing period ends. LDC MergeCo can renew its request when it files its rebasing application.

2 CONTEXT AND PROCESS

2.1 The Applicants

Kitchener-Wilmot Hydro is a municipally owned electricity distribution company that provides electricity distribution and related services to approximately 99,000 customers in the City of Kitchener and the Township of Wilmot. It is owned by Kitchener Power Corp. (KPC) which is a holding company owned by the City of Kitchener and the Township of Wilmot. Kitchener-Wilmot Hydro is affiliated with Kitchener Energy Solutions Inc., which is 100% owned by KPC and provides non-regulated energy services, including streetlight maintenance.

Waterloo North Hydro is a municipally owned electricity distribution company that provides electricity distribution and related services to approximately 58,000 customers in the City of Waterloo, the Township of Woolwich and the Township of Wellesley. It is owned by Waterloo North Hydro Holding Corporation (Waterloo Holdco) which is owned by the City of Waterloo, the Township of Woolwich and the Township of Wellesley. Waterloo North Hydro is affiliated with Alliance Metering Solutions which is owned by Waterloo Holdco.

If the Transaction is approved, the amalgamated entity will serve over 157,000 customers.

On January 12, 2022, a Merger Participation Agreement (MPA) was entered into by The Corporation of the City of Kitchener, The Corporation of the Township of Wilmot, The Corporation of the City of Waterloo, The Corporation of the Township of Woolwich, and The Corporation of the Township of Wellesley, KPC, Kitchener-Wilmot Hydro Inc., Kitchener Energy Services Inc., Waterloo Holdco, Waterloo North Hydro Inc., and Alliance Metering Solutions Inc. The effect of the MPA is the amalgamation of KPC and Waterloo Holdco to create Merged Holdco[1], and the amalgamation of Kitchener Wilmot Hydro and Waterloo North Hydro to create LDC MergeCo.[2]

2.2 The Application

The Applicants seek OEB approval of the following aspects of the Transaction:[3]

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[1] Subject to OEB and Competition Act approval
[2] The shareholders intend to continue with Alliance Metering Solutions and Kitchener Energy Solutions Inc. as separate corporations wholly owned by the Merged Holdco.
[3] EB-2022-0006, Application, p. 20-22, January 31, 2022

- Leave for a new holding company (Merged Holdco) to acquire control of Kitchener-Wilmot Hydro and Waterloo North Hydro pursuant to section 86(2)(b) of the OEB Act
- Leave to amalgamate Kitchener-Wilmot Hydro and Waterloo North Hydro to form a new electricity distribution company (LDC MergeCo) pursuant to section 86(1)(c) of the OEB Act
- The issuance of an electricity distribution licence for LDC MergeCo, pursuant to section 60 of the OEB Act
- The cancellation of the electricity distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro when the electricity distribution licence for LDC MergeCo is issued
- Leave to transfer the current and any future rate orders of Kitchener-Wilmot Hydro and Waterloo North Hydro to LDC MergeCo, pursuant to section 18 of the OEB Act
- Leave for the continued tracking of costs by LDC MergeCo to existing deferral and variance accounts of Kitchener-Wilmot Hydro and Waterloo North Hydro
- Leave to track certain grossed-up Payment in Lieu impacts as described in the Application in Account 1592 - Payment in Lieu and Tax Variances, Sub-Account CCA Changes for the Waterloo North Hydro service area
- Leave to defer rebasing for 10 years following closing of the proposed Transaction (Deferred Rebasing Period)[4]
- Leave pursuant to section 78 of the OEB Act to maintain two separate distribution rate zones for each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas for both the Deferred Rebasing Period and a further 10-year Rate Harmonization Period (Special Request) further to Section 9.3 of the MPA
- A deferral account to track costs associated with the proposed Earnings Sharing Mechanism (ESM)

To facilitate the Transaction, Merged Holdco will issue fully paid and non-assessable Common Shares and Special Shares in the capital of Merged Holdco upon completion of the Transaction. The Merged Holdco ownership will be according to the table below. Following that Transaction, Kitchener-Wilmot Hydro and Waterloo North Hydro will amalgamate to form LDC MergeCo.

[4] Following which LDC MergeCo intends to prepare a rate harmonization proposal that will harmonize the rates in the Kitchener-Wilmot Hydro rate zone with the Waterloo North Hydro rate zone over a further 10 years following the 10-year deferred rebasing period (Rate Harmonization Period). This is set out in Section 9.3 of the MPA.

Table 1 – Merged Holdco Ownership %

Party	Merged Holdco	Equity & Voting %
City of Kitchener	• 53,390 Common Shares • 9,225 Class A Special Shares	53.39%
Township of Wilmot	• 4,490 Common Shares • 775 Class A Shares	4.49%
City of Waterloo	• 30,830 Common Shares • 7,320 Class B Special Shares	30.83%
Township of Woolwich	• 8,510 Common Shares • 2,020 Class B Special Shares	8.51%
Town of Wellesley	• 2,780 Common Shares • 660 Class B Special Shares	2.78%

2.3 The Process

The Applicants filed the Application on January 31, 2022. The OEB issued a Notice of Application on February 17, 2022, inviting interested parties to register as intervenors or file a letter of comment with the OEB. On March 16, 2022, the OEB issued Procedural Order No. 1 (PO1), in which it approved School Energy Coalition (SEC) and Pollution Probe as intervenors. PO1 also set out a schedule for a discovery process and submissions.

On April 6, 2022, the Applicants filed a letter with the OEB requesting an extension to the deadline to file responses to interrogatories. On April 11, 2022, the OEB issued Procedural Order No. 2 (PO2) which granted the request and adjusted the dates for other steps in the proceeding due to the requested extension. PO2 adjusted the date by which interrogatory responses were to be filed to April 25, 2022. Intervenor and OEB staff submissions were due to be filed by May 9, 2022, and the Applicants’ reply submission was to be filed by May 20, 2022. All parties filed their submissions by the deadlines set out in PO2.

3 REGULATORY PRINCIPLES

3.1 The "No Harm" Test

The OEB applies the "no harm" test in its assessment of merger, acquisition, amalgamation and divestiture (MAAD) applications.[5] The OEB considers whether the "no harm" test is satisfied based on an assessment of the cumulative effect of the transaction on the attainment of its statutory objectives. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.[6]

The statutory objectives to be considered by the OEB in relation to electricity are set out in the OEB Act as follows:

1. To inform consumers and protect their interests with respect to prices and the adequacy, reliability and quality of electricity service.
2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.
3. To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario, including having regard to the consumer's economic circumstances.
4. To facilitate innovation in the electricity sector.[7]

While the OEB has broad statutory objectives, in applying the "no harm" test the OEB's focus is on the objectives that are most directly relevant to the impact of the proposed transaction, namely, price, reliability and quality of electricity service to customers, as well as the cost-effectiveness, economic efficiency and financial viability of the consolidating utilities. The OEB considers this an appropriate approach, given the

[5] The OEB adopted the "no harm" test in a combined proceeding (RP-2005-0018/EB-2005-0234/EB2005-0254/EB-2005-0257) as the relevant test for determining applications for leave to acquire shares or amalgamate under Section 86 of the OEB Act and it has been subsequently applied in applications for consolidation. As set out in the OEB's *Handbook to Electricity Distributor and Transmitter Consolidations*, the OEB has, and will continue to apply its "no harm" test in reviewing consolidation transactions.
[6] OEB Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016 (MAADs Handbook)
[7] *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15 Schedule B, section 1

performance-based regulatory framework under which regulated entities are required to operate and the OEB's existing performance monitoring framework.

3.2 OEB Policy on Rate Making Associated with Consolidations

The Ontario electricity sector has several dozen electricity distributors ranging in size from just over one thousand customers to well over one million customers. To encourage consolidations within the sector, the OEB has introduced policies on rate-making that provide consolidating distributors with an opportunity to offset transaction costs with savings achieved as a result of the consolidation. The *Report of the Board on Rate-Making Associated with Distributor Consolidation* (2015 Report)[8] permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

The OEB *Handbook to Electricity Distributor and Transmitter Consolidations* (MAADs Handbook)[9] provides that the extent of the deferred rebasing period is at the option of the distributor and no supporting evidence is required to justify the selection of the deferred rebasing period. Consolidating entities must, however, select a definitive timeframe for the deferred rebasing period. This is to allow the OEB to assess any proposed departure from this stated plan. When a consolidated entity has opted for a deferred rebasing period, it has committed to a plan based on the circumstances of the consolidation and, if it seeks to amend the deferred rebasing period, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interest of customers.[10]

The 2015 Report sets out the rate-setting mechanisms during the deferred rebasing period and requires consolidating entities that propose to defer rebasing beyond five years to implement an Earnings Sharing Mechanism (ESM) for the period beyond five years to protect customers and ensure that they share in increased benefits from consolidation.

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

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[8] EB-2014-0138, Report of the Board on Rate-Making Associated with Distributor Consolidation, March 26, 2015
[9] MAADs Handbook, pp. 12-13
[10] MAADs Handbook, p. 12

The Applicants selected to defer rate rebasing for ten years following the completion of the Transaction.

4 DECISION ON THE ISSUES

In the subsections that follow the OEB has assessed the effect of the Transaction on attaining the following OEB objectives:

- Price, Economic Efficiency and Cost Effectiveness
- Reliability and Quality of Electricity Service
- Financial Viability

4.1 Application of the "No Harm" Test

The OEB has applied the "no harm" test in assessing the Application and has concluded that the Transaction meets this test. The OEB therefore approves the amalgamation of Kitchener-Wilmot Hydro and Waterloo North Hydro into a single electricity distribution company, LDC MergeCo, subject to certain conditions discussed in the sections that follow.

4.1.1 Price, Economic Efficiency and Cost Effectiveness

To demonstrate "no harm," applicants are required to show that there is a reasonable expectation based on underlying cost structures that the costs to serve customers following a consolidation will be no higher than they would otherwise have been.[11] In its review of consolidation proposals, the OEB assesses the underlying cost structures of the consolidating utilities, both now and in the future.[12]

To address OEB requirements related to cost structures, the Applicants forecasted the financial impact of the amalgamation-related efficiency gains as well as distribution rate impacts. The Applicants stated that the annual operating, maintenance and administrative (OM&A) savings will grow to approximately $3.6 million by year 10, following the completion of the Transaction. Based on the Applicants' forecasts, the Transaction is also expected to lower distribution costs for customers by approximately 3.1% through the Deferred Rebasing Period and by 4.5% following the transfer of the merger benefits in year 11.[13] The Applicants noted that their "long-term forecasts for total revenue in year 11, following rate rebasing, have been developed based on currently reasonable inflation and growth assumptions (as well as projections for the sustained productivity savings)".[14]

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[11] MAADs Handbook, p. 7
[12] MAADs Handbook, p. 6
[13] Application, p. 35
[14] Application, p. 36

The Applicants anticipate OM&A efficiencies totaling $33 million over the Deferred Rebasing Period.[15] The primary drivers of the OM&A savings are forecasted from the following OM&A categories: salary and wages, operating services, information technology, professional services and corporate.

The Applicants did not forecast any material cost savings related to capital investments, so none were included in the forecast of efficiency gains.

In its submission, OEB staff noted that the LDC MergeCo scenario provided by the Applicants may underestimate the achievable savings, and that there are likely ample opportunities for sufficient savings. Overall, OEB staff submitted that the Transaction has the potential to deliver benefits to both Kitchener-Wilmot Hydro and Waterloo North Hydro customers.[16]

SEC submitted that it believes the projected OM&A savings are achievable and that LDC MergeCo may exceed the forecasted OM&A savings. SEC noted the number of upcoming retirements during the Deferred Rebasing Period, as well as employee attrition for duplicated functions, which should allow LDC MergeCo to achieve and potentially exceed its OM&A savings projected in the Application.[17]

Although no capital savings have been forecasted for this application, both OEB staff and SEC believe that the proposed transaction will create net savings in capital expenditures in the long run.[18]

OEB staff's submission also discussed the distribution revenue per customer differential between the two utilities. OEB staff recognized 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. OEB staff noted that the differences in aggregate distribution revenue per customer data, as provided in this application, are influenced by other factors in addition to differences in the rates charged to customers of Kitchener-Wilmot Hydro and Waterloo North Hydro.[19]

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[15] Total OM&A savings net of integration and implementation costs are estimated to be $28.8 million.
[16] OEB staff Submission, p. 11, May 9, 2022
[17] SEC Submission, p. 2, May 9, 2022
[18] SEC Submission, p.2 and OEB staff Submission, pp. 8-9, May 9, 2022
[19] OEB Staff Submission, pp. 9 – 10. OEB staff's submission noted the following as examples: differences in the profiles of customers, i.e., the proportion of residential versus general service and large users, and differences in the energy consumption and demand are major factors, as well as rate design differences between different utilities.

OEB staff submitted that as part of the future rebasing application (i.e., for rates starting January 2033), the OEB should require the Applicants to 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. LDC MergeCo should be required to demonstrate the savings that have 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.[20]

OEB staff noted that if the application to rebase 2033 rates does not satisfactorily address the rate-setting aspects of the Transaction, as set out in the Rate Handbook, the OEB can address the matter in the rebasing application. OEB staff noted that the OEB has in some instances disallowed rate harmonization proposals and required merging utilities to continue separate rate zones.[21]

SEC submitted that the Applicants have provided sufficient evidence that shows the Transaction will create economic efficiencies and benefit customers in both service territories through cost savings in future rates. If at the time of rebasing, the costs for the amalgamated company (i.e., LDC MergeCo) are higher for customers of either of the predecessor utilities (i.e., Kitchener-Wilmot Hydro or Waterloo North Hydro), as compared to the status-quo scenarios, the OEB has previously said that those excess costs are to be borne by the shareholders and not ratepayers.[22] SEC stated that this is an important protection for customers that ensures they are not harmed by the transaction when MAADs approval is granted.[23]

SEC noted that the Applicants have not provided the assumptions for the status-quo scenarios in the years in which Kitchener-Wilmot Hydro and Waterloo North Hydro would have rebased which makes it difficult to assess whether these scenarios are reasonable. SEC submitted that, at LDC MergeCo's first rebasing application after the Deferred Rebasing Period, it should be required to provide details of the assumptions so the OEB can assess the reasonableness of the status-quo scenarios for the purpose of ensuring customers are not harmed, and if they would be, what costs should be allocated to the shareholders. [24]

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[20] OEB staff Submission, pp. 10-11
[21] *Ibid*, p. 11 and referring to EB-2017-0049
[22] SEC Submission, p. 2 and referring to EB-2018-0270, Decision and Order, April 30, 2020, p.23
[23] SEC Submission, p. 2
[24] *Ibid*, pp. 2-3

Pollution Probe submitted that, by the end of the deferral period, LDC MergeCo should either have reduced costs and/or increased the level of outcomes (measured by scorecard and other metrics) achieved for the same level of rate payer investment. Pollution Probe submitted that a comprehensive summary of these strategic investments, efficiencies and outcomes should be included in the rebasing application to demonstrate the value the merger achieved.[25]

In reply to the submissions of OEB staff and SEC on the potential underestimation of savings, the Applicants reiterated that the legal test associated with this MAADs application is a “no harm” test and stated:

> If the Applicants choose to be conservative and prudent in their savings estimates, that is because it is ultimately the Applicants’ reputation that suffers if the estimates turn out to be incorrect. The Applicants do not agree with the suggestions of either SEC or OEB staff. And, in any event, those suggestions are moot. The legal test is “no harm” and clearly the Applicants have satisfied this test.[26]

The Applicants also did not agree with OEB staff’s suggestion that, at the next rebasing application, LDC MergeCo should demonstrate how savings have accrued to the individual customers of Kitchener-Wilmot Hydro and Waterloo North Hydro. The Applicants submitted that this is an onerous task and that requiring the merged entity to maintain separate results during the Deferred Rebasing Period will result in lower savings due to the incremental administrative burden.[27]

The Applicants also submitted that savings and benefits are expected to be achieved in the Deferred Rebasing Period, and that a rate harmonization period is proposed to allow customers of Kitchener-Wilmot Hydro rate zone to realize the benefits over time.[28]

Findings

The OEB finds that the Applicants have demonstrated that the Transaction will achieve economic efficiencies and will likely deliver cost savings to customers in future rates. The OEB is of the view that for the rebasing application for 2033 rates, requiring LDC MergeCo to demonstrate how savings have accrued to customers in the two rate zones will assist the OEB in determining that savings will in fact be delivered to customers in

[25] Pollution Probe Submission, p. 4
[26] Kitchener-Wilmot Hydro/Waterloo North Hydro Reply Submission, p. 4, para 11
[27] *Ibid*, p. 2, para 8
[28] *Ibid*, p. 3, para 13

both rate zones and in assessing the rates harmonization plan that is expected to be part of that application.

4.1.2 Reliability and Quality of Electricity Service

The MAADs Handbook requires consolidating utilities to indicate the impact that a proposed transaction will have on customers with respect to the quality and reliability of electricity service. In considering the impact and whether the “no harm” test has been met, the OEB is informed by, among other things, the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard.[29]

The Application set out the System Average Interruption Duration Index (SAIDI) and System Average Interruption Frequency Index (SAIFI) statistics for Kitchener-Wilmot Hydro and Waterloo North Hydro from 2016 to 2020. The Applicants provided preliminary 2021 reliability results in response to interrogatories.[30]

The Applicants stated that a key objective of the Transaction will be to ensure customer service, safety and reliability meets or exceeds existing levels in each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas. 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”.[31]

OEB staff and SEC did not express any concerns about the reliability and quality of service as a result of the amalgamation.

OEB staff and SEC referenced the fact that 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 neighboring operations centers during significant outages. SEC also noted that the Applicants propose to consolidate control rooms and form a single centralized 24/7 control room which will provide an opportunity to adopt industry best practices around distribution automation with a positive impact on reliability.[32] OEB staff agreed that the move towards a centralized control room may also streamline operations.[33]

[29] Handbook, January 19, 2016, p. 4
[30] Interrogatory Responses, SEC-2, April 25, 2022
[31] Application, p. 27
[32] SEC Submission, page 3 and Application, p. 41
[33] OEB staff Submission, p. 13

Findings

The OEB is satisfied that the amalgamated company can reasonably be expected to maintain the service quality and reliability standards currently provided by each of the amalgamating utilities. While the test is “no harm”, the OEB expects that the merged company will be able to adopt industry best practices around distribution automation with a positive impact on reliability through the consolidation of control rooms to form a centralized 24/7 control room.

4.1.3 Financial Viability

The MAADs Handbook indicates that the impact of a proposed transaction on the acquiring utility’s financial viability (in the case of an acquisition) or on the consolidated entity’s financial viability (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.

The Applicants stated that the 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. The Applicants submitted that there is no adverse effect on the financial viability of the Applicants[34] and confirmed that post-closing adjustments are not expected to be material.[35]

With respect to the financing of transaction and integration costs to implement the proposed transaction, the Applicants stated that the costs will be financed through the anticipated productivity savings expected from the merger during the Deferred Rebasing Period.[36]

[34] Application, p. 46
[35] Interrogatory Response, Staff-21, April 25, 2022
[36] Application, p. 45

The Applicants stated that they expect to work with a financial institution on the longer-term financing plan for LDC MergeCo, including a proposal for a $45M revolving line of credit.[37] The Applicants are targeting a long-term A-range rating for LDC MergeCo.

OEB staff noted that synergy savings from years one and two are anticipated to exceed the total incremental OM&A integration and implementation costs incurred over the same period.[38] In OEB staff's opinion, the Transaction would not negatively impact the financial viability of the Applicants.

Intervenors did not make any submissions with respect to the impact of the Transaction on the financial viability of the Applicants.

Findings

The OEB accepts the assurance of the Applicants that there will be no adverse effect on the financial viability of either the Applicants or the amalgamated company upon completion of the Transaction. The Applicants forecast the debt to capital ratio for LDC MergeCo to be 39%, which is lower than the 60% debt level deemed by the OEB for rate-setting. This will provide the amalgamated company flexibility to manage extraordinary events.

4.2 Rate Harmonization Period – Special Request

The Applicants requested leave pursuant to Section 78 of the OEB Act to maintain two separate distribution rate zones for each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas for both the Deferred Rebasing Period and the Rate Harmonization Period. The Rate Harmonization Period can be described as the ten years following the 10-year deferred rebasing period (i.e., years 11-20).

The Applicants included the Special Request in this Application as a result of section 9.3 of the MPA which states:

> In the event that the KPC Group or Waterloo North Group, as applicable, is of the opinion, acting reasonably, that the OEB Approval decision
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> (i) will reduce the sitout period (i.e., the deferred rebasing period) to less than 10 years and/or reduce the expected savings that may be allocated the direct and indirect shareholders of LDC Amalco during the sitout period pursuant to the policies of the OEB, and/or

[37] Application, p. 47. The $45M is the combination of the existing lines of credit of Kitchener-Wilmot Hydro and Waterloo North Hydro.
[38] OEB staff Submission, p. 15

(ii) does not approve the continuation of Distribution Rate Zones for a minimum period of 20 years post-Closing, which shall be expressly identified as a separate and distinct head of relief under the order requested in the mergers, amalgamations, acquisitions and divestitures (MAADs) application filed by the Parties pursuant to Section 9.1(a) (in each case, an "**Adverse Determination**"),

either the KPC Group or Waterloo North Group, as applicable, may provide written notice to the other parties of such potential Adverse Determination. The Parties agree to cooperate and negotiate any desirable or required amendments to this Agreement to address a potential Adverse Determination. For clarity, the mergers, amalgamations, acquisitions and divestitures (MAADs) application filed by the Parties pursuant to Section 9.1(a) will seek, over a minimum period of 20 years following Closing, the harmonization of Zone A and Zone B Rates in a fair and reasonable manner for LDC Amalco's customers.[39] (emphasis in original)

OEB staff supported the Applicants' proposal to maintain two separate rate zones during the 10-year Deferred Rebasing Period but not during the Rate Harmonization Period.

OEB staff stated that it is unclear why formal approval is required as part of this MAADs application since the Applicants have acknowledged that a future panel of the OEB can approve a shorter (or presumably even a longer) rate harmonization period.[40] OEB staff submitted that this request should be a component of LDC MergeCo's future rate harmonization plan and the current MAADs application is not the appropriate venue.

SEC submitted that the OEB should reject the Applicants' request, in this proceeding, to maintain separate rate zones after LDC MergeCo rebases. SEC noted that the MAADs Handbook is clear that issues of rate harmonization should be dealt with at rebasing, not in a MAADs application.[41] Further, SEC stated that it is premature to approve the request as the parties and the OEB do not have the benefit of foreknowledge of any post amalgamation information. MAADs applications are not rate applications, and so there has been limited evidence on what rates may look like when LDC MergeCo first rebases, and what the rate harmonization options could be.[42]

[39] Application, Attachment I – MPA, Section 9.3, p. 92
[40] OEB staff Submission, p. 17
[41] SEC Submission, p. 2
[42] *Ibid,* p. 5

SEC further submitted that approving the request for two rate zones after the Deferred Rebasing Period for at least 10 years would “fetter the discretion of a future OEB panel”.[43] For example, a future OEB panel’s ability to set the same rates for all customers of LDC MergeCo would be restrained until 2043.[44]

Pollution Probe submitted that the benefits of maintaining two separate rate zones for an additional 10 years following the end of the Deferred Rebasing Period is unclear and that there would be an incremental administrative burden to continue two separate rate zones over an additional 10 years. Pollution Probe noted that the Applicants indicated that they are willing to assume this voluntarily and have accounted for this in the proposed merger plan. Pollution Probe also submitted that customers were not informed of the plan that rate harmonization would take place over 10 years.[45] Pollution Probe suggested that it may be appropriate to defer a decision on this request until the rebasing application for LDC MergeCo.[46]

In their reply, the Applicants stated that the Special Request was to maintain two separate rate zones during the Rate Harmonization Period but that they are not proposing a rate structure or a rate harmonization plan.[47] The Applicants also did not agree that the Special Request limits the options of future OEB panels. The Applicants submitted that “two separate rate zones for a 10-year period does not necessarily imply that all customer classes will have two separate tariffs for the entirety of the rate harmonization period. A rate class could have the same Tariff in both rate zones while maintaining separate rate zones”.[48] Further, the Applicants stated that “[I]f the OEB subsequently determines that harmonization should occur more quickly than 10 years, then the merged entity would simply have OEB approved Tariffs for two separate rate zones where the Tariffs are in all other respects identical.”[49]

The Applicants stated that they are willing to bear the administrative burden of maintaining two separate rate zones, and in the Applicants’ view, it is a small price to pay to satisfy a key condition of the shareholders in the MPA and otherwise avoid the occurrence of an Adverse Determination[50] – and the potential loss of the entire Transaction.

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[43] *Ibid,* p. 6
[44] *Ibid*
[45] From 2033 to 2042
[46] Pollution Probe Submission, pp. 3-4
[47] Kitchener-Wilmot Hydro/Waterloo North Hydro Reply Submission, p. 6 of 14, para 22
[48] Ibid, p. 6, para 23-24
[49] Kitchener-Wilmot Hydro/Waterloo North Hydro Reply Submission, p. 6 of 14, para 25-26
[50] See section 9.3 of the MPA

Findings

The OEB finds that it is premature to determine whether separate rate zones should be maintained beyond the Deferred Rebasing Period for an additional ten years. The Applicants have not provided sufficient evidence to allow the OEB to understand what adverse implications would arise sufficient to amount to an Adverse Determination as defined in the MPA, if the additional ten-year period is not approved at this time. The Applicants also have not provided any evidence as to why it would be in the best interests of ratepayers to decide this issue now.

The MAADs Handbook addresses the expected timing of rate harmonization plans. The onus is on the Applicants to provide evidence sufficient to justify deviating from the Handbook.

The MAADs Handbook states:

> 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.
>
> 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.

When LDC MergeCo files its rate harmonization plan, with a proposed timeline for the plan, including any proposal to continue separate rate zones and for how long, the OEB will be in a position to understand all relevant aspects of the proposed rate harmonization plan. This is preferable to deciding one aspect now and other aspects later. Nothing in this decision precludes LDC MergeCo from including its proposed ten-year period or some other period when it files its rates harmonization plan.

4.3 Accounting Issues

4.3.1 Earnings Sharing Mechanism

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.[51] 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.[52]

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.[53] OEB staff submitted that the Applicants' proposed ESM is consistent with this aspect of the OEB policy, however stub period(s) may need to be taken into consideration.[54]

Intervenors did not make any submissions on the proposed ESM.

The Applicants confirmed that the regulatory net income and achieved (i.e., actual) 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.[55]

Although in the interrogatory responses the Applicants agreed with the approach taken by OEB staff to calculate the consolidated deemed/ approved ROE of 8.43% (i.e., weighted by the OEB-approved rate base),[56] in the reply submission the Applicants made a different statement.[57] The Applicants suggested that the consolidated deemed/ approved ROE should be weighted by the deemed equity component of rate base for Kitchener-Wilmot Hydro and Waterloo North Hydro, as reported in their respective 2021 *Reporting and Record Keeping Requirements* (RRR) filings, as opposed to weighted by the OEB-approved rate base of each legacy distributor. However, as noted below, the Applicants agreed that a consolidated deemed/approved ROE of 8.43% is appropriate.

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[51] Application, p. 50
[52] Application, p. 50; Reply Submission, p. 7 of 14
[53] Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016, pp. 16-17
[54] OEB Staff Submission, p. 20
[55] Interrogatory Responses, Staff-26
[56] Interrogatory Responses, Staff-26; Staff-29, Attachment C, Draft Accounting Order, Account 2435 – Accrued Rate-Payer Benefit
[57] Reply Submission, p. 7 of 14

The Applicants also confirmed in the interrogatory responses that values from the OEB's RRR 2.1.7 filing are generally used in the calculation of rate base values factored into achieved (i.e., actual) ROE (as opposed to rate base values from the last cost of service proceeding), with the deemed equity component remaining at 40%.[58]

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, and confirmed that this rate is appropriate.[59] OEB staff submitted that the consolidated deemed/approved ROE of 8.43% is appropriate,[60] as the OEB approved the consolidated deemed/approved ROE using a similar computation in a recently issued MAADs decision and order.[61]

ESM Disposition

The Applicants stated 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.[62] OEB staff submitted that it would not object to this sequencing of the reporting and disposition of the ESM account balance and also noted that there have been precedents where the ESM is disposed at the end of the Deferred Rebasing Period.[63]

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.[64] 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 and that in the recent decision for Brantford Power and Energy+, no stub period was contemplated, considered or offered.[65]

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[58] Interrogatory Responses, Staff-26
[59] Interrogatory Responses, Staff–26; Reply Submission, p. 7 of 14
[60] OEB Staff Submission, p. 21
[61] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, page 13
[62] Interrogatory Responses, Staff–27
[63] OEB Staff Submission, p.21; 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)
[64] Interrogatory Responses, Staff-25
[65] EB-2021-0280

In their interrogatory responses, the Applicants described several items that, in their view, could lead to an ESM that is not accurate, if stub period calculations are required.[66]

In contrast to the Applicants' position, OEB staff submitted that the ESM should be implemented starting in year six of the Deferred Rebasing Period following the amalgamation (i.e., the anniversary of when the Transaction closes), which may not necessarily coincide with the start of a calendar year.[67] OEB staff submitted that this practice is consistent with OEB policy which does not require the five year period to exactly align with a calendar year period.[68]

OEB staff noted that a similar ESM stub period was approved by the OEB in a prior proceeding.[69] 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.

OEB staff noted that the Applicants did not take issue with the ESM ending on December 31, 2032, as also confirmed in their reply submission.[70] OEB staff submitted 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.

In their reply submission, the Applicants noted that the stub period would not be aligned with audited actual financial results and should the OEB force a mid-year audit, additional resources and costs would be incurred.[71] The Applicants submitted that the ESM start date should start January 1 to align with the rate year and the regulatory reporting period and specifically that the ESM period should begin on January 1, 2028.[72]

ESM Draft Accounting Order

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[66] Interrogatory Responses, Staff-25
[67] OEB Staff Submission, p.22
[68] Handbook to Electricity Distributor and Transmitter Consolidations, January 19, 2016, p.16; EB-2014-0138, Report of the Board Rate-Making Associated with Distributor Consolidation, March 26, 2015, p. 6
[69] OEB Staff Submission, p.22; EB-2021-0312, North Bay Hydro Distribution Limited, Espanola Regional Hydro Distribution Corporation, Decision and Order, March 17, 2022, p.17
[70] OEB Staff Submission, p. 23; Reply Submission, p. 8 of 14
[71] Reply Submission, p. 7 of 14, para 32
[72] Reply Submission, p. 7 & 8 of 14, para 33 and 37

In their interrogatory responses, the Applicants filed a draft accounting order regarding the ESM.[73] In the event that the OEB was to determine 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), OEB staff submitted that the OEB should direct the Applicants to re-file the ESM draft accounting order to incorporate this.[74]

Findings

The OEB approves the Applicants' proposal for an ESM to be implemented for years six through ten of the Deferred Rebasing Period. Adjustments to revenue and expenses will be reviewed at the time of disposition of shared savings. The OEB concludes that the Applicants' proposal is consistent with the MAADs Handbook.

The ESM will share excess earnings above 300 basis points of the consolidated entity's deemed ROE on a 50:50 basis with customers in years six to ten after the merger. The OEB finds that the deemed ROE shall be computed based on the approved ROE percentages for each of Kitchener-Wilmot Hydro and Waterloo North Hydro from their last cost of service (2020 and 2021 respectively), weighted by the deemed equity component of rate base for Kitchener-Wilmot Hydro and Waterloo North Hydro. The approved ROE on which to base the ESM is therefore 8.43%.

The OEB has determined that Account 2435 – Accrued Rate-Payer Benefit should be used to record the earnings above 300 basis points, 50% of which is to be shared with customers.

The OEB agrees with the Applicants and OEB staff that the results of the ESM will be filed annually. However, the detailed review and disposition of the ESM account balance will instead be conducted at the same time as the other Group 2 balances, in order to reduce regulatory burden. Please refer to section 4.3.3 Group 1 and 2 Deferral and Variance Accounts of this Decision for more detail.

The OEB has considered the implications of any stub period on the ESM framework and is of the view that a calendar year based approach is an acceptable basis for the ESM. As a result, the OEB has determined that the start-date of the ESM shall be January 1, 2028 and the end-date shall be December 31, 2032, given that the Applicants' next rebasing application will have rates expected to be effective January 1, 2033.

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[73] Interrogatory Responses, Staff-29, Attachment C, Draft Accounting Order, Account 2435 – Accrued Rate-Payer Benefit
[74] OEB Staff Submission, p.23

The OEB directs the Applicants to re-file the ESM draft accounting order to reflect the OEB's findings in this Decision.

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

The Applicants requested approval for LDC MergeCo to track the grossed-up PILs impact of the variance between the unsmoothed accelerated CCA approach agreed to by Waterloo North Hydro in its 2021 cost of service settlement proposal[75] and the effective PILs impact of the phase-out/elimination of the accelerated CCA anticipated to begin after 2023, until LDC MergeCo's rebasing.[76] The Applicants proposed that Account 1592, Sub-Account CCA Changes, be used to track these amounts.

The Applicants also noted that Account 1592, Sub-Account CCA Changes, 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.[77]

OEB staff submitted that the continued use by Waterloo North Hydro of Account 1592, 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.[78] OEB staff also submitted that Account 1592, Sub-Account CCA Changes, 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.

OEB staff agreed with the Applicants' proposal to report Account 1592 with the sub-accounts set out in Table 2 below.[79] Further clarification was provided in the Applicants' reply submission regarding the expected timing of requests for disposition and/or review of these sub-accounts, as outlined in Table 2 below.[80]

75 EB-2020-0059
76 Application, January 31, 2022, p. 21; Reply Submission, p. 8 of 14
77 Interrogatory Responses, Staff-31; Reply Submission, p. 9 of 14
78 OEB Staff Submission, page 24
79 OEB Staff Submission, p. 24; Interrogatory Responses, Staff-31
80 Reply Submission, para 42 & 45

Table 2 – Account 1592 Sub-Accounts and Disposition

Sub-Account #	Description of Sub-Account	Expected Timing of Disposition and/or Review of the Sub-Account Balances
Sub-Account 1	New balances arising for future PILs differences that will affect LDC MergeCo and are not specific to historical LDCs	A review of this sub-account in LDC MergeCo's next cost of service application
Sub-Account 2	Waterloo North Hydro Account 1592 balances relating to the wind-down of the Accelerated Investment Incentive Program (AIIP) as described in response to SEC-11 and Staff-30	A review of this sub-account in the IRM application at the end of year five of the Deferred Rebasing Period
Sub-Account 3	Historical Account 1592 balances relating to historical Kitchener-Wilmot Hydro balances as described in response to Staff-31(b) and also the differences between the PILs in rates and the actual PILs calculated with the phasing out of the accelerated CCA[81]	A review of this sub-account in the IRM application at the end of year five of the Deferred Rebasing Period

OEB staff submitted that the mechanics of the calculation of amounts recorded in Account 1592, Sub-Account CCA Changes (i.e., the three sub-accounts described in Table 2 above), should be reviewed in the proceeding when the sub-account is brought forth for disposition, and not in the current proceeding.[82] OEB staff further submitted that there are many unknown factors at this time that may impact how the sub-account balances should be calculated and that there may be alternative methodologies in calculating the sub-account balances.

[81] Reply Submission, p. 9 of 14, the Applicants also confirmed that this Kitchener-Wilmot Hydro sub-account will also record the differences between the PILs in rates and the actual PILs calculated with the phasing out of the accelerated CCA.
[82] OEB Staff Submission, p. 26

SEC did not object to the Applicants' proposal regarding Waterloo North Hydro's Account 1592, Sub-Account CCA Changes. SEC also submitted that the specific mechanics and methodology for calculating the sub-account balances should be considered at the next rebasing application when clearance is sought.[83]

In their reply submission, the Applicants agreed that the mechanics of the calculation of the sub-accounts should not be determined in this Application, but reviewed when the balance is brought forth for disposition in a future application, when all relevant factors are known.[84]

Findings

The OEB approves the Applicants' proposal to track in Account 1592, Sub-Account CCA Changes, the grossed-up PILs impact of the variance between the unsmoothed accelerated CCA approach agreed to by Waterloo North Hydro in its 2021 cost of service settlement proposal[85] and the effective PILs impact of the phase-out/elimination of the accelerated CCA anticipated to begin after 2023, until LDC MergeCo's rebasing.

The OEB agrees with the Applicants' submission that Account 1592, Sub-Account CCA Changes, 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.

The OEB agrees that the mechanics of the calculations recorded in Account 1592, Sub-Accounts CCA Changes, should be reviewed in the proceeding when the sub-accounts are brought forth for disposition, and not in the current proceeding. There are many unknown factors at this time that may impact how the Account 1592 sub-accounts balances are calculated, as well as alternative methodologies to calculate the Account 1592 sub-accounts balances.

The OEB has determined that the detailed review and disposition of the Account 1592, Sub-Accounts, CCA Changes set out in Table 2 will be conducted at the same time as the other Group 2 balances, as well as held separately by rate zone during the Deferred Rebasing Period. However, an exception shall apply to Account 1592, Sub-Account CCA Changes #1 in Table 2 (i.e., new balances that will affect LDC MergeCo and not specific to historical LDCs) which may be combined during the Deferred Rebasing

[83] SEC Submission, p. 3
[84] Reply Submission, p. 9 of 14
[85] EB-2020-0059

Period. Please refer to section 4.3.3 Group 1 and 2 Deferral and Variance Accounts of this Decision for more detail.

4.3.3 Group 1 and 2 Deferral and Variance Accounts

The Applicants requested 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.[86] 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.[87]

Regarding DVAs, SEC made submissions on Account 1592, Sub-Account CCA Changes. SEC and Pollution Probe also made submissions relating to Account 1508 – Other Regulatory Assets, Sub-Account Impact of Post-Merger Accounting Policy Changes. These intervenor submissions are discussed in section 4.3.2 Account 1592, PILs and Tax Variances, Sub-Account CCA Changes, and section 4.3.4 Accounting Policy Changes in this Decision.

Group 1 DVAs

The Applicants stated 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.[88] OEB staff supported 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 align with OEB direction in a prior proceeding.[89]

OEB staff further submitted 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.[90]

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[86] Application, p.55
[87] Interrogatory Responses, Staff-32
[88] Interrogatory Responses, Staff-32
[89] OEB Staff Submission, p. 27; EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, p.16
[90] OEB Staff Submission, p. 27

In response to OEB staff's submission, the Applicants agreed that they will bring forward a plan for consolidation of Group 1 balances in an IRM application, with consolidation of the balances taking place at the start of a rate year.[91]

OEB staff also asked the Applicants to clarify their statement that they will address the host/embedded relationship between the Kitchener-Wilmot Hydro and Waterloo North Hydro rate zones as part of the first rebasing application following the Deferred Rebasing Period.[92] In response, the Applicants provided reasons why the host/embedded distributor relationship will need to continue until their next cost of service application as the rates charged by Kitchener-Wilmot Hydro were determined at its last cost of service application, based on an allocation of costs.[93]

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 and Account 1508, Sub-Account Pole Attachment Revenue Variance.[94]

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.[95]

The Applicants suggested 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.[96] At this time, the Applicants anticipate that Group 2 balances arising during the Rate Harmonization Period would be combined.

OEB staff submitted 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.[97] This treatment of Group 2 balances is consistent with the OEB findings in a prior proceeding.[98] OEB staff also noted that there have been instances where the

[91] Reply Submission, para 53
[92] OEB Staff Submission, p. 28
[93] Reply Submission, para 54 & 55
[94] Interrogatory Responses, Staff-32
[95] Interrogatory Responses, Staff-33
[96] Interrogatory Responses, Staff-33
[97] OEB Staff Submission, p. 28
[98] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, page 16

OEB has required that Group 2 accounts be brought forth for disposition during the Deferred Rebasing Period.[99]

OEB staff submitted that the Group 2 accounts should be held separately by rate zone during the ten-year Deferred Rebasing Period, consistent with the OEB findings in a prior proceeding.[100] OEB staff agreed 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.

Regarding the Rate Harmonization Period, OEB staff supported the consolidation of Group 2 accounts effective with the first rebasing year of the consolidated entity.[101]

In their reply submission, the Applicants agreed with the OEB staff position that the Applicants file for disposition of Group 2 balances after year five of the Deferred Rebasing Period and that Group 2 accounts be held separately by rate zone during the Deferred Rebasing Period.[102]

Findings

The OEB grants leave for LDC MergeCo to continue to track costs to the existing Group 1 and Group 2 deferral and variance accounts currently approved by the OEB for Kitchener-Wilmot Hydro and Waterloo North Hydro.

The OEB has determined that the Group 2 accounts shall be held separately by rate zone during the Deferred Rebasing Period and notes that the OEB made similar findings in prior proceedings.[103]

However, exceptions shall be made for Account 2435, Accrued Rate-Payer Benefit, and Account 1592, Sub-Account CCA Changes #1 in Table 2 (i.e., new balances that will affect LDC MergeCo and not specific to historical LDCs), which may be combined during the Deferred Rebasing Period. The OEB took a similar approach in another

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[99] 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)
[100] OEB Staff Submission, p. 29; EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, p.16
[101] OEB Staff Submission, p. 29
[102] Reply Submission, p. 11 and 12 of 14
[103] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, page 16; EB-2021-0312, North Bay Hydro Distribution Limited, Espanola Regional Hydro Distribution Corporation, Decision and Order, March 17, 2022, p.23

proceeding regarding a sub-account of Account 1592 that is expected to capture impacts from a merged entity, as opposed to legacy entities.[104]

The OEB requires that Group 1 accounts be consolidated as soon as practical to increase regulatory efficiencies and synergies. The OEB directs the Applicants to file their Group 1 consolidation plan, no later than the rate application for year six of the Deferred Rebasing Period.

The OEB notes that it is more efficient to bring forward all of the Group 2 accounts for detailed review and disposition at the time of rebasing after the Deferred Rebasing Period. However, the OEB is concerned that this could result in a significant accumulation of either debit or credit balances. The OEB therefore requires LDC MergeCo to file Group 2 balances with the rate application for year six of the Deferred Rebasing Period together with a proposal for disposition, and then at the next rebasing application. The OEB panels for those applications can decide whether disposition is appropriate at that time. This treatment of Group 2 balances is similar to the OEB findings in a prior proceeding.[105]

The OEB accepts the Applicants’ explanation as to why the host/embedded distributor relationship will need to continue until their next rebasing application, as the rates charged by Kitchener-Wilmot Hydro were determined at its last cost of service application, based on an allocation of costs.

The expected timing of the consolidation of the Group 2 accounts during the Rate Harmonization Period will be addressed in the next rebasing application.

4.3.4 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.[106]

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.[107] The Applicants have reviewed the accounting policies for Kitchener-Wilmot

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[104] EB-2021-0312, North Bay Hydro Distribution Limited, Espanola Regional Hydro Distribution Corporation, Decision and Order, March 17, 2022, p.23
[105] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, page 16
[106] Application, January 31, 2022, p.56
[107] Interrogatory Responses, Staff-34

Hydro and Waterloo North Hydro to determine what changes in accounting policy the acquiree may be required to align to that of the acquirer and stated that no material policy differences have been identified. However, the Applicants noted that the rates of depreciation differ slightly in some areas.[108]

OEB staff submitted 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.[109] 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, Accounting Changes Under CGAAP (including a return component applied to the balance).

In the interrogatory responses, the Applicants stated that it is not appropriate to track the differences (such as rate base impacts) in a deferral account, as this could result in a duplication of results between the ESM and the proposed accounting policy changes deferral account mechanism.[110] OEB staff disagreed with the Applicants, primarily because sharing factors and earnings levels would not impact the proposed accounting policy changes deferral account calculations, but would impact the ESM calculations.[111]

In their reply submission, the Applicants agreed that any material impacts arising from changes in accounting policy should be recovered from or refunded to customers.[112]

Impact of Changes in Depreciation Rates

The Applicants suggested that LDC MergeCo's materiality threshold is $465,000.[113]

OEB staff stated that it was unable to conclude at this time that there would be an immaterial impact on LDC MergeCo from Waterloo North Hydro adopting the

[108] Interrogatory Responses, SEC-14
[109] OEB Staff Submission, p. 30
[110] Interrogatory Responses, Staff-34
[111] OEB Staff Submission, p. 32
[112] Reply Submission, p. 13 of 14
[113] Interrogatory Responses, Staff-34, Attachment C, Draft Accounting Order, Account 1508 – Other Regulatory Assets, Sub Account Impact of Post-Merger Accounting Policy Changes

depreciation rates of Kitchener-Wilmot Hydro and provided an example in its submission.[114]

SEC noted that the impact of harmonizing depreciation rates is unknown, but could be material, and submitted that the Applicants should track and record in a deferral account the differences due to Waterloo North Hydro aligning its accounting standards to Kitchener-Wilmot Hydro.[115]

Pollution Probe submitted that for asset investment during the deferral period, it should be clear what amortization period LDC MergeCo intends to use for joint assets, such as new systems or joint investment in other capital infrastructure.[116] Where the amortization period differs (as opposed to the same amortization period), the Applicants should outline the approach they intend to use.

In their reply submission, the Applicants stated that useful lives used for depreciation purposes are accounting estimates, not accounting policies and therefore there is no obligation under IFRS for Waterloo North Hydro to adopt Kitchener-Wilmot Hydro's depreciation rates, or vice versa.[117]

The Applicants further stated that OEB staff appears to be assuming that all assets in the merged entity will follow Kitchener-Wilmot Hydro's depreciation rates embedded in its most recent rate application, but this may not be the case. LDC MergeCo will review depreciation rates in 2022 (as they would do every year) and will apply any changes in estimate, if necessary, on a prospective basis (as they would also do every year). This process does not change as a result of the proposed merger.

In their reply submission, the Applicants also agreed that Account 1576 is appropriate in the current circumstances.

Accounting Policy Changes Draft Accounting Order

OEB staff submitted that 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,[118] should be subject to several modifications.[119] Some of

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[114] OEB Staff Submission, p. 31 and 32
[115] SEC Submission, p. 4
[116] Pollution Probe Submission, p. 5
[117] Reply Submission, p. 13 of 14
[118] Interrogatory Responses, Staff - 34, Attachment C, Draft Accounting Order, Account 1508 – Other Regulatory Assets, Sub Account Impact of Post-Merger Accounting Policy Changes
[119] OEB Staff Submission, p. 33-35

the key differences noted by OEB staff were that the draft accounting order and illustrative example should be revised to:

a) Include references to changes to depreciation policy, as well as changes to capitalization policy
b) Reflect only changes of Waterloo North Hydro adopting Kitchener-Wilmot Hydro's policies, since LDC MergeCo will be maintaining Kitchener-Wilmot Hydro's policies (and there should be no impact on Kitchener-Wilmot Hydro – there will only be an impact on the former Waterloo North Hydro)
c) State that the cumulative variance will be recovered from, or refunded to, customers in Waterloo North Hydro's rate zone and not both rate zones, for the same reasons noted in b)
d) Include a reference to an effective date
e) Change the references from the "rate of return component" to "return component"

In their reply submission, the Applicants noted that both the assets of Kitchener-Wilmot Hydro and Waterloo North Hydro may be subject to revised depreciation rates in LDC MergeCo. The Applicants disagreed with OEB staff's submission that the draft accounting order be revised to exclude any impact to the Kitchener-Wilmot Hydro rate zone customers.[120]

Disposition Considerations

OEB staff submitted 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.[121] OEB staff further recommended that the account balance 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. OEB staff suggested that:

- If the balance in the account is immaterial (i.e., less than $465,000), the account should be closed without disposition (with no further entries required).
- If the balance in the account is 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.

[120] Reply Submission, p. 14 of 14
[121] OEB Staff Submission, p. 35

The Applicants agreed with OEB staff's approach that, at the time the account is brought forward for review, if the amount in the account is immaterial, the OEB may order that no disposition is required.[122] The Applicants also agreed with OEB staff's suggestion that the account balance should be reviewed as part of the IRM application for either 2023 or 2024 rates.[123]

Findings

The OEB notes that it would be inefficient for LDC MergeCo to track immaterial differences caused by accounting policy changes resulting from the merger over the full ten-year Deferred Rebasing Period. However, the OEB finds that, at this time, it is not possible to assess the materiality of differences regarding accounting policy changes (if any), including depreciation estimates.

The OEB is therefore establishing a deferral account, Account 1508 – Other Regulatory Assets, Sub-Account Impact of Post-Merger Accounting Policy Changes, to track the rate base impact, using the methodology established for Account 1576, arising from Waterloo North Hydro's adoption of Kitchener-Wilmot Hydro's accounting policies (including depreciation estimates). The OEB notes that the Account 1576 mechanism is intended to capture impacts of both capitalization and depreciation changes from those embedded in rates at last rebasing, made during the incentive rate-setting term, and not solely capitalization impacts.

The OEB has determined that the account will only reflect changes of Waterloo North Hydro adopting Kitchener-Wilmot Hydro's accounting policies (including depreciation estimates) and not capture impacts from both legacy distributors. Accordingly, the OEB has also determined that the account shall be disposed only to Waterloo North Hydro rate zone customers, and not to both Waterloo North Hydro rate zone and Kitchener-Wilmot Hydro rate zone customers. These findings align with the approach directed by the OEB in a prior proceeding.[124] The OEB notes that the purpose of this account is to capture differences driven by the merger, specifically Waterloo North Hydro's adoption of Kitchener-Wilmot Hydro's accounting policies, and not to capture routine types of differences that may be driven by the periodic accounting policy updates that are required under IFRS for financial reporting purposes.

The OEB finds that the effective date of the account shall be January 1, 2023.

[122] Reply Submission, p. 14 of 14
[123] Reply Submission, p. 14 of 14
[124] EB-2021-0280, Brantford Power Inc. and Energy+ Inc, Decision and Order, March 17, 2022, p.16

The OEB has determined that the balance will be reviewed as part of the IRM application for 2024 rates and, if the balance is lower than the materiality threshold for LDC MergeCo of $465,000, the account will be closed without disposition and no further entries are required. Otherwise the detailed review and disposition of the deferral account balance will be conducted at the same time as the other Group 2 balances, and to the customers of the former Waterloo North Hydro. Please refer to section 4.3.3 Group 1 and 2 Deferral and Variance Accounts of this Decision for more detail.

The OEB does not agree with OEB staff that the balance should be disposed in the 2024 IRM, as it would be more efficient to clear this account at the same time as the other Group 2 balances.

The OEB also does not agree with OEB staff and the Applicants that the balance could also initially be reviewed as part of the IRM application for 2023 rates, as the account will only be made effective January 1, 2023. As a result, there may be little information available regarding the account balance, given that the Applicants' 2023 rate applications are expected to be filed in the summer of 2022.

The OEB directs the Applicants to re-file the Account 1508 accounting policy changes draft accounting order (including the illustrative example) to reflect the OEB's findings in this Decision, as well as accept the additional OEB staff proposed modifications to the draft accounting order. These modifications are described in the background section of this Decision entitled "Accounting Policy Changes Draft Accounting Order".

4.4 Rate-setting Considerations

4.4.1 Deferred Rebasing Period

The Applicants elected to defer rate rebasing for ten years following the completion of the Transaction.

Pollution Probe submitted that while the OEB has determined that allowing a longer deferred rebasing period is appropriate to incent consolidation, there must be an appropriate balance between incentives provided to utilities and the protection provided to customers.

Pollution Probe stated that there will be significant changes over the Deferred Rebasing Period and noted the significant amount of time before the Applicants intend to file a combined Business Plan and Distribution System Plan (DSP) as part of their next cost of service application in 2033.[125] Pollution Probe noted that the Business Plan and DSP are not just critical internal utility documents, but public documents that provide transparency and the ability to understand the utility's priorities and align planning and implementation efforts (e.g., energy and emission plans) in a cost-effective manner.[126]

Pollution Probe recommended that the OEB consider a condition that requires LDC MergeCo to publish an integrated Business Plan and DSP prior to the end of year five of the Deferred Rebasing Period.

The Applicants disagreed with Pollution Probe's recommendation and cited an OEB letter confirming the added cost and burden associated with filing a DSP.[127] The Applicants argued that the OEB's policies indicate when a DSP would be necessary with respect to consolidations, and that earlier filing is not warranted. Similarly, the filing of a Business Plan during the deferred rebasing period appears to be a "make work" project with no meaningful outcomes anticipated.[128]

Findings

The OEB approves the ten-year Deferred Rebasing Period requested by the Applicants. The ten-year deferral period is an incentive established by the OEB to help drive consolidation in the electricity sector. This deferral period provides the amalgamated company with the opportunity to recover transaction costs through synergy cost savings and not from customers.

The OEB's MAADs Handbook specifies that the term of the deferred rebasing is at the option of the distributor up to ten years, and an applicant does not need to file evidence in support of the deferral period it chooses. The OEB concludes that the Applicants' proposal is consistent with the OEB's policy. Except as provided for in section 4.4.2 of this Decision, the OEB will not require LDC MergeCo to file a DSP or business plan during the Deferred Rebasing Period.

4.4.2 Availability of Incremental Capital Module

The Incremental Capital Module (ICM) is an additional rate-setting mechanism under the Price Cap IR option to allow adjustment to rates. The details of the mechanism are described in the *Report of the Board: New Policy Options for the Funding of Capital*

[125] Pollution Probe Submission, p. 2
[126] *Ibid*, p. 3
[127] Applications for 2023 Electricity Distribution Rates, December 1, 2021, p. 3
[128] Kitchener-Wilmot Hydro/Waterloo North Hydro Reply Submission, p. 10 of 14

Investments: The Advanced Capital Module, issued on September 18, 2014[129], and a supplemental report with further enhancements was issued in January 2016.[130] In a letter from the OEB regarding applications for 2023 electricity distribution rates, the OEB stated that in the instance of a utility consolidation, distributors are expected to file an updated DSP if their ICM application falls in a rate year that is beyond the planning horizon of their previous DSP.[131]

The Applicants stated that they do not expect to bring forward an ICM application during the Deferred rebasing Period.[132] The Applicants proposed that if LDC MergeCo intends to file an ICM related to capital investment in LDC MergeCo distribution system beginning in 2025, regardless of which service area that ICM is for, it will file a consolidated DSP.

OEB staff agreed with the Applicants' proposal and noted that from a planning perspective, it is important to understand the Applicants' planning as a combined utility when considering the need and prudence of an ICM.

Findings

The OEB finds that should LDC MergeCo file an ICM related to capital investment in LDC MergeCo's distribution system beginning in 2025, regardless of which service area that ICM is for, it shall concurrently file a consolidated DSP. While existing OEB policies do not stipulate a time frame for a consolidated DSP, the OEB concludes that it is good utility practice as part of a consolidation to update a DSP for the consolidated entity at the earliest opportunity to take advantage of the synergies that the amalgamation presents. In the absence of a consolidated DSP, the OEB cannot determine if incremental capital can be accommodated within the base rates for the predecessor distributors.

4.4.3 Stretch Factor

The Applicants confirmed that they intend to use a combined stretch factor when seeking approval for setting rates for both the Kitchener-Wilmot Hydro and Waterloo North Hydro service territories, when the Pacific Economics Group Research LLC

[129] EB-2018-0219, Report of the OEB – New Policy Options for the Funding of Capital Investments: The Advance Capital Module, September 18, 2014
[130] EB-2014-0219, Report of the OEB – New Policy Options for the Funding of Capital Investments: Supplemental Report, January 22, 2016
[131] Letter of the OEB – Applications for 2023 Electricity Distribution Rates, December 1, 2021
[132] Interrogatory Response, SEC-10, April 25, 2022

assessment would permit it.[133] OEB staff supported the use of a combined stretch factor and noted that this methodology has been accepted by the OEB in the past.[134]

Findings

The OEB approves the use of a combined stretch factor for LDC MergeCo to use in IRM rate applications as soon as a stretch factor is available for the merged company.

[133] Interrogatory Response, Staff-13
[134] EB-2019-0018, Partial Decision and Interim Rate Order, December 12, 2019, p.6

5 LICENCE

The Applicants requested that, upon completion of the Transaction, the OEB issue LDC MergeCo a new distribution licence and that following issuance of the licence to LDC MergeCo, the distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro be cancelled. The Applicants filed the draft Licence Application which confirmed that LDC MergeCo's service area will consist of the current service areas of Kitchener-Wilmot Hydro and Waterloo North Hydro and that the Transaction would have no adverse impact on competition or the reliability and quality of supply and will promote economic and energy efficiency in the distributors' service areas.[135]

OEB staff supported the Applicants' request for a new distribution licence for LDC MergeCo and the subsequent cancellation of the distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro. OEB staff also supported that the current and future rate orders of Kitchener-Wilmot Hydro and Waterloo North Hydro be transferred to LDC MergeCo on the basis that the transfers are required to facilitate the proposed amalgamation, and complementary to the Applicants' request for a new distribution licence for LDC MergeCo.

Findings

The OEB approves the Applicants' request for approval of a new distribution licence for LDC MergeCo, the approval of which will include cancellation of the distribution licences of Kitchener-Wilmot Hydro and Waterloo North Hydro. The licence will include all of the standard conditions of licence established for electricity distributors. The Applicants shall notify the OEB of the final Transaction date so that the new licence can be issued.

[135] The Licence Application was updated in interrogatory response Staff-19 (and filed as Attachment B) to provide a signed and dated version. The Applicants noted that it is considered "draft" since certain information (such as such as Full Legal Name of Applicant, Ontario Corporation Number and Date of Formation) 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.

6 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Merged Holdco is granted leave to acquire control of Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc.

2. Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. are granted leave to amalgamate and continue as LDC MergeCo, or such other name as may be established for the amalgamated local distribution company.

3. The leave granted in paragraphs 1 and 2 shall expire 18 months from the date of this Decision and Order. If the transaction has not been completed by that date, a new application will be required in order for the transaction to proceed.

4. Kitchener-Wilmot Hydro Inc. and Waterloo North Inc. shall notify the OEB of the completion of the transactions referred to in paragraphs 1 and 2 above.

5. Once the notice referred to in paragraph 4 has been provided to the OEB, the OEB will transfer the rate orders of Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. to LDC MergeCo.

6. Once the notice referred to in paragraph 4 has been provided to the OEB, the OEB will issue the new Electricity Distribution Licence to LDC MergeCo to include the service areas formerly served by Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc.

7. When the OEB issues the new Electricity Distribution Licence to LDC MergeCo, the Electricity Distribution Licence of Kitchener-Wilmot Hydro Inc. (ED-2002-0573) and Waterloo North Hydro Inc. (ED-2002-0575) will be canceled.

8. Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. are granted approval to continue, after the amalgamation, to track costs to the deferral and variance accounts currently approved by the OEB for each of the Applicants, subject to the OEB's findings in this Decision.

9. As part of its rebasing application for 2033 rates, LDC MergeCo shall file information to demonstrate how savings have accrued to customers in the two rate zones in accordance with the OEB's findings in this decision.

10. Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. shall file updated accounting orders for the ESM account, Account 2435, Accrued Rate-Payer Benefit, and Account 1508 – Other Regulatory Assets, Sub-Account Impact of Post-Merger Accounting Policy Changes, no later than **July 8, 2022**.

11. Should School Energy Coalition, Pollution Probe, or OEB staff wish to comment on the draft accounting orders, they must do so by filing a submission with the OEB and copying Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. no later than **July 15, 2022,** however the OEB does not intend to grant cost awards for review of the draft accounting orders.

12. If Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. wish to reply to any submissions received, it must do so no later than **July 22, 2022**.

13. The School Energy Coalition and Pollution Probe shall file with the OEB and forward to Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. their respective cost claims no later than **July 15, 2022**.

14. Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. shall file with the OEB and forward to the School Energy Coalition and Pollution Probe any objections to the claimed costs of the School Energy Coalition and Pollution Probe by **July 22, 2022**.

15. The School Energy Coalition and Pollution Probe shall file with the OEB and forward to Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. any responses to any objections to their respective cost claims by **July 29, 2022**.

16. Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. shall pay the OEB's costs of and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

Parties are responsible for ensuring that any documents they file with the OEB, such as applicant and intervenor evidence, interrogatories and responses to interrogatories or any other type of document, **do not include personal information** (as that phrase is defined in the *Freedom of Information and Protection of Privacy Act*), unless filed in accordance with rule 9A of the OEB's Rules of Practice and Procedure.

Please quote file number, **EB-2022-0006** for all materials filed and submit them in searchable/unrestricted PDF format with a digital signature through the OEB's online filing portal.

- Filings should clearly state the sender's name, postal address, telephone number and e-mail address.
- Please use the document naming conventions and document submission standards outlined in the Regulatory Electronic Submission System (RESS) Document Guidelines found at the File documents online page on the OEB's website.
- Parties are encouraged to use RESS. Those who have not yet set up an account, or require assistance using the online filing portal can contact registrar@oeb.ca for assistance.
- Cost claims are filed through the OEB's online filing portal. Please visit the File documents online page of the OEB's website for more information. All participants shall download a copy of their submitted cost claim and serve it on all required parties as per the Practice Direction on Cost Awards.

All communications should be directed to the attention of the Registrar and be received by end of business, 4:45 p.m., on the required date.

With respect to distribution lists for all electronic correspondence and materials related to this proceeding, parties must include the Case Manager, Georgette Vlahos at georgette.vlahos@oeb.ca and OEB Counsel, Ljuba Djurdjevic at ljuba.djurdjevic@oeb.ca.

Email: registrar@oeb.ca
Tel: 1-877-632-2727 (Toll free)

DATED at Toronto June 28, 2022

ONTARIO ENERGY BOARD

Nancy Marconi

Digitally signed by Nancy Marconi
Date: 2022.06.28 11:55:54 -04'00'

Nancy Marconi
Registrar