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OEB Staff Discussion Paper

Evaluation of Policy on Utility Consolidations

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Overview

On July 27, 2023, the Ontario Energy Board (OEB) issued a [letter](#) launching a consultation to engage stakeholders to review and update the OEB's [Handbook to Electricity Distributor and Transmitter Consolidations](#) (MAADs Handbook), and associated *Filing Requirements for Consolidation Applications*.¹ The OEB's letter noted that the focus of the consultation is on electricity distribution-related consolidations.² The OEB advised that the review will leverage experience to-date of the OEB's approximately 20 consolidation-related decisions issued since the original MAADs Handbook was published in 2016, and is expected to identify and address any continuing barriers to consolidation, while ensuring customers are protected. The consultation is also expected to address recommendations related to consolidations as outlined in the Auditor General of Ontario's Value for Money audit report, [Ontario Energy Board: Electricity Oversight and Consumer Protection](#) (AG Audit Report).³

The July 2023 letter stated that it was anticipated that OEB staff would meet with a sample size of utilities on a one-on-one basis, and intervenor input would be sought through a small group meeting. Among other matters, OEB staff sought to gain insights on experiences in filing and participating in consolidation application(s), as applicable, and to provide stakeholders with an opportunity to comment on elements of the OEB's current MAADs Handbook and filing requirements for consolidation applications.⁴

During August and September 2023, OEB staff held a total of nine meetings with utilities and intervenors to receive initial feedback.⁵ After having received initial feedback from distributors and intervenors, OEB staff worked to consolidate that feedback and develop proposals for broader consultation. Most proposals outlined in this OEB Staff Discussion Paper result from consideration of that feedback.

¹ *Handbook to Electricity Distributor and Transmitter Consolidations*, January 19, 2016. The MAADs Handbook uses the term consolidation to be inclusive of mergers, acquisitions, amalgamations and divestitures. Schedule 2 of the MAADs Handbook contains the Filing Requirements for Consolidation Applications.

² The OEB's letter noted the review will not consider the applicability of the MAADs Handbook to natural gas consolidation applications at this time.

³ Office of the Auditor General - Value for Money Audit: *Ontario Energy Board: Electricity Oversight and Consumer Protection*, recommendation 11, pp. 43-44

⁴ OEB Letter, p. 3

⁵ OEB staff held one-on-one meetings with two "small" utilities, two "medium" utilities, two "large" utilities, and two utilities that have not consolidated. OEB staff met with five intervenors as part of a group meeting. One intervenor group was not available for the scheduled meeting. As such, summarized comments should be interpreted as viewpoints heard from those utilities and intervenors with whom OEB staff met.

There are currently 58 rate-regulated distributors in Ontario with the smallest serving about 315 customers, and the largest about 1.4 million customers. OEB staff is of the view that there will be emerging challenges faced within the energy sector posed by net zero carbon initiatives such as increased use of electric vehicles and other electrification initiatives, challenges related to cybersecurity, the need for resiliency in the face of climate change, management of distributed energy resources, considerations of distribution system operator models, and other changes as the energy sector evolves. These initiatives will pose challenges and may require utilities to increase their service capabilities. While consolidation is not the only way to meet these challenges, enhancing utility capabilities may be better addressed through the economies of scale resulting from further consolidation in the electricity sector. It is with this perspective that OEB staff has formed its recommendations.

Overall, OEB staff are not proposing any major changes to the MAADs Handbook and/or filing requirements for consolidation applications. Meetings with stakeholders did not identify any significant barriers to consolidation or major gaps in consumer protection from existing OEB policies. The proposals staff are making, summarized below, are primarily related to areas of clarification on current policy, evolving certain language, and additional detail required as part of MAADs applications. Net new requirements to address the recommendations outlined in the AG Audit Report have been proposed. Supporting discussion for each proposal follows.

No Harm Test

- The “no harm” test should continue but be clarified.
 - Clarify that in assessing “no harm”, both quantitative (e.g., cost) and qualitative information (e.g., reliability and resilience) included in the application will be weighed in consideration of the circumstances of each case to determine whether the proposed transaction, on a net basis, has a positive or neutral effect on the attainment of the OEB’s objectives.
- The OEB’s objectives have been amended since the issuance of the MAADs handbook and should be updated.

Cost Structures

- Update filing requirements to outline the information that should be provided for underlying comparative cost structure analysis (i.e., revenue requirement analysis).

<ul style="list-style-type: none"> • Forecast revenue requirement both under consolidation and under the status-quo scenario of the predecessor utilities remaining as stand-alone utilities should be provided. <ul style="list-style-type: none"> ○ Analysis should include information for each year of the elected deferred rebasing period and include the post-consolidation rebasing year. ○ Assumptions used in these forecasts should be documented (e.g., inflation, productivity, cost of service adjustments, evolving energy sector, expected Incremental Capital Module requests, if applicable, etc.).
<ul style="list-style-type: none"> • Addition of language to address evolving energy sector. <ul style="list-style-type: none"> ○ The OEB will take into consideration evidence which highlights expected impacts to cost structures from an evolving energy sector relative to the status quo, with detailed supporting rationale. Further, the OEB reminds applicants that the OEB will weigh both the quantitative and qualitative impacts of a proposed transaction and consider the circumstances of each case to determine whether the proposed transaction, on a net basis, has a positive or neutral effect on the attainment of the OEB’s objectives.
<ul style="list-style-type: none"> • At the time of the post-consolidation rebasing application, the consolidated entity should file a similar revenue requirement analysis (as above) based on updated actuals to that point in time (and including forecasts for the bridge year (the last year of the deferred rebasing) and the rebasing test year on a best-efforts basis. • A comparison and discussion of the MAADs application forecasts versus those filed in the post-consolidation rebasing application should be provided.
Deferred Rebasing Period
<ul style="list-style-type: none"> • Maintain option to select a definitive timeframe for the deferred rebasing period of up to 10-years (maximum).
<ul style="list-style-type: none"> • Applicants should identify the rate year in which rebased rates would be effective in the consolidated utility’s rebasing application.
<ul style="list-style-type: none"> • Update language in current MAADs Handbook in the section “Early Termination or Extension of Selected Deferred Rebasing Period” <ul style="list-style-type: none"> ○ During the deferred rebasing period, specifically after year four, a consolidated entity may apply to the OEB for rebasing for the consolidated entity. ○ A consolidated entity that seeks to rebase earlier than its elected deferral period should inform the OEB of its intent and provide sufficient reason for the request. ○ A consolidated entity having selected a deferred rebasing period less than 10 years, may seek to extend its selected deferred rebasing period. However, the OEB notes that despite the ability for consolidated entities to extend the deferred rebasing period, a consolidated entity having selected a deferred rebasing period less

than 10 years, that seeks to extend its selected deferred rebasing period (up to a maximum of ten years) must file supporting, compelling rationale why this is required. The OEB will consider the reasons and information provided, including other relevant factors such as the distributor's financial and service quality performance.

- Treatment of deferral periods in the event of successive consolidations by the same entity should be reviewed and addressed on a case-specific basis.
 - Confirm the remaining deferral period for the previously consolidated entity.
 - Identify the elected number of years for the deferred rebasing period (maximum 10 years) for the utility being consolidated into the previously consolidated entity and identify what rate year that rebased rates would be effective for (in other words, for the most recent utility being acquired or merged into the previously consolidated entity).
 - Identify the proposed timing for rebasing of the new consolidated entity.
 - If the applicants seek to extend the elected deferred rebasing period of the previously consolidated entity (if the originally elected period was less than ten years), the onus will be on the applicant(s) to justify the need for, and benefits of, any requested extension to the current deferral period.

Future Rate Structures

- Plans for future rate structures (e.g., anticipated new rate classes, explanation of cost allocation beyond the deferred rebasing period) can be discussed if supportive of "no harm" claim. However, there should **not** be a requirement to do so.
- While details of any rate harmonization plan are not required in a consolidation application, a statement indicating whether the consolidated utility intends to undertake rate harmonization at the time of rebasing or, if not, an explanation for not doing so, should be included. Where the utility does intend to harmonize rates, a brief description of the plan should also be provided.

Performance Metrics & Reporting

- Consolidated entities which elect to defer rebasing for more than five years (i.e., 6-10 years), should file a mid-term report detailing progress to-date on the steps taken towards integration. OEB staff's proposed minimum requirements for this mid-term report are set out in its Performance Metrics & Reporting discussion.
- In the first rebasing application for a consolidated utility, updates to this information should be provided including for any period not covered by the initial mid-term report.

<ul style="list-style-type: none"> • Any reporting requirements on any conditions of approval and/or the maintenance of records during the deferred rebasing period should be up to the discretion of and should be considered by the OEB panel assigned to each consolidation application. • OEB staff's view is that the OEB should determine an appropriate level and frequency of reporting on these matters during deferred rebasing periods.
<ul style="list-style-type: none"> • Reliability Metrics: Applicants that have voluntarily filed feeder level information historically leading up to the consolidation application, are expected to provide a listing of feeder reliability by rate zone (i.e. for the predecessor utilities) for the most recently completed historical years available, up to five years. • For utilities that have not historically reported feeder level information voluntarily, OEB staff recommends encouraging these utilities to include such data in the consolidation application for the most recently completed historical years leading up to the consolidation application, up to five years, if feeder-level reliability information is available. • Following approval of a consolidation application, if feeder-level reliability information is available, and if at least one of the pre-consolidation utilities has been reporting feeder level reliability information historically for at least one of the legacy rate zones, the OEB should require the consolidated utility to continue reporting this data for any available rate zone, and identify the rate zone for each feeder during the deferred rebasing period. • The OEB can consider how to address circumstances in which applicants cannot provide feeder-level reliability information for any rate zone on a case-by-case basis.
<ul style="list-style-type: none"> • Service Quality Metrics: The current practice of reporting service quality metrics on a consolidated basis post-consolidation should continue.
<p>Cost Recovery Treatment for Transaction, Transition, Integration Costs</p>
<ul style="list-style-type: none"> • Approach to deal with exceptions for the recovery of transaction and transition costs should be dealt with on a case-by-case basis (maintain status quo). <ul style="list-style-type: none"> ○ Add wording to MAADs Handbook noting that if an applicant considers that it has unique circumstances which may warrant recovery of transaction and/or transition costs, evidence should be brought forth in the consolidation application for the OEB's consideration.
<ul style="list-style-type: none"> • Use of consistent wording throughout MAADs Handbook and filing requirements for consolidation applications – “transition” costs instead of “integration” costs.

- Add language in the updated MAADs Handbook to state that at the post-consolidation rebasing, all capital assets classified as part of the utility's "transition" costs (i.e., capitalized costs intended to integrate operations) which were invested in and put in-service since the consolidation will be subject to review, on a case-by-case basis. The nature of the expenditure and whether it would have occurred regardless of the consolidation will be reviewed, in addition to the typical review for need and prudence. The OEB will determine whether they should be included in the opening test year rate base, if applicable.

Incremental Capital Funding Availability to Consolidated Utilities

- In consolidation applications, document any expected future Incremental Capital Module (ICM) requests during the deferred rebasing period, and provide any details, as available.
- Update MAADs Handbook to reflect OEB correspondence issued since January 2016 regarding ICM funding availability during the deferred rebasing period for consolidated utilities.
- Add wording to MAADs Handbook stating that if, during its deferred rebasing period, a consolidated utility finds that it has significant capital needs not easily accommodated by an ICM, it should consider rebasing.
- Seek input on whether the OEB should implement any changes to the inflation rate(s) used in calculating the materiality threshold for incremental capital funding prior to the OEB considering the ICM policy in its entirety as part of a separate consultation, given that inflation is only one component of the calculation.
- If a change is proposed, what inflation rate(s) should be used.

Accounting Matters

Timing of Disposition (Group 2 Deferral and Variance Accounts (DVAs))

- If deferred rebasing period > 5 years, applicant(s) should provide a plan to bring in Group 2 DVAs for potential disposition.
- Balances should be requested for disposition if material at that time.
- If the deferred rebasing period < 5 years, applicant(s) would still have the flexibility of requesting Group 2 DVAs for disposition, if warranted and supported.

Accounting Policy Changes

- Require applicant(s) to establish an account to capture impact of accounting policy changes post-consolidation. Require explanation if the account is not needed.
- Establish accounting order in the MAADs proceeding, with the effective date being the close of the transaction date.
- The account should track the revenue requirement impact of accounting policy changes and should not be limited to recording the rate base impact.

- Upon completion of the utilities' assessment of accounting policy changes, utilities may propose to close the account, if the impact is not material.
- Materiality should be based on the materiality for the predecessor utility whose accounting policies are changed and be disposed to the customers of the predecessor utility that underwent accounting policy changes.

Tracking of DVAs (Group 1 and Group 2)

- Group 1: encourage utilities to consolidate accounts as soon as practicable, but this is dependent on items such as data from various systems (e.g., billing system).
- Group 2: utilities should provide a proposal in the MAADs application on whether the accounts are proposed to continue on a legacy rate zone basis or a consolidated basis, with supporting rationale.

Earnings Sharing Mechanism (ESM)

Mechanics of ESM

- ESM should be established for a deferred rebasing period longer than five years.
- ESM should be determined on a calendar-year basis.
- Deemed consolidated ROE calculated based on the approved ROE percentages for each utility from their last rebasing application, weighted by the deemed equity component of rate base of each utility in their last rebasing application.
- Establish accounting order in the MAADs proceeding, with effective date when the MAADs transaction closes.
- Clarify ESM to include all transactions and transition costs as well as savings.

Performance Standards

- Following the issuance of an updated MAADs Handbook, the OEB should undertake a review of the section 86 performance standards for timelines of MAADs proceedings.
- OEB staff invites comments on what criteria may allow an application to be processed under shorter versus a longer timeframe.

Other

Z-Factor – Materiality Threshold Calculation

- Add section in the MAADs Handbook related to Z-Factor materiality thresholds for consolidated utilities:
 - Adjusting a distributor's revenue requirement to set the materiality threshold may be appropriate when predecessor utilities, or a consolidated utility's rate zones, have not rebased for more than five years. When it is apparent from the dates of the last OEB-approved revenue requirement that there has likely been a significant change, the OEB finds it reasonable to adjust the materiality threshold to recognize the likelihood of such change. Specifically, the cumulative impact of IRM rate adjustments and growth in demand (customers,

kWh and kW), should be reflected in the applicant's calculation of its materiality threshold. If an applicant does not believe such adjustments are warranted, it should provide justification.

Recovery of Incremental Operations, Maintenance & Administration (OM&A)

- For incremental OM&A expenses not related to a qualifying ICM request – no need for new means of recovery, as existing tools (Z-factors, DVAs) are well-established.
- For incremental funding for OM&A that is directly tied to a qualifying ICM request, stakeholders may raise this issue at the time the OEB undertakes its consultative process to review its ICM policy.
 - OEB staff is not proposing any change in this regard for consolidating utilities in the updated MAADs Handbook.

Timing of New MAADs Filing Requirements

- Applicants should strive to reflect any updated filing requirements, to the extent possible, in their applications. For any updates not adopted, applicants should include an explanation as to why.
- New reporting requirements arising out of the Auditor General Audit Report should be applicable and required in all cases going forward.

Pro forma Financials

- Add to current requirement to provide assumptions/explanations, methodology used to forecast amounts in pro-forma financial statements.

OEB Act Objectives

- Update OEB Act references to reflect most up-to-date language.
- In applying the “no harm” test, the OEB’s primary focus on impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector remains appropriate.

Licence Application

- Clarify that the licence application requests are to be included as part of the consolidation application; licensing matters will only be completed if the proposed consolidation is approved and when the utility informs the OEB that an approved consolidation is completed (i.e., per existing procedure for associated licensing changes).

OEB Policy Documents on Rate-Making Associated with Distributor Consolidation

OEB approval is required for electricity-related consolidation transactions described under section 86 of the *Ontario Energy Board Act, 1998*.⁶

The OEB's current policies on rate-making matters associated with consolidation in the electricity distribution sector are set out in two reports. The first report titled [Rate-making Associated with Distributor Consolidation](#)⁷ issued on July 23, 2007 (2007 Report) was supplemented by a [2015 Report](#) with the same name.⁸ The OEB subsequently issued its MAADs Handbook which provides guidance to applicants and stakeholders on applications to the OEB for approval of electricity distributor and transmitter consolidations.⁹ The MAADs Handbook consolidates information that is provided in the two reports noted above and identifies the key rate-making considerations expected to arise in consolidation transactions.¹⁰ Subsequently, the OEB issued letters updating capital funding option availability for consolidating utilities. Recent OEB decisions on specific consolidations and rate applications during deferred rebasing periods also provided guidance on MAADs-related matters.

The updated MAADs Handbook resulting from this consultation will replace the OEB's current policies on rate-making matters associated with consolidation in the electricity distribution sector as set out currently in two reports of the OEB, as well as the current MAADs Handbook.¹¹

What We Heard and OEB Staff Proposals

OEB staff has summarized the major overarching themes heard from stakeholders below.

⁶ *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, Sched. B

⁷ EB-2007-0028, *Report of the Board on Rate-Making Associated with Distributor Consolidation*, July 23, 2007

⁸ EB-2014-0138, *Report of the Board on Rate-Making Associated with Distributor Consolidation*, March 26, 2015

⁹ MAADs Handbook, January 19, 2016

¹⁰ The MAADs Handbook notes that applicants are encouraged to review both reports (i.e., the 2007 Report and the 2015 Report) in preparing their applications for both the consolidation transaction and subsequent rate application.

¹¹ As part of any final version of the MAADs Handbook and/or filing requirements for consolidation applications resulting from this consultation, OEB staff notes that there may be language that has been superseded by other OEB-issued correspondence which requires updating. These more administrative updates may not be covered as part of this Discussion Paper.

Some utilities expressed a view that further consolidation is needed and beneficial, while other utilities are less certain. Some are concerned about the prospects for acquisitions of smaller and non-contiguous utilities, and the risk of inheriting a utility that may need significant capital and operating cost infusion to be able to cope with increasing technological requirements and challenges.

Discussions with stakeholders revealed that most believe that the OEB's existing consolidation policies, and the regulatory process to seek approval for a consolidation, do not create disincentives to pursue a consolidation. Some intervenors commented that the OEB's current policies have created a favorable environment for utilities to pursue mergers (for example, the option to defer rebasing for up to ten years, and the availability of incremental capital funding through the ICM mechanism). A common theme among stakeholders was that barriers or obstacles to consolidation relate to external factors, and not to the OEB's consolidation policies or application process.

Most believe the "no harm" test should continue, but perhaps be clarified. Many utilities commented that qualitative (and not just quantitative) benefits of a proposed consolidation are important and should be considered by the OEB in assessing whether to approve a proposed transaction.

Many utilities expressed support for a deferred rebasing period of up to ten years, but several also recognized that the sector is currently at a crossroads (e.g., electrification, energy transition). There will be impacts on costs and underlying cost structures, but at this time, those impacts are unknown. As such, a few utilities suggested the need for more flexibility to rebase sooner. Intervenors commented that the option to elect a deferral as long as ten years should be reassessed given increased cost pressures going forward.

Several utilities commented that prospective changes to rates that could result from but which are not integral to the consolidation agreement should be outside the scope of a MAADs application. It was noted that rates are impacted not just by the underlying cost structures of utilities, but can change over time as a result of shifting load patterns, load shapes, etc. As such, rates are a matter that generally should be best addressed when the consolidated entity rebases.

Overall, OEB staff observed a common theme of desiring flexibility in the consolidation policy on accounting matters to recognize different circumstances of various utility consolidations.

In preparation for the launch of this consultation, OEB staff undertook an introspective review informed mainly by experiences from previous MAADs proceedings and by rate applications involving consolidated utilities. OEB staff also reviewed the current language included in the MAADs Handbook and filing requirements for consolidation applications. This review formed the basis for the issues to be considered in discussions with external stakeholders in one-on-one meetings. Material used during the meetings with stakeholders can be found on the OEB's [Engage with Us](#) page for this consultation.

While the presentation materials formed the basis for the scoping of issues with stakeholders at each meeting, discussions with stakeholders were not limited to only those topics and questions. During the one-on-one meetings, stakeholders were invited to discuss any issues or key areas of concern to them related to the MAADs policy. Generally, the common and/or main comments heard in the stakeholder meetings related to the topics identified by OEB staff in the meeting material (but not necessarily the exact questions posed). Further, while OEB staff and stakeholders discussed the large majority of topics, not all topics were covered in all meetings.

“No Harm” Test

Most stakeholders supported maintaining the “no harm” test.¹² However, based on comments heard, clarification of what satisfying the “no harm” test means would be beneficial.

One intervenor pointed to the OEB's decision in a recent consolidation application and commented that it should become the OEB's policy for consolidation transactions. In that decision, the OEB required that the acquiring utility's shareholder absorb any costs above a status quo “goalpost”.¹³

Many utilities commented that more qualitative aspects of proposed consolidations need to be considered by the OEB in supporting the “no harm” test. For example, a utility noted that historically an assessment of “no harm” has focused on a review of underlying cost structures but explained that underlying costs may increase but result in improved outcomes (e.g., better service quality and reliability over time). Another utility

¹² The “no harm” test was established by the OEB in 2005 - OEB File No. RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257, Combined Proceeding Decision, August 31, 2005

¹³ EB-2018-0270, Hydro One Networks Inc. and Orillia Power Distribution Corporation: The Applicants committed to ensuring that the total costs collected from acquired Orillia Power customers will remain between the “goalposts” of the projected year 11 residual cost-to-serve and Orillia Power's year 11 status quo revenue requirement. The projected Orillia Power year 11 revenue requirement (without consolidation) represents the “upper goalpost”; Hydro One's residual cost to serve Orillia Power customers (with consolidation) represents the “lower goalpost”. The difference between the two goalposts is equivalent to the cost savings of each proposed transaction. The OEB found that if the fully allocated revenue requirement for the new year 11 Orillia Power rate classes is higher than the year 11 status quo forecast of Hydro One, these excess costs shall be borne by the shareholder and not by the ratepayers.

commented that the manner in which the newly consolidated entity can provide better services, for example, with expanded expertise and resources that the predecessor utilities may not have had access to, should be considered. In other words, improved distributor capability should be a consideration in addition to cost impacts.

One intervenor commented that the MAADs Handbook should be updated to reflect the OEB's updated statutory objectives as set out in section 1 of the OEB Act.

OEB Staff Discussion

OEB staff supports the continuation of the “no harm” test in assessing proposed consolidations and sees no reason at this time for the OEB to move away from its stated position with regard to the no harm test that, “in the context of share acquisition and amalgamation applications, it is the test that best lends itself to the objectives of the Board as set out in section 1 of the Act.”¹⁴

The “no harm” test considers whether a proposed transaction will have an adverse effect on the attainment of the OEB's statutory objectives, as set out in section 1 of the OEB Act. **OEB staff agrees that the updated version of the MAADs Handbook resulting from this consultative process should reflect the OEB's updated objectives.** More details are provided in the OEB Act Language section of this Discussion Paper.

OEB staff acknowledges that “to demonstrate ‘no harm’, the requirement of applicants to show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been”¹⁵, has largely looked at the effect of the proposed transaction on underlying cost structures and, in some instances, rates. OEB staff notes that consideration of a proposed consolidation's cost structures is important as these ultimately translate into rates that will be borne by ratepayers. However, OEB staff does not view the OEB's current assessment of “no harm” to exclude consideration of the non-financial impacts that the applicants in an amalgamation, or acquirer in an acquisition, foresee. Examples could include improvements to service quality, reliability, resiliency, technological advancements or enhanced utility capabilities. OEB staff notes that intended non-cost benefits and possibly associated investments are frequently documented by the applicant utilities and are explored in MAADs applications.

¹⁴ OEB File No. RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257, Combined Proceeding Decision, August 31, 2005, p. 6

¹⁵ MAADs Handbook, p. 7

OEB staff points to two specific references in the current MAADs Handbook in support of its view that the OEB's current assessment of "no harm" does not exclude the consideration of non-financial impacts of a proposed consolidation or acquisition.

The OEB considers whether the "no harm" test is met based on an assessment of the **cumulative** effect of the transaction on the attainment of the OEB's statutory objectives.¹⁶ **[Emphasis added]**

And,

The impact that the proposed transaction will have on economic efficiency and cost effectiveness (in the distribution or transmission of electricity) will be assessed based on the applicant's identification of the various aspects of utility operations where it expects sustained operational efficiencies, both quantitative and **qualitative**.¹⁷ **[Emphasis added]**

OEB staff understands the excerpts above to mean that the OEB will assess not only the expected quantitative benefits of a proposed transaction, but also the expected qualitative benefits, to determine whether, overall, there will be "no harm" to customers. **OEB staff proposes the MAADs Handbook be updated to include language which clarifies that both quantitative (e.g., cost), and qualitative information (e.g., reliability and resilience) included in the application will be weighed in consideration of the circumstances of each case to determine whether the proposed transaction, on a net basis, has a positive or neutral effect on the attainment of the OEB's objectives.** Further that the definition of the "no harm test" is not a colloquial understanding of "no harm" but is based on the tests laid out in the MAADs policy.

OEB staff does not agree that the MAADs policy should adopt the OEB's decision which required that the acquiring utility's shareholder absorb any costs above a status quo "goalpost". By their very nature, there will be unique circumstances to each proposed consolidation before the OEB. If an applicant wishes to put forth its own proposals or mechanisms in its application to support its evidence of "no harm", it may and should do so. Similarly, OEB staff and intervenors may propose specific considerations for the OEB as part of consolidation applications, as warranted. In determining whether to approve a consolidation transaction, OEB panels of Commissioners can avail themselves of different mechanisms and requirements of applicants depending on the specifics of the case. This holds true both at the time of considering whether to approve or deny a consolidation transaction, and when the consolidated entity rebases.

¹⁶ Ibid, p. 4

¹⁷ Ibid, p.8

Consolidation applications, by their very nature, are based on best available forecasts at the time. At the time of the consolidated entity's rebasing application, the OEB assesses the rate-setting aspects of the consolidation to determine whether they are satisfactory. OEB staff is of the view that there should be flexibility in the MAADs policy to account for different circumstances and different utility consolidations.

Cost Structures

The OEB uses the term "cost structures" in the MAADs Handbook. One of the filing requirements for consolidation applications notes that an applicant is to provide a "year over year comparative cost structure analysis."¹⁸

OEB staff notes that the term "cost structure" is not defined in the MAADs Handbook or filing requirements for consolidation applications, and there may be differing views respecting the interpretation of cost structure. OEB staff sought input on what interviewed utilities and intervenors understood by it, and whether it could be better explained.

Most utilities and intervenors recognized revenue requirement as a suitable statistic for comparisons between the proposed consolidation and the "status quo" stand-alone scenario when detailing cost structure analyses. One party raised the question of whether a MAADs application is an initial test of "no harm" to customers, followed by a review at rebasing to determine if that is the case (i.e., should the status quo versus consolidated analysis be assessed at the time of the MAADs application, and at the time of the post-consolidation rebasing). Many utilities raised concerns about the difficulty of preparing forecasts for the deferred rebasing period, particularly if it extends to ten years, given the changing environment in which utilities operate. Many commented that the unknown effects of the energy transition on cost structures and on the operation of utilities will make status quo forecasting more difficult.

OEB Staff Discussion

As noted in the MAADs Handbook:

A simple comparison of current rates between consolidating distributors does not reveal the potential for lower cost service delivery. These entities may have dissimilar service territories, each with a different customer mix resulting in differing rate class structure characteristics. For these reasons, the OEB will assess the underlying cost structures of the consolidating utilities.¹⁹

¹⁸ Filing Requirements for Consolidation Applications, January 19, 2016, p. 5

¹⁹ MAADs Handbook, p. 6

The issue which arises is that a simple comparison of rates before and after consolidation may not be an accurate comparison between predecessor utilities involved in a proposed consolidation. Current rates for different utilities may reflect differences in business environments, different customer mixes, choices for cost allocators and for rate design (not only recently, but also reflecting past cost allocation and rate design choices), as well as (for example) host or embedded distributor relationships, and deemed high-voltage distribution assets. OEB staff notes that this applies not only for comparisons of different utilities' rate applications, but, in the context of a consolidation application, how to compare the predecessor utilities versus what might occur (at the next rebasing or later) if a proposed consolidation is approved.

As such, OEB staff concurs that revenue requirement is a suitable statistic for doing "cost structure" comparisons between the proposed consolidating utilities and the "status quo" stand-alone scenario. However, utilities should be encouraged to augment this information with other cost-related analyses that they may have done in support of the proposed consolidation.

OEB staff proposes that as part of a consolidation application, applicants be required to provide a revenue requirement analysis showing the expected revenue requirement both under consolidation, and under the status quo scenarios for the duration of the elected deferred rebasing period, and the post-consolidation rebasing year. While OEB staff believes the current wording in the MAADs Handbook referencing cost structures should remain, the filing requirement which states that applicants are to "Provide a year over year comparative cost structure analysis for the proposed transaction, comparing the costs of the utilities post transaction and in the absence of the transaction"²⁰ should change to "Provide a year over year comparative revenue requirement analysis for the proposed transaction, comparing the costs of the utilities post-transaction and in the absence of the transaction for the duration of the deferred rebasing period, up to and including the post-rebasing year". For the post-consolidation rebasing year, the utility should include the forecast net savings that would flow to ratepayers at that time. The expected revenue requirement for the post-consolidation rebasing year is needed as the consolidated utility will be coming off the Incentive Rate-setting Mechanism (IRM) adjustment period and the OEB will need to see what the expected costs for the consolidation and the expected savings at rebasing are.

²⁰ Filing Requirements for Consolidation Applications, p. 6

OEB staff has provided, below, an example of a revenue requirement analysis for a merger between two utilities which elect a ten-year deferred rebasing period.²¹ Depending on the type of consolidation, the tables may need to be adapted by applicants as required.

Assumptions

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
Customer Growth (%) - Utility 1											
Customer Growth (%) - Utility 2											
Inflation (%)											
Stretch Factor on a Standalone Basis (%) – Utility 1											
Stretch Factor on a Standalone Basis (%) – Utility 2											
Stretch Factor on a Consolidated Basis (%) – Rate Zone 1											
Stretch Factor on a Consolidated Basis (%) – Rate Zone 2											

²¹ Many components of the example provided were sourced from the interrogatory response to SEC-9 in the application by Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc. for leave to amalgamate (EB-2022-0006).

Revenue Requirement – Standalone

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
	Budget	IRM	IRM	COS	IRM	IRM	IRM	IRM	COS	IRM	IRM
Utility 1											
	Budget	IRM	IRM	IRM	COS	IRM	IRM	IRM	IRM	COS	IRM
Utility 2											
Standalone Total – Utility 1 + Utility 2											

Revenue Requirement – Merged

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	Year 11
	Budget	IRM	IRM	IRM	IRM	IRM	IRM	IRM	IRM	IRM	COS
Rate Zone 1											
	Budget	IRM	IRM	IRM	IRM	IRM	IRM	IRM	IRM	IRM	COS
Rate Zone 2											
Merged Total											

Note: Year 11 = rebasing year under the merged scenario.

OEB staff notes that some past applications have provided this type of analysis, while others have not. Further, in instances where this information has been provided, the details, and level of those details, has not been consistent. Intervenors commented that applicants should document the assumptions used to determine their forecasts. **OEB staff agrees. Applicants should document their reasonable assumptions about inflation and productivity adjustments, and what would be normal expected cost of service revenue requirement adjustments at normally scheduled rebasing years during the deferred rebasing period.²² Utilities should also document any assumptions made related to the impact of an evolving energy sector. Further, if the utilities have reasonable expectations of any ICMs or other cost recovery mechanisms, both in terms of timing and in quanta (i.e., revenue requirement), they should reflect that in both the consolidated and stand-alone scenarios, or otherwise provide adequate explanation.**

²² In general, utilities would base their forecasts of these hypothetical rebasings based on past experience, but also informed by information on current inflation, interest rate and market returns, and cost trends of the utility that the utility uses to generate its forecasts.

Clarity in what should be provided, and consistency in how it is presented, should reduce any potential barriers for applicants, potentially minimize interrogatories, and assist OEB staff, intervenors, and the OEB in assessing a proposed transaction.

As noted above, some utilities raised concerns about preparing forecasts for the deferred rebasing period, particularly given the changing environment (e.g., energy transition). OEB staff understands this and recognizes that these are forecasts of what might be expected, and that the confidence interval may expand exponentially the further out information is forecast. However, an OEB panel of Commissioners deciding whether to approve or deny the proposed MAADs transaction requires reasonable forecasts on which to base its decision. As noted above, utilities should document any assumptions made related the impact of an evolving energy sector. OEB staff considers that this important financial information is needed at the time of the MAADs application to demonstrate one key aspect of satisfaction of the “no harm” test, as noted above.

The current MAADs Handbook states,

To demonstrate “no harm”, applicants must show that there is a reasonable expectation based on underlying cost structures that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been.²³

As stated previously, OEB staff is of the view that the energy sector will be evolving. This will pose challenges for all utilities and may require increased capabilities. An increase in capabilities may impact a utility’s cost structure. **OEB staff proposes the following paragraph be added to the updated MAADs Handbook:**

The OEB will take into consideration evidence which highlights expected impacts to cost structures from an evolving energy sector relative to the status quo, with detailed supporting rationale. Further, the OEB reminds applicants that the OEB will weigh both the quantitative and qualitative impacts of a proposed transaction and consider the circumstances of each case to determine whether the proposed transaction, on a net basis, has a positive or neutral effect on the attainment of the OEB’s objectives.

With respect to the question of whether the status quo stand-alone versus consolidated analysis is to be used at the time of the MAADs application or at the time of the post-consolidation rebasing of the consolidated entity, OEB staff’s opinion is that it should be a requirement in both applications.

²³ MAADs Handbook, p. 7

In the MAADs application, this analysis is useful evidence that is informative to the OEB panel and other parties regarding the satisfaction of the “no harm” test based on current information, and has been used as such in recent MAADs applications.

OEB staff proposes that at the time of the post-consolidation rebasing application, the consolidated entity should file a similar revenue requirement analysis as detailed above (i.e., under both the status quo stand-alone scenario and consolidated scenario), but based on actual information, as available, to that point in time on a best-efforts basis. This would, of necessity, include forecasts for the bridge year (the last year of the deferred rebasing) and the rebasing test year.

At the time of the consolidated entity’s rebasing application, OEB staff would expect a simple comparison of the analyses filed in the rebasing application to those filed in the MAADs application. Documentation on differences in actual inflation and stretch factors, growth, unanticipated needed investments, and other matters as required, from what was forecast at the time of the MAADs, or details of additional actual costs (e.g., ICMs or Z-factors) may suffice.

This type of variance analysis may help to understand differences from the forecasts provided at the time of the MAADs, and which were considered by the OEB panel deciding the MAADs case. Further, it will assist in providing a comparison of the consolidated utilities’ expected revenue requirement at the time of the MAADs application, and that proposed for the rebasing year. The variance analysis may also help to answer questions such as, have there been cost efficiencies, and how big are they relative to the revenue requirement? Have there been realized savings (that are now to be shared with ratepayers) – in other words, has the consolidation been a success compared to what would have prevailed in the status quo? Have there been changes within the energy sector that have affected cost forecasts?

The OEB panel deciding on a subsequent rate application can take that evidence into consideration in its decision of what revenue requirement and rates to approve at rebasing.

However, for reasons explained above, OEB staff believes that all parties should be reasonable in such testing of these data. As noted previously, consolidation applications, by their very nature, are based on best available forecasts at the time, and the confidence interval expands exponentially the further out information is forecast. It is understood that the environment in which utilities operate may have evolved from the time of the MAADs application to the rebasing application. The intent of providing forecasts with associated assumptions as part of the consolidation application, and then

updating those forecasts at rebasing, will assist the utility, the OEB and other stakeholders in understanding what may have changed during the deferred rebasing period. This, in turn, will aid in parties' and the OEB's assessment of the reasonableness of the consolidated entities' revenue requirement at the time of the rebasing application.

Deferred Rebasing Period

To encourage consolidations, the OEB has introduced policies that provide consolidating distributors with an opportunity to offset transaction costs with any achieved savings. With the 2015 Report, the OEB permitted consolidating distributors to defer rebasing for up to ten years from the closing of the transaction. The OEB requires consolidating distributors to identify in their consolidation application the specific number of years for which they choose to defer rebasing (up to a maximum of ten years). No supporting evidence is required to justify the selection.

Key takeaways from the meetings held with utilities and intervenors are as follows:

- Most utilities view the option to elect up to ten years to defer rebasing as an incentive to consolidate.
- While most utilities appreciate the choice to be able to elect a deferred rebasing period of up to ten years, there was some sentiment that electing a deferral period of ten years may not be practical going forward as electrification, energy transition, distributed energy resources, and other technological challenges yet to emerge, evolve, and may pose investment challenges to a utility deferring rebasing for a lengthy period.
- A couple of utilities noted that greater flexibility in the ability to change their initially chosen deferred rebasing period (generally to a shorter deferral and earlier rebasing) would be beneficial.
- Intervenors viewed ten years as too long to defer rebasing when considering increasing cost pressures going forward, and the loosening of access to incremental capital through the OEB's ICM policy, both of which put upward pressure on rates.
- Regarding the potential circumstance where a consolidation occurs during a rebasing deferral period from a prior consolidation, one utility noted the length of the subsequent deferral should be decided on a case-by-case basis, while another utility commented that, if "no harm" can be demonstrated, a subsequent ten-year deferral should be permitted by the OEB.

OEB Staff Discussion

OEB staff proposes that the OEB’s current policy, which permits consolidating distributors to elect to defer rebasing for up to ten years from the closing of the transaction, and that no supporting evidence is required to justify the selection, should be maintained.

To-date, the OEB has yet to adjudicate on a rebasing application following consolidation in which a ten-year deferred rebasing period had been elected. In OEB staff’s view, it is premature at this time to limit rebasing to less than ten years until greater experience is gained by utilities, other stakeholders and the OEB.

The OEB’s current policy aims to strike an appropriate balance between the incentives provided to utilities and the protection provided to customers. OEB staff is of the view that the current policy provides distributors with the flexibility to manage their own, unique circumstances.

To provide additional certainty to the consolidated utility, the OEB and other stakeholders, **OEB staff also recommends that the applicants specifically identify the rate year that rebased rates would be effective in the consolidated utility’s rebasing application.**²⁴

In response to matters raised regarding emerging issues such as electrification, distributed energy resources, and other matters related to an evolving energy sector which may materialize at a faster pace, implying that a ten-year deferral period may increasingly become non-viable, OEB staff reiterates that the current MAADs Handbook allows utilities to seek early termination (or extension) of its selected deferred rebasing period.

The MAADs Handbook, under the section entitled “Early Termination or Extension of Selected Deferred Rebasing Period”, states that:

The OEB considers that consolidations can provide for greater efficiencies and benefits to customers and is committed to reducing regulatory barriers to consolidations. The OEB has allowed for a deferred rebasing period to eliminate one of the identified barriers to consolidations. The OEB remains of the view that having consolidating entities operate as one entity as soon as possible after the transaction is in the best interest of consumers. That being said, when a consolidating entity has opted for a deferred rebasing period, it has committed to

²⁴ For example, for a consolidation that is completed sometime in 2024, with a five-year deferral period, the applicants should indicate whether rebased rates would be effective for 2028 or 2029.

a plan based on the circumstances of the consolidation. For this reason, if the consolidated entity 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.

Distributors who subsequently request a shorter deferred rebasing period than the one that has been selected (and where at least one of the pre-consolidation rate-setting plans has expired) will be required to file rationale to support the need to amend the previously selected deferred rebasing period. Similarly, a consolidated entity having selected a deferred rebasing period less than 10 years, that seeks to extend its selected deferred rebasing period must explain why this is required.²⁵

OEB staff is of the view that utilities may view the language in the current MAADs Handbook to be rigid in the context of the election of the deferred rebasing period. **OEB staff proposes that the excerpt above in the MAADs Handbook change to the following:**

The OEB considers that consolidations can provide for greater efficiencies and benefits to customers and is committed to reducing regulatory barriers to consolidations. The OEB remains of the view that having consolidating entities operate as one entity as soon as possible after the transaction is in the best interest of consumers.

During the deferred rebasing period, specifically after year four, a consolidated entity may apply to the OEB for rebasing for the consolidated entity.²⁶ The consolidated entity application will allow the OEB to establish rates that reflect the efficiencies from the consolidation transaction.

A consolidated entity that seeks to rebase earlier than its elected deferral period should inform the OEB of its intent and provide sufficient reason for the request.

A consolidated entity having selected a deferred rebasing period less than 10 years, may seek to extend its selected deferred rebasing period. However, the OEB notes that despite the ability for consolidated entities to extend the deferred rebasing period, a consolidated entity having selected a deferred rebasing period less than 10 years, that seeks to extend its selected deferred rebasing period (up

²⁵ MAADs Handbook, p. 13

²⁶ Based on the assumption that the last rebasing year was the year prior to the first full year of consolidation, “after year four” would align with the OEB’s five-year rate plan if a utility chose to rebase in the first year it had an opportunity to do so.

to a maximum of 10 years) must file supporting, compelling rationale why this is required. The OEB will consider the reasons and information provided, including other relevant factors such as the distributor's financial and service quality performance.

OEB staff's proposals are based on the understanding that, at the time of a MAADs application, a utility may not have foresight into potential financial and/or operational issues that may arise in running the newly consolidated entity. The operating environment of utilities can change, and most likely will, over time for numerous reasons.

Multiple Transactions

Since the issuance of the MAADs Handbook, the matter of multiple transactions (i.e., the potential circumstance where a consolidation occurs during a deferred rebasing period from a prior consolidation of one of the applicant utilities) arose in the consolidation application filed by Alectra Utilities Corporation and Guelph Hydro Electric Systems Inc.²⁷ The OEB's Decision stated:

The Applicants correctly point out that “[t]he Handbook does not specifically consider the circumstances where a consolidation occurs during a rebasing deferral period from a prior consolidation”. Therefore, the OEB finds that even though a ten-year deferred rate rebasing period (i.e., 2019 to 2028 inclusive) raises potential conflicts with some of the other principles underlying the OEB's consolidation policy, it was reasonable for the Applicants to rely upon the policy, and it would be inappropriate for the OEB to impose another deferral period. The OEB therefore approves the Applicants' deferred rate rebasing proposal as filed.²⁸

OEB staff is of the view that it is challenging for the OEB to be prescriptive in its policy with respect to the appropriate length of the deferred rebasing period in the case of multiple transactions given differences in how long each respective consolidation may take to recover transaction and transition costs.

OEB staff agrees that the issue should be dealt with on a case-by-case basis.

Each transaction may offer the potential for different kinds of benefits that vary in nature and timing. Scenarios involving multiple transactions should be considered based on their own circumstances.

²⁷ EB-2018-0014

²⁸ Ibid, Decision and Order, October 18, 2018, p. 14

OEB staff proposes that the MAADs Handbook and filing requirements include language to indicate that, in the event of consecutive consolidations by the same distributor, applicants should:

- **Confirm the remaining deferral period for the previously consolidated entity.**
- **Identify the elected number of years for the deferred rebasing period (maximum 10 years) for the utility being consolidated into the previously consolidated entity and identify for what rate year that rebased rates would be effective (in other words, for the most recent utility being acquired or merged into the previously consolidated entity).**
- **Identify the proposed timing for rebasing of the new consolidated entity.**
- **If the applicants seek to extend the elected deferred rebasing period of the previously consolidated entity (if the originally elected period was less than ten years), the onus will be on the applicant(s) to justify the need for, and benefits of, any requested extension to the current deferral period.**

While some flexibility should be afforded where a consolidated entity in a deferred rebasing period enters a further consolidation transaction before the end of the initial deferral period, OEB staff is of the view that it should be limited. Of key importance, in OEB staff's view, is removing the potential circumstance of the deferral of rebasing indefinitely.

OEB staff believes that the last bullet point above allows the OEB to rationalize successive MAADs transactions involving one utility deferring rebasing for a longer period than originally contemplated (but only if the original deferral period elected was less than ten years), and assesses the impacts of potentially retaining savings on a continuing basis for shareholders rather than sharing those savings with ratepayers. It also commits the utility to explaining why further delays in reviews of costs, operations, and rates of a consolidated utility and its predecessor utilities by the OEB is in the public interest.

Future Rate Structures

The MAADs Handbook states "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".²⁹

²⁹ MAADs Handbook, p. 17

Certain issues relating to future rate structures have, however, been discussed in some consolidation applications. Accordingly, OEB staff sought feedback from utilities and intervenors regarding the relevance of such details in assessing a consolidation application.

- A few utilities noted future rate structures should not be discussed in a consolidation application. An entity is in a better position to develop options in the future.
- Several utilities noted that a general overview of future rate structures may be provided, if helpful to the OEB.
- Some intervenors correlated the idea of future rate structures to the “no harm” test and noted that if what is meant by the “no harm” test is to assess if consumers are no worse off than they otherwise would be, addressing future rate structures in a consolidation application is fundamental.

OEB Staff Discussion

OEB staff proposes that the MAADs Handbook and filing requirements for consolidation applications be updated to state that, if an applicant wishes to discuss its preliminary plans for future rate structures (e.g., anticipated new rate classes, explanation of cost allocation beyond the deferred rebasing period) of the consolidated entity in support of its claim that “no harm” would result from the approval of a transaction, it may do so. However, there should not be a requirement to do so.

In developing its proposal, OEB staff considered the OEB’s decision in Hydro One Inc.’s application for approval of its purchase all of the issued and outstanding shares of Orillia Power Distribution Corporation.³⁰ In that decision, the OEB reiterated that although the MAADs Handbook states that “rate setting” following a consolidation will not be considered as part of a section 86 application, that does not mean the OEB will not consider the costs that acquired customers will have to pay following an acquisition (both in the short term and the long term). The OEB went on to state that it would have been reasonable to see a forecast of costs to serve acquired customers beyond the ten-year deferral period, and an explanation of the general methodology of how costs would be allocated after the deferral period. The OEB did recognize that any forecast cost structures and cost allocation would include various assumptions and could not be expected to be 100% accurate for what would apply at the time of the future rebasing.³¹

³⁰ EB-2016-0276

³¹ Ibid, Decision and Order, April 12, 2018, pp. 11-13

OEB staff notes consideration of costs in the future may not only be applicable in acquisition cases, but also in mergers between two utilities. In any merger scenario, it is understood that one of the merging entities may have a higher distribution revenue per customer than the other.³² In some cases the difference is not significant, while in others it may be. 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.³³ Consideration and discussion in a consolidation application of how these matters may be addressed at the time of a rebasing application may help assist the OEB in its assessment of the application with respect to the “no harm” test.

OEB staff believes the addition of the option for an applicant to discuss its preliminary plans for future rate structures:

- supports the idea that MAADs applications should be flexible; and
- recognizes that different transaction types may require different information to support the transaction’s claim of “no harm”.

Further, OEB staff highlights that the OEB does not necessarily preclude this from happening now. The current Chapter 2 Filing Requirements indicate that for a distributor filing an application to rebase following a consolidation, it must detail the efficacy of any rate plan confirmed as part of a MAADs application.³⁴

Rate Harmonization

OEB staff proposes that the MAADs Handbook and filing requirements for consolidation applications be updated to include language indicating that while details of any rate harmonization plan are not required in a consolidation application, a statement indicating whether the consolidated utility intends to undertake rate harmonization at the time of rebasing or, if not, an explanation for not doing so, should be included. Where the utility does intend to harmonize rates, a brief description of the plan should also be provided.

In its 2007 Report, the OEB stated:

³² Distribution revenue per customer has sometimes been assessed in MAADs applications, as a proxy for rates or other “cost structures” for distribution services. In combining fixed and variable charges, it can provide a more aggregate proxy for meaningful comparisons between utilities or rate zones, but may not cover all drivers.

³³ For example, differences in customer mix, high voltage assets deemed as distribution assets for one utility, host/embedded and high voltage charges, etc.

³⁴ Filing Requirements for Electricity Distribution Rate Applications - 2023 Edition for 2024 Rate Applications, December 15, 2022, p. 16

Currently, the filing requirements applicable to MAADs transactions ask parties to indicate in their application whether they intend to undertake a rate harmonization process after the proposed transaction is completed and, if they do, to provide a description of the plan. The Board does not intend to eliminate that requirement, as this can be informative as to the intentions of the consolidated entity. However, the issue of rate harmonization in the context of a consolidation transaction is better examined at the time of rebasing, because this is when the consolidated entity will apply for its combined revenue requirement.³⁵

OEB staff believes the language in the current MAADs Handbook should be updated to align with the 2007 Report. OEB staff supports requiring this information as it may serve as a signal to the OEB, ratepayers, and intervenors that potential issues to be decided at the time of next rebasing have been considered by parties to a transaction.

OEB staff believes it is equally important that, if the OEB adopts OEB staff's proposals under this section, the MAADs Handbook explicitly state that any plans for future rate structures or rate harmonization discussed in a MAADs application should be viewed as preliminary plans, and are not seen as being exhaustive or binding, unless otherwise decided by an OEB panel based on the specific approvals sought as part of the proposed consolidation transaction. Further, the intent of providing high-level information with respect to future rate structures and/or rate harmonization plans as part of a MAADs application is not to conflate section 78 (i.e., rates) matters, that are appropriately considered at the time of a rebasing application, with section 86 matters.

Performance Metrics & Reporting

The AG Audit Report made specific recommendations to the OEB related to consolidations.³⁶ The AG Audit Report states:

To protect electricity customers from negative impacts of Local Distribution Company (LDC) consolidations, and to facilitate the maintenance of a cost-effective and economically efficient electricity distribution sector, we recommend that the Ontario Energy Board:

- implement effective and timely monitoring of post-consolidation activities during deferred rebasing periods to obtain periodic status updates from LDCs on steps taken toward integration and to verify that consolidated entities are adhering to approval conditions for consolidations and maintaining necessary records; and

³⁵ 2007 Report, p. 7

³⁶ Office of the Auditor General - Value for Money Audit: *Ontario Energy Board: Electricity Oversight and Consumer Protection*, November 2022, pp. 41-44

- require acquired and merged entities to continue to report on key performance measures (for example, reliability metrics) separate from the consolidated entities during deferred rebasing periods to create greater transparency.³⁷

OEB staff discussed the AG Audit Report recommendations with meeting participants.

- Most utilities questioned the intended use of the information by the OEB during deferred rebasing periods. Many also questioned whether there will be potential consequences if forecast savings are not met or exceeded.
- At least four utilities interviewed commented that the idea of requiring more reporting, and reporting separately may not only be a disincentive to pursue mergers, but also may have the unintended impact of undoing or minimizing efficiencies of consolidation.
- Several utilities said the OEB should leverage data resulting from the OEB's Reliability and Power Quality Review (RPQR) consultation for reliability metrics.³⁸
- Several intervenors noted that reporting on service quality and reliability by predecessor utility throughout the term of the plan is important. Further, it would be helpful to report on the realized costs, benefits, and savings during deferral periods.
 - One intervenor specifically commented that forecast savings and costs are put forth as evidence in MAADs applications to support an applicant's position that approval of a proposed transaction would satisfy one aspect of the "no harm" test. As such tracking actual results against these forecasts should be a requirement.
 - One intervenor commented that reporting of specific initiatives implemented as promised versus those not implemented should be provided.

OEB Staff Discussion

In OEB staff's view, there are two main areas discussed in the AG Audit Report for the OEB's consideration – monitoring of post-consolidation activities and separate reporting on key performance measures.

³⁷ Ibid, pp. 43-44

³⁸ The RPQR consultation is expected to develop a comprehensive regulatory framework for reliability and power quality in the Ontario electricity sector. The initial phase of the RPQR focuses on enhancing and improving the reliability data reporting by electricity distributors. The second phase aims to enhance distributors' accountability by gathering data on loss of supply events and increase transparency by collecting customer-specific reliability information.

Monitoring of Post-Consolidation Activities

The AG Audit Report concluded that the OEB's existing framework does not include standardized monitoring of post-consolidation activities before the end of the deferred rebasing period. Further, monitoring is important to confirm that after consolidation, utilities are adhering to any conditions of approval set by the OEB and that post-consolidation integration activities are progressing as planned to generate long-term value for customers.³⁹

OEB staff's view is that the monitoring of post-consolidation activities before the end of the deferred rebasing period is warranted and can be beneficial. Monitoring of post-consolidation activities may:

- Provide greater transparency to customers.
- Provide a forum for the utility to tell its consolidation "story" – for example, information on integration progress and efficiencies gained.
- Provide transparency on any obstacles faced by the utility in reaching its targets.
- Provide other interested parties which may be considering consolidation with information and guidance about potential areas and the quantum of savings that could be realized through consolidation.
- Align with other types of approvals that typically carry with them conditions such as leave to construct applications that typically require post-project reporting.

While OEB staff believes a certain level of monitoring of post-consolidation activities should be required, OEB staff is cognizant of the potential burden of imposing additional requirements on consolidated entities. An appropriate balance must be struck between the regulatory and financial requirements of utilities with increased transparency for customers and other stakeholders.

One of the filing requirements for consolidation applications states,

Identify the impact that the proposed transaction will have on the economic efficiency and cost effectiveness (in the distribution or transmission of electricity), identifying the various aspects of utility operations where the applicant expects sustained operational efficiencies (both quantitative and qualitative).⁴⁰

Applicants in consolidation applications have filed evidence which includes activities where efficiencies are expected to be achieved. A scan of recent MAADs applications highlights the following examples:

- Optimization and reduction of staffing levels (through retirements and attrition)
- Reduction in corporate governance costs

³⁹ AG Audit Report, pp. 41-42

⁴⁰ Filing Requirements for Consolidation Applications, p. 5

- Reduction in information technology costs (e.g., hardware and software maintenance fees)
- Reduction in regulatory costs and audits
- Elimination of duplicate third-party administrative services (e.g., legal, auditing, consulting services)

While the information provided is not binding (unless expressly noted otherwise by an OEB panel), the forecasts and expected areas of efficiencies are an indication of what the consolidated utilities (or acquiring utility) think could be achieved. The information provided is also, in part, what is used by the OEB to reach its decision on a consolidation application and serves as the starting point for the OEB panel considering the first rate rebasing application post-consolidation.

OEB staff proposes that, for new consolidation applications approved going forward, for an entity which elects to defer rebasing as a result of consolidation for more than five years (i.e., 6-10 years), a mid-term report should be filed detailing the progress to date on the steps it has taken towards integration. At a minimum, the progress to date on the various activities where efficiencies were expected, the savings associated with those efficiencies, a qualitative discussion on enhanced reliability and service quality as a consolidated distributor and the progress towards the recovery of transaction and transition costs should be documented and discussed. The mid-term report should also provide a discussion on the potential obstacles seen by the utility in reaching its targets going forward.⁴¹ In the first rebasing application for a consolidated utility, updates to this information should be provided including for any period not covered by the initial mid-term report.

OEB staff understands that a utility requires sufficient time to achieve savings and efficiency gains, and these will not begin to be realized until the transaction is completed, and the new entity has begun to operate. The savings are also likely to change over time as the utility begins to better understand its operating needs and environment. Further, transaction and transition costs of a MAADs transaction can continue for several years following the completion of the transaction. OEB staff believes that requiring a mid-term report if the elected deferral period is greater than five years strikes a reasonable balance between the burden of additional reporting during the deferral period, and increased transparency for customers and other stakeholders.

With respect to the AG Audit Report recommendation that the OEB should be verifying that distributors are adhering to conditions of approval and maintaining necessary

⁴¹ This mid-term report can be filed on the record of the MAADs proceeding as a post-hearing filing.

records, OEB staff generally agrees, but believes it is challenging to be prescriptive with a requirement which would apply in all cases. Conditions of approval, the verification of adherence to those conditions, and requirements to maintain certain records during a deferred rebasing period, can differ widely from application to application, based on what is proposed by the utility or stakeholders, and on what is decided by the OEB panel hearing the case. What may make sense in one case may not make sense in another. **As such, OEB staff proposes that any reporting requirements on adherence to any conditions of approval and/or the maintenance of records during the deferred rebasing period should be considered by, and established at the discretion of, the panel of OEB Commissioners assigned to decide each consolidation application. OEB staff is of the view that the OEB should determine an appropriate level, and frequency, of reporting on these matters from applicants during deferred rebasing periods, by the OEB panel considering the application.**

Separate Reporting on Key Performance Measures

The AG Audit Report concluded that:

... reporting performance at the consolidated level may not provide customers with adequate insight into the service quality and reliability of the local distribution networks that directly support them. It would also make it difficult to assess whether the projected benefits have materialized post-consolidation.⁴²

Currently, post-consolidation, most *Reporting and Record-keeping Requirements* (RRR) information is filed with the OEB on a consolidated basis.⁴³ The MAADs Handbook states that having consolidated entities operate as one entity as soon as possible after the transaction is in the best interest of consumers.⁴⁴ Further, the OEB has previously opined on the issue of separate reporting. In that case, the OEB stated that it "...does not require, nor encourage reporting on a "separate" utility basis. Rather the expectation of the OEB is that LDC Co shall report in accordance with the requirements of its licence."⁴⁵

The MAADs Handbook states:

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

⁴² AG Audit Report, p. 43

⁴³ There are a few instances where filing by rate zone is either mandatory, or an option. For example, customer numbers (reporting by rate zone is mandatory), energy consumption and demand (reporting by rate zone is mandatory), and Group 1 deferral and variance account balances (reporting by rate zone is optional).

⁴⁴ MAADs Handbook, p. 13

⁴⁵ EB-2016-0025/EB-2016-0360, Decision and Order, December 8, 2016, p. 26

be informed by the metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard.

...

Under the OEB's regulatory framework, utilities are expected to deliver continuous improvement for both reliability and service quality performance to benefit customers. This continuous improvement is expected to continue after a consolidation and will continue to be monitored for the consolidated entity under the same established requirements.⁴⁶

Reliability Metrics

As outlined previously, the AG Audit Report recommended that the OEB require acquired and merged entities to continue to report on key performance measures (for example, reliability metrics) separate from the consolidated entities during deferred rebasing periods to create greater transparency.

The OEB's scorecards for utilities⁴⁷ currently provide reliability metrics for the System Average Interruption Duration Index (SAIDI) and the System Average Interruption Frequency Index (SAIFI). These measures are provided for each year for each distributor. In the event of consolidation, SAIDI and SAIFI statistics are provided at the consolidated distributor level, and not by rate zone.

For purposes of this MAADs consultation and MAADs policy going forward, and to address the recommendation of the Auditor General, OEB staff sees value in being able to make comparisons between rate zones for a consolidated utility during the deferred rebasing period. However, OEB staff recognizes that this should be done in a way that does not establish a barrier to system integration between merged utilities and does not pose a significant increase in administration. This rate zone level information will help the OEB assess whether the consolidated utility's ratepayers are experiencing continuous improvement in reliability.

On January 30, 2024, as part of its ongoing RPQR consultations, the OEB implemented new reporting by electricity distributors to improve customer awareness of reliability. Specifically, the OEB established voluntary reporting by distributors on reliability data at the distribution feeder level and expects this information will be supportive in building customer awareness and understanding of reliability of their distribution service.⁴⁸ OEB

⁴⁶ MAADs Handbook, p. 7

⁴⁷ Utility scorecards track and show comprehensive performance information for each electricity utility in Ontario, over a range of time and for a specific year.

⁴⁸ EB-2021-0307, OEB Letter, Implementing Voluntary Feeder-Level Reliability Reporting, January 30, 2024

staff notes that the RPQR working group has discussed the implementation of a requirement for feeder-level reporting.⁴⁹

OEB staff proposes that the MAADs filing requirements for consolidation applications be updated to include feeder level information if available. Specifically, applicants that have voluntarily filed feeder level information historically leading up to the consolidation application, are expected to provide a listing of feeder reliability by rate zone (i.e. for the predecessor utilities) for the most recently completed historical years available, up to five years. Alternatively, the OEB could place this information on the record of a consolidation application if it has been filed through RRRs. For utilities that have not historically reported feeder level information voluntarily, OEB staff recommends encouraging these utilities to include such data in the consolidation application for the most recently completed historical years leading up to the consolidation application, up to five years, if feeder-level reliability information is available.

Following approval of a consolidation application, OEB staff is of the view that if feeder-level reliability information is available, and if at least one of the pre-consolidation utilities has been reporting feeder level reliability information historically for at least one of the legacy rate zones, the OEB should require the consolidated utility to continue reporting this data for any available rate zone, and identify the rate zone for each feeder during the deferred rebasing period.

The OEB can consider how to address circumstances in which applicants cannot provide feeder-level reliability information for any rate zone on a case-by-case basis.

OEB staff recognizes that as time passes and utilities work to integrate systems between merged utilities (where possible), particular feeders may serve different rate zones or even multiple rates zones. This can be addressed through qualitative explanations.

Service Quality Metrics

With respect to whether service quality metrics should be reported separately (i.e., by rate zone) post-consolidation, utilities commented that service quality metrics should continue to be reported on a consolidated basis.

Generally, utilities suggested that the benefit of reporting separately versus the incremental costs of tracking these data points needs to be considered. An example

⁴⁹ See RPQR Consultation Engage with Us webpage, Working Group Meeting Material #16, Slide 18

provided was that it would not be efficient for a consolidated utility to have a centralized call center, but track customer calls by rate zone. The synergies of consolidation would be impacted by maintaining two sets of reporting mechanisms.

Most intervenors noted that reporting on service quality by predecessor utility throughout the term of the plan is important. This would assist parties at the time of the consolidated entity's rebasing application to determine if any degradation in the metrics occurred, post-consolidation.

OEB staff believes that, in most situations, the potential cost of tracking and reporting on service quality metrics by rate zone post-consolidation outweighs the potential benefits. OEB staff agrees that there would be an inherent level of inefficiency in tracking results separately given that, typically, distributors in a deferred rebasing period due to consolidation are working toward centralizing functions to potentially achieve efficiencies. These efficiencies/savings are expected to be passed on to customers at the time of the consolidated entity's rebasing application.

OEB staff notes that the OEB establishes industry targets for certain measures in the scorecard. Section 7 of the OEB's *Distribution System Code* sets the minimum conditions that a distributor must meet in carrying out its obligations to distribute electricity under its licence with respect to service quality requirements.⁵⁰ Each distributor, regardless of consolidation, is expected to meet these targets. The OEB uses scorecards to, among other uses, help monitor an individual utility's performance and determine if corrective action is needed.

As stated in the MAADs Handbook,

The OEB has a proactive performance monitoring framework that inherently protects electricity customers from harm related to service quality and reliability and has established the mechanisms to intervene if corrective action is warranted. The OEB will be informed by the metrics that are used to evaluate a distributor's performance in assessing a proposed consolidation transaction.

All of these measures are in place to ensure that distributors meet expectations regardless of their corporate structure or ownership.⁵¹

And,

⁵⁰ Distribution System Code, August 2, 2023.

⁵¹ MAADs Handbook, p. 5

Under the OEB’s regulatory framework, utilities are expected to deliver continuous improvement for both reliability and service quality performance to benefit customers. This continuous improvement is expected to continue after a consolidation and will continue to be monitored for the consolidated entity under the same established requirements.⁵²

Further, OEB staff also believes that it may be difficult for consolidated distributors to determine if any decrease in achieved results are because of the consolidation or because of some other factor.

For the reasons above, **OEB staff proposes that the current practice of consolidated distributors reporting service quality metrics on a consolidated basis post-consolidation continue.** Moreover, OEB staff reiterates a component of its proposal for the filing of a mid-term report under the sub-section *Monitoring of Post-Consolidation Activities*. This proposal stipulates that a qualitative discussion on enhanced service quality as a consolidated distributor overall should be included as part of the mid-term report for those distributors which elect a deferred rebasing period of more than five years. Further, any updates to this information should be provided in the first rebasing application for the consolidated utility, including for any period not covered by the initial mid-term report.

Cost Recovery Treatment for Transaction, Transition/Integration Costs

The OEB’s policies regarding recovery of costs associated with MAADs applications were established beginning in the early 2000s and have been consistently maintained and applied since then.

OEB staff notes that, during the interviews, intervenors highlighted the issue of the inclusion of integration capital costs at rebasing as discussed in the current Enbridge Gas proceeding.⁵³ The OEB issued its decision on Enbridge Gas’ application on the Phase 1 on natural gas distribution rates effective January 1, 2024.⁵⁴

The OEB’s policy is that “incremental transaction and integration costs are not generally recoverable through rates”. Consolidation proposals are primarily a business decision of management of utilities involved and affected ratepayers have little, if any, input or control into the proposed transaction.

⁵² Ibid, p. 7

⁵³ EB-2022-0200, Enbridge Gas Inc. for 2024-2028 rate plan, and specifically in the Phase 1 of the case to established rebased gas distribution rates for January 1, 2024.

⁵⁴ EB-2022-0200, Decision and Order, December 21, 2023.

OEB staff raised the issue during stakeholder meetings of whether additional direction on transaction costs is required in the MAADs Handbook. The consensus heard was that these exceptions should be dealt with on a case-by-case basis.

An intervenor also highlighted that the MAADs Handbook and filing requirements for consolidation applications should be consistent in the language used in relation to MAADs-related costs. The words “transaction costs”, “transition costs”, and “integration costs” seem to be used interchangeably, and clarity and/or consistency should be provided in the updated MAADs Handbook.

OEB Staff Discussion

While the general policy is that incremental transaction and integration costs are not generally recoverable through rates, exceptions have been approved. For example, in the application for approval for Dubreuil Lumber Inc. to sell its distribution system to Algoma Power Inc., the OEB agreed with Algoma that as this is a unique circumstance, it is appropriate to allow Algoma to recover its reasonable transaction and integration costs.⁵⁵

OEB staff believes that the approach to deal with exceptions on a case-by-case basis, based on the circumstances and where adequately supported, should continue. If an applicant considers that it has unique circumstances which may warrant recovery of transaction and/or transition costs, evidence should be brought forth in the consolidation application for OEB consideration.

What are MAADs-related Costs?

MAADs policies and filing requirements have not defined MAADs-related costs over the years. In OEB staff’s view, MAADs related costs are defined as the following:

- Transaction costs are costs incurred that are directly attributable to the development of the proposed MAADs transaction and its execution. Specifically, transaction costs would include the following:
 - Business development and project planning costs to develop the proposed transaction;
 - Costs for negotiation of the proposed transaction, including due diligence reviews, negotiation, contract drafting, legal review, accounting advice and review, dealings and filings with securities regulators, any public information, consultations and surveys. This would include any internal costs directly attributable to the negotiation process, but also any external costs for consultants and external legal, accounting and other assistance.

⁵⁵ EB-2018-0271, Decision and Order, p. 23

- Costs for the preparation of and filing of the MAADs application, and the utility's regulatory costs for the processing of the application (at least to the extent that these costs are incremental to normal regulatory costs recovered through rates). These regulatory costs also include the OEB's own costs (i.e., Notice, translation, transcription in technical conferences or oral hearings) and any approved cost awards for eligible intervenors related to the application.
- Assuming approval of the MAADs transaction, there will also be costs incurred to close the approved transaction. These include (for example) legal and accounting costs, fees for incorporation, licensing fees, branding, and bank fees.

These transaction costs are one-time costs and are classified as operating expenses.

- Transition costs are costs that are attributable to the consolidation, and often are related to being able to operationalize efficiencies that the consolidation enables.
 - One example would be the costs of severance packages offered to some employees of one or more of the involved utilities related to labour savings. Another example may be IT system integration costs.
 - Sometimes these transition costs may be apparent at the time of the closing of the MAADs, but in many cases transition costs may occur for some limited period after consolidation as the management of the newly consolidated utility gains experience with the changed business and opportunities are identified.
 - These costs may occur for some time, but they are also expected to be time-limited and temporary. At some point, further efforts to execute operational savings should be considered "normal business" operations of the consolidated utility, and not transitional costs and efficiencies.

Beginning in the 2015 Report, and the consultation process leading to it, there were references to integration costs:⁵⁶

Distributors explained that the transition and integration costs of a MAADs transaction, although largely incurred upfront can continue for two to four years following the completion of the transaction. Whereas efficiency gains and savings resulting from the transaction will not start to be realized until the transaction is completed, and the new entity has begun to operate. Distributors indicated that given the nature and timing of these costs and savings, ***annual net benefits ([reductions or savings in] operational costs less transition and integration costs)*** are in many cases negative during the first two to four years. Therefore, it may take

⁵⁶ 2015 Report, p. 5

anywhere from six to ten years to reach a break-even point, where the cumulative savings exceed the cumulative acquisition and integration costs. [Emphasis added]

There is no definition of integration costs, or how they are distinguished from transition costs. OEB staff views the two terms synonymously and proposes to revert to transition costs.

OEB staff notes that the term “integration costs” was introduced in the 2015 Report, without a clear understanding of what these were. As noted earlier, OEB staff proposes to revert to older wording of transition costs. Transaction and transition costs have been more commonly used and are probably better understood by the OEB, utilities and other stakeholders. OEB staff has provided discussion earlier on what types of costs are commonly encountered as transaction and transition costs in MAADs application. The list is not exhaustive, and OEB staff notes that the categorization is not definitive; different utilities may document similar costs as transaction or transition costs depending on their circumstances.

OEB staff notes that transaction and transition costs have generally been treated as expensed costs since 1999, and most utilities have adhered to this in recent consolidation applications. However, the topic of “integration capital” costs, or capitalization of integration costs has arisen.

Since capitalized costs are for assets that are longer lived, and many, especially major, assets invested in by utilities have longer lives – even exceeding the maximum deferred rebasing term length of ten years – this raises issues of what is recoverable during the deferred rebasing period versus what is recoverable at the next rebasing (and going forward to the end of the asset’s useful life).

OEB staff proposes that recovery of transaction and transition costs related to the consolidation should not be recoverable in most circumstances. There are exceptions where the unique circumstances of a proposed consolidation warrant approval of such cost recovery; this is discussed earlier.

Since expensed transition and transaction costs are temporary and time-limited, it is presumed that they will not be a consideration at the next rebasing (and that they were recovered through savings achieved during the deferred rebasing period).

OEB staff proposes that language be included in the updated MAADs Handbook to state that, at the post-consolidation rebasing, all capital assets classified as part of the utility's "transition" costs (i.e., capitalized costs intended to integrate operations) which were invested in and put in-service since the consolidation will be subject to review, on a case-by-case basis. The nature of the expenditure and whether it would have occurred regardless of the consolidation will be reviewed, in addition to the typical review for need and prudence. The OEB will determine whether these capitalized costs should be included in the opening test year rate base, if applicable.

Incremental Capital Funding Availability to Consolidated Utilities

Over the course of discussions with meeting participants, OEB staff heard several other comments on the topic of ICM availability during MAADs deferral periods. Some key takeaways include:

- Applicants should identify any known future ICMs as part of the consolidation application.
- Concerns with respect to certainty to access to capital, if required, during deferred rebasing.
- Criticism with how current ICM policy is being interpreted and applied, and that the ICM policy needs to be reviewed.

OEB Staff Discussion

OEB staff agrees that an additional filing requirement should be added to require applicants to note any known or reasonably anticipated future ICMs in a consolidation application. A description of the nature of the project and expected timing should also be provided. This additional information will assist in OEB staff's, intervenor's, and the OEB's assessment of the revenue requirement analysis that is being proposed to be made a requirement (see Cost Structures section of this document).

OEB staff proposes that the MAADs Handbook should be updated to reflect the stand-alone correspondence issued by the OEB regarding ICM availability since the issuance of the 2016 MAADs Handbook.⁵⁷

⁵⁷ For example, the OEB's February 2022 letter provided additional flexibility for electricity distributors which have selected an extended deferred rebasing period (beyond five years) under the OEB's current MAADs policy, to apply for incremental capital funding for an annual capital program during the extended rebasing period (i.e., years six to ten of their deferral period) if they can demonstrate certain criteria.

OEB staff also proposes that language should be added to the MAADs Handbook to note that if, during its deferred rebasing period, a consolidated utility finds that it has significant capital needs not easily accommodated by an ICM, it should consider rebasing. As noted previously, OEB staff understands that, at the time of a MAADs application, a utility may not have foresight into potential financial and/or operational issues that may arise in running the newly consolidated entity. The operating environment of utilities can change, and most likely will, over time for numerous reasons. OEB staff's proposed additional language here relates to the discussion under the Deferred Rebasing Period section of this Discussion Paper where OEB staff is proposing additional language to signal the OEB's openness for utilities to request for an early termination of their elected deferred rebasing period.

ICM Policy

OEB staff seeks input on what inflation rate(s) should be used in the materiality threshold formulas for incremental capital funding for reasons discussed below.

The ICM was introduced as part of 3rd Generation IRM in 2008, beginning with 2009 rates.⁵⁸ The ICM was introduced to provide for needed incremental capital funding during the price cap IRM period, i.e., without triggering the need to rebase early.

In 2014 and 2015, the ICM policy was reviewed based on the experience in ICM applications and decisions to that time, and on the new *Renewed Regulatory Framework for Electricity* introduced in 2012. The 2014 and 2015 reviews resulted in two Reports of the Board, issued in September 2014 and January 2016.⁵⁹ A key change in the 2016 Report was a revision to the ICM Materiality Threshold to better reflect the longer time between rebasing, including for consolidating utilities, as the original formula assumed only one year of rate adjustments since rebasing.

The original materiality threshold and the revised materiality threshold formulae use the current IPI to proxy annual inflation adjustments for rates since rebasing. Historically, this did not create major concerns, in part due to short periods between rebasing applications. The same can be said even with longer periods between rebasing applications - while fluctuations were experienced, inflation measures were consistently around the 2% target from 2006 through to the first year of the COVID-19 pandemic.

This started to change as inflation started to rise rapidly by mid-2021 as the world started to recover after the first year of the COVID-19 pandemic. The OEB-issued IPIs

⁵⁸ EB-2007-0673, *Report of the Board on 3rd Generation IRM*, July 15, 2007 and *Supplemental Report of the Board on 3rd Generation IRM*, September 17, 2008.

⁵⁹ EB-2014-0219, *Report of the Board on New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, September 18, 2014 and *Report of the OEB On New Policy Options for the Funding of Capital Investments: Supplemental Report*, January 22, 2016

for 2022-2024 demonstrate the persistence of higher inflation than has been experienced since the 1990s:

2022.	3.3%
2023.	3.7%
2024.	4.8% (5.4% for electricity transmitters)

Since the IPI is based on (lagged) historical data, current data indicates that central bank interest rate hikes and quantitative tightening measures are bringing inflation down, but the decrease in inflation is slow and resilient, and the path to returning to the Bank of Canada's 2% target may take time.

The OEB uses the current IPI as a proxy for all years since the last rebasing, for administrative simplicity. The ICM formula was intended to be as mechanistic as possible given its inclusion in incremental rate-setting mechanism (IRM) applications. However, as inflation increases, the current formula overestimates what is funded or fundable in price cap-adjusted rates; as inflation decreases the reverse situation will occur.

The current MAADs policy requires that the ICM materiality threshold be calculated separately for each rate zone. OEB staff proposes no change to this. Further, OEB staff notes that, in many instances, the materiality threshold will be different for each rate zone, as the last rebasing year for each predecessor utility may be different.

OEB staff is seeking comments on whether the OEB should implement any changes to the inflation rate(s) used in calculating the materiality threshold for incremental capital funding prior to the OEB considering the ICM policy in its entirety as part of a separate consultation, given that inflation is only one component of the calculation. If a change is proposed, what inflation rate(s) should be used. OEB staff is seeking comments on these matters to assist the OEB in determining how to proceed.

Accounting Matters

The current MAADs Handbook specifies that disposition of deferral and variance account (DVAs) is only relevant to the consolidation if it affects the financial viability of the acquiring utility or consolidated entity.⁶⁰ It further states that an account disposition request should be addressed in rate applications and not in the MAADs proceeding. However, various issues relating to DVAs have arisen in past MAADs proceedings or subsequent rate applications that may benefit from upfront clarity during the MAADs proceedings. These issues have related to the disposition timing of Group 2 DVAs, how

⁶⁰ MAADs Handbook, p. 18

certain DVAs are to be tracked going forward (i.e., on a consolidated or rate zone basis), the need for the establishment of an account to record the impact of accounting policy changes, and tax matters.

Disposition Timing

The common theme in feedback from utilities and intervenors relating to DVAs is to allow utilities to have flexibility in their disposition of DVAs. Stakeholders generally saw the benefit of disposing Group 2 DVAs during the deferred rebasing period if significant balances have accumulated. Intervenors noted that the longer the period until disposition, the higher the likelihood that the knowledge for the legacy balances is no longer available. A utility noted that depending on whether the total Group 2 account balances is a refund to or recovery from ratepayers, disposition of total Group 2 accounts may be able to help mitigate bill impacts if required. However, stakeholders were also mindful that this could result in increased work and administrative processes if Group 2 DVAs were to be brought forth for disposition in IRM applications and required a prudence review process.

Tracking of Accounts

With regard to tracking DVAs on a rate zone or consolidated basis post-MAADs transaction, stakeholders also noted that there should be flexibility. Utilities generally suggested that consolidating accounts would assist in achieving efficiencies. Utilities noted that for Group 1 accounts, the decision to consolidate Group 1 accounts often depends on the harmonization of certain systems (e.g., billing systems) of the merged utilities. For Group 2 accounts, the specific nature of the account may need to be considered when determining whether the account should be tracked on a rate zone or consolidated basis following the MAADs transaction (e.g., an account may apply only to specific group of customers).

Accounting Policy Changes Deferral Account

Utilities saw merit in establishing a consistent approach to this account which addresses accounting policy changes following the MAADs transaction. Utilities noted that it would be helpful to provide clarification on whether an Accounting Policy Changes Deferral Account is required and the mechanics of the account. One utility stated that materiality should also be a consideration when determining whether an account is required. Intervenors were of the view that there should be an expectation that utilities bring forth accounting policy changes to the extent possible in the MAADs application. The onus is on the utility to discuss whether an account is required.

Tax Matters

Tax matters have arisen in some MAADs proceedings.⁶¹ Utilities stated that tax matters should be included in a MAADs application on an as-needed basis if there is a ratepayer impact.

OEB Staff Discussion

Disposition Timing

In accordance with the *Electricity Distributors' Deferral and Variance Account Review Initiative* (EDDVAR), Group 1 DVAs are reviewed and subject to disposition if they meet a pre-set threshold during the IRM term.⁶² This practice continues during the deferred rebasing period for utilities that underwent a MAADs transaction. Group 2 accounts require a prudence review and are subject to disposition in a rebasing rate application, which is typically every five years.⁶³

As deferred rebasing periods may be up to ten years, Group 2 account balances for the predecessor utilities that have consolidated may not be disposed of for ten or more years. Significant balances may accumulate in these accounts during this period and could lead to intergenerational inequity concerns and/or result in large bill impacts on disposition. Earlier and/or frequent disposition of Group 2 accounts post-consolidation would address this concern. However, this needs to be balanced with the costs of required prudence reviews in IRM rate applications which contain Group 2 dispositions requests.

OEB staff sees a benefit in allowing utilities the flexibility to propose disposition based on their specific circumstances. **OEB staff proposes that if the deferred rebasing period is longer than five years, utilities should provide a plan to bring in Group 2 accounts for potential disposition (e.g., at the mid-point of the deferred rebasing period) to mitigate intergenerational inequity. Balances should be requested for disposition if they are material at that time. If the deferred rebasing period is less than five years, OEB staff notes that utilities would still have the flexibility of requesting disposition of Group 2 account balances, if warranted and supported.**

Tracking of Accounts

OEB staff recognizes that utilities may gain efficiencies by tracking accounts on a consolidated basis, rather than a rate zone basis. Given the nature of the Group 1

⁶¹ EB-2018-0242, Decision and Order, Peterborough Distribution Inc., Peterborough Utilities Services Inc., Hydro One Networks Inc., and 1937680 Ontario Inc., April 30, 2020, p.44 & 45

⁶² EB-2008-0046, Report of the OEB on Electricity Distributors' Deferral and Variance Account Review Initiative (EDDVAR), July 31, 2009, p.10

⁶³ Ibid, pp. 6 & 13

accounts and the reliance on data from various systems (e.g., billing system), OEB staff agrees that it would be practical and efficient for utilities to consolidate the Group 1 accounts. Therefore, for Group 1 accounts, **OEB staff proposes to encourage utilities to consolidate the accounts as soon as it is practical.**

For Group 2 accounts, OEB staff is of the view that the nature of some legacy accounts will most likely warrant tracking on a rate zone basis for purposes of cost causality. Tracking accounts on a rate zone basis will enable those accounts to be disposed to the group of customers that contributed to the balance of those accounts. However, there could also be some accounts where tracking on a rate zone basis may not be warranted post-MAADs transaction.⁶⁴ **Therefore, OEB staff proposes that utilities be required to provide a proposal in their MAADs applications on which Group 2 accounts are to be tracked on a legacy rate zone basis or consolidated basis going forward, with supporting rationale.**

Accounting Policy Changes

OEB staff acknowledges that at the time of the MAADs application, utilities may not have had the opportunity to identify and assess the accounting policy changes required. However, these changes may be material and could result in a refund to, or recovery from, ratepayers. Therefore, **OEB staff proposes that in all MAADs applications, a consolidated utility will be required to establish an account to record the impact of accounting policy changes, effective at the transaction's closing date, unless the predecessor utilities provide sufficient justification as to why such an account is not needed.**

The account will serve to symmetrically protect both the consolidated utility and ratepayers. The account should record the revenue requirement impact of accounting policy changes and should not be limited to recording the rate base impact as there could be significant impacts from revenue requirement elements beyond rate base. OEB staff agrees that materiality should be a consideration for the continued tracking of amounts in this account so that the cost of maintaining the account does not outweigh the benefit. **OEB staff proposes that once the consolidated utility has completed its assessment of accounting policy changes required, the consolidated utility may propose to close the account in the next IRM application where an audited balance in this account is available, if the impacts of the accounting policy changes are not material. In such cases, OEB staff suggests that no disposition would be required. OEB staff proposes that materiality be based on the**

⁶⁴ For example, Account 1522 – Pension & OPEB Forecast Accrual vs. Cash Payment Differential Carrying charges, Account 1508 – Other Regulatory Assets, Sub-account Green Button Initiative Costs may be tracked on a consolidated basis.

materiality for the predecessor utility whose accounting policies are changed and be disposed to the customers of the predecessor utility that underwent accounting policy changes.

Although OEB staff notes that there are precedents where materiality was based on the consolidated utility (rather than the predecessor utility), OEB staff supports materiality to be established based on the predecessor utility, given that it is the predecessor utility that is being specifically impacted by the accounting policy changes.⁶⁵

OEB staff further proposes that an accounting order should be established in the MAADs proceeding, with the effective date on the close of the transaction date. Consistent with the filing requirements for cost of service applications, the accounting order must include a description of the mechanics of the account, and provide examples of general journal entries, and the proposed account duration.⁶⁶ The distributor must also file evidence demonstrating how the eligibility criteria of causation, materiality, and prudence have been met.

Earnings Sharing Mechanisms (ESM)

In the 2015 Report, the OEB extended the deferred rebasing period up to ten years, considering the length of time in which consolidated utilities may require to reach a break-even point where cumulative savings exceed the cumulative acquisition and integration costs.⁶⁷ However, the 2015 Report also noted that there were concerns that extending the deferral period will provide an opportunity for shareholders to retain more savings than those necessary to recover costs, which may result in a windfall for shareholders at the expense of ratepayers.⁶⁸ Therefore, the OEB established the requirement for an ESM to address that ratepayer concern. The OEB stated that the sharing provides for shareholders to continue to recover transaction costs while ensuring customers of the consolidated entity benefit from the efficiencies and savings the new distributor has achieved.⁶⁹

⁶⁵ EB-2021-0280, Decision and Order, Brantford Power Inc. and Energy + Inc. MAADs, March 17, 2022, p. 17, EB-2022-0006, Decision and Order, Kitchener-Wilmot Hydro Inc. Waterloo North Hydro Inc. MAADs, June 28, 2022. p. 33

⁶⁶ Filing Requirements For Electricity Distribution Rate Applications - 2023 Edition for 2024 Rate Applications, Chapter 2, Cost of Service, December 15, 2022, pp. 66 & 67

⁶⁷ As discussed in the section titled Cost Recovery Treatment for Transaction, Transition/Integration Costs, OEB staff considers that the term integration is synonymous with transition and will revert to the older term of transition costs.

⁶⁸ 2015 Report, p. 6

⁶⁹ 2015 Report, p. 7

The 2015 Report also set out the form of the ESM, specifically that it would be consistent with the OEB's incentive rate-setting policy where a regulatory review may be initiated if a distributor's annual reports show performance outside of the +/- 300 basis points earnings dead band.⁷⁰ Furthermore, the 2015 Report indicates that excess earnings are to be shared with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the allowed ROE. The MAADs Handbook further clarified that earnings will be assessed each year once audited financial results are available and excess earnings beyond 300 basis points will be shared with customers annually.⁷¹

The MAADs Handbook stated that no evidence is required in support of an ESM that follows the form set out in the 2015 Report. The MAADs Handbook also noted that applicants are invited to propose an alternative ESM that better achieves the objective of protecting customer interests during the deferred rebasing period.

During the stakeholder meetings, intervenors recommended clarifying the rationale for the ESM: whether the purpose was to share benefits generated from the MAADs transaction or to protect ratepayers' interests from any negative consequences resulting from a lengthy deferred rebasing period. One utility noted that the rationale for the ESM made sense, but depending on the circumstances of the specific consolidated utility, five years may not be a sufficient period to recover integration and transaction costs. Another utility suggested that an ESM may deter utilities from pursuing MAADs. Stakeholders also commented that there should be flexibility in how ESMs should be calculated or the ability to propose another type of mechanism that could achieve the same objective as intended for the ESM.

The mechanics of ESMs have been discussed in MAADs proceedings and subsequent rate applications. Stakeholders agree that there would be a benefit in clarifying some of the mechanics for the ESM. In particular, stakeholders preferred the ESM be calculated on an annual calendar-year basis and include all transaction/integration costs as well as savings in the ESM calculation. Stakeholders also supported ESM amounts be disposed in a rebasing application.

OEB Staff Discussion

OEB staff supports the intent of the ESM which is to protect ratepayers and notes that the details for the ESM as noted in the 2015 Report and the MAADs Handbook remain valid. To address intervenor concerns regarding the purpose of the ESM, OEB staff

⁷⁰ 2015 Report, pp. 6 & 7

⁷¹ MAADs Handbook, p. 16

supports the OEB's previous statement that the sharing (as per an ESM) provides for shareholders to continue to recover transaction costs, while ensuring customers of the consolidated entity will benefit from the efficiencies and savings the new distributor has achieved.⁷²

In OEB staff's view, an ESM, which shares excess earnings between shareholders and ratepayers, balances the opportunity for the consolidated utility to accrue some net savings to the shareholder while still protecting ratepayer interest. **OEB staff continues to support the rationale for an ESM as stated in the current MAADs policies and the requirement to establish an ESM for a deferred rebasing period longer than five years.**

With regard to the form of the ESM, the 2015 Report established the default ESM to be 50:50 sharing for all earnings that are more than 300 basis points above the consolidated entity's allowed ROE.⁷³ OEB staff notes that the 300-basis point band is a well-established tool that the OEB has used for various purposes for many years. As noted in the MAADs Handbook, it is consistent with the incentive rate-setting policy for off-ramps.⁷⁴ It is used in the means test for advanced capital modules/incremental capital modules, and the means test for recovery of balances recorded in Account 1509 - Impacts Arising from the COVID-19 Emergency.⁷⁵ In addition, OEB staff sees merit in using a default ESM approach as a starting point because using a consistent initial approach for all consolidated utilities can lead to regulatory efficiencies. **OEB staff supports the continued form of ESM as set out in the MAADs Handbook as the default method, including the 50:50 sharing for all earnings that are more than 300 basis points above the consolidated entity's allowed ROE.**

Though OEB staff supports a default form of ESM, OEB staff also supports the flexibility for utilities to propose an alternative ESM as contemplated in the MAADs Handbook. The MAADs Handbook indicated that the ESM as set out in the 2015 Report may not achieve the intended objective of customer protection for all types of consolidation proposals.⁷⁶ For these cases, applicants were invited to propose an ESM that better achieves the objective of protecting customer interests during the deferred rebasing period.

⁷² 2015 Report, p. 7

⁷³ 2015 Report, p. 6 & 7

⁷⁴ MAADs Handbook p. 16

⁷⁵ Report of the OEB, *New Policy Options for the Funding of Capital Investments: The Advanced Capital Module*, September 18, 2014, p.15 (EB-2014-0219), and *Report of the OEB, Regulatory Treatment of Impacts Arising from the COVID-19 Emergency*, p.15 (EB-2020-0133)

⁷⁶ MAADs Handbook, p. 16

OEB staff notes that the stakeholders agreed with flexibility in ESMs. One utility commented that net savings may not arise until later than the 6th year of a longer-term rebasing deferral. OEB staff is of the view that in such a scenario, the applicant may propose an ESM that better suits its circumstances with a supporting rationale. For example, the proposed ESM may commence in a later year but share a higher portion of earnings with ratepayers. OEB staff considered whether alternative mechanisms beyond an ESM should also be considered, but concluded that an ESM is the most effective tool to protect ratepayers.

The MAADs Handbook stated earnings will be assessed each year once audited financial results are available and excess earnings beyond 300 basis points will be shared with customers annually.⁷⁷ In OEB staff's view, regulatory efficiencies can be gained if any excess earnings recorded in an ESM account are requested for disposition in the consolidated utility's next rebasing application instead of annually. An ESM account is a Group 2 account - requesting the disposition of the ESM account at rebasing would be consistent with the OEB's disposition policy for Group 2 accounts.⁷⁸ A prudence review of the account for all years of the ESM can be reviewed together at the time of the rebasing application, rather than being reviewed annually in an IRM rate application, which is intended to be a mechanistic process. Furthermore, the results of the ESM calculation can be considered along with any other MAADs consideration required at the time of the next rebasing application. If the audited ESM balances covering all applicable years of the rate term are not available at the time of the next rebasing application, then OEB staff recommends that this outstanding balance(s) shall be brought forward for disposition in the subsequent IRM application(s) following the next rebasing application.

OEB staff agrees with stakeholders that the ESM should be calculated on an annual calendar-year basis and include all transactions/integration costs, as well as savings, in the ESM calculation. OEB staff is of the view that an annual ESM calculation, rather than a cumulative ESM calculation would be appropriate for ESM balances that are requested for disposition at rebasing.

OEB staff is of the view that utilities would need to provide an update of the annual audited ESM balance in each of their IRM or Custom IR Update applications for all applicable years of the rate term.

⁷⁷ MAADs Handbook, p. 16

⁷⁸ EB-2008-0046, *Report of the OEB, on Electricity Distributors' Deferral and Variance Account Review Initiative* (EDDVAR), July 31, 2009, p.13

Many consolidations close on dates that are not at calendar year end. Calculating ESMs on a calendar-year basis, regardless of when the MAADs transaction closed, would be efficient and practical as the data required would align with the consolidated utility's financial reporting period. The data would also have the benefit of being audited accordingly.

OEB staff proposes that for purposes of ESM calculations, calendar year data is used regardless of the actual closing data of the consolidation. If a MAADs transaction closes prior to June 30 in a given year, the ESM should be applied starting at January 1 of the same calendar year. Similarly, if the MAADs transaction closes after June 30 in a given year, the ESM should be applied starting at January 1 of the subsequent calendar year. For example, if the ESM is effective starting in year six of the deferred rebasing period and the MAADs transaction closed on March 30, the ESM would be calculated starting January 1 of year six. On the other hand, if the MAADs transaction closed August 1, the ESM would be calculated starting January 1 of year seven.

With regard to transition and transaction costs, to the extent they continue to be incurred in the years the ESM is calculated, **OEB staff proposes that that they be included in the ESM calculation for the years ESM is calculated.** This symmetrical treatment allows for ratepayer protection while acknowledging utility costs.

At the time of consolidation, the consolidating utilities may also have differing deemed ROEs. **The most appropriate way to determine a deemed ROE for the purposes of the ESM calculations for the consolidated entity would be to weight the approved ROEs for each utility from their last rebasing application, by the deemed equity component of the rate base of each utility in their last rebasing application.** OEB staff notes that the OEB has approved this approach in prior cases and does not see any reason to deviate from this approach.⁷⁹

OEB staff further proposes that an accounting order should be established in the MAADs proceeding, with the effective date when the MAADs transaction closes, as discussed in more detail above. OEB staff believes that there would be greater regulatory efficiencies in establishing the ESM account in the MAADs proceeding, rather than revisiting the issue and establishing the account in a subsequent rate application prior to the effective date of the ESM.

⁷⁹ EB-2021-0280, Decision and Order, Brantford Power Inc. and Energy + Inc. MAADs, March 17, 2022, p. 13, EB-2022-0006, Decision and Order, Kitchener-Wilmot Hydro Inc. Waterloo North Hydro Inc. MAADs, June 28, 2022, p. 21

Consistent with the filing requirements for cost of service applications, the accounting order must include a description of the mechanics of the account, and provide examples of general journal entries, and the proposed account duration.⁸⁰ The distributor must also file evidence demonstrating how the eligibility criteria of causation, materiality, and prudence have been met.

Performance Standards for MAADs Applications

The procedural process of MAADs applications was reviewed with stakeholders at the one-on-one meetings.

No major concerns with the OEB's processes with respect to consolidation applications were noted by participants. OEB staff heard from one utility that if an application seems straightforward – for example a proposed consolidation where one utility is already operating another utility – the OEB could perhaps consider a more streamlined proceeding.

In terms of performance standards for processing a consolidation application, one utility noted that getting a timely decision is of utmost importance, and a level of certainty around decision timing is beneficial. Intervenors generally commented that the OEB processes MAADs applications relatively efficiently and would not want to see reduced procedural involvement.

At this time, OEB staff is not proposing any changes to the OEB's performance standard for section 86 (change of ownership or control of utilities and assets) applications for electricity distributors based on the comments heard from participants.⁸¹

OEB staff does note however that the current performance standards for section 86 applications are determined by hearing type (i.e., oral or written). For other application types the OEB has adopted performance standards based on the complexity of the application. Upon the conclusion of this consultation, the OEB may wish to consider whether application complexity influences processing and time required for review, which may not necessarily relate to the type of hearing. **OEB staff suggest the OEB undertake a review to align the section 86 performance standards with changes to other application types by converting from a written versus oral hearing structure to a short form versus complex structure, following the issuance of the updated MAADs Handbook.**

⁸⁰ Filing Requirements For Electricity Distribution Rate Applications - 2023 Edition for 2024 Rate Applications, Chapter 2, Cost of Service, December 15, 2022, p. 66 & 67

⁸¹ See OEB webpage [Performance Standards for Processing Applications](#)

OEB staff invites comments on what criteria stakeholders believe may allow an application to be processed under shorter versus a longer timeframe.

Other

Meetings with utilities and intervenors brought to OEB staff's attention other matters which do not expressly fall into one of the categories discussed above. Further, one topic discussed below (Z-Factor – Materiality Threshold Calculation) was not raised by stakeholders during meetings with OEB staff, however, OEB staff is of the view that it would be beneficial to provide guidance in the MAADs Handbook with respect to how the OEB may consider the materiality of Z-Factor requests by consolidated utilities. Currently, the MAADs Handbook does not address this matter.

OEB staff provides its discussion and proposal on each topic in turn.

Z-Factor – Materiality Threshold Calculation

Z-factors are intended to provide for unforeseen events outside of management's control, and are a common feature of IR plans. In general, the cost to a distributor of these events must be material and its cost causation clear.⁸² The OEB-defined materiality threshold for a Z-factor claim as set out in the *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors* is:

- \$50 thousand for distributors with a distribution revenue requirement less than or equal to \$10 million;
- 0.5% of distribution revenue requirement for distributors with a revenue requirement greater than \$10 million and less than or equal to \$200 million; and
- \$1 million for distributors with a distribution revenue requirement of more than \$200 million.⁸³

OEB staff proposes a new section related to Z-Factor materiality thresholds for consolidated utilities be added to updated MAADs Handbook outlining the following:

Adjusting a distributor's revenue requirement to set the materiality threshold may be appropriate when predecessor utilities, or a consolidated utility's rate zones, have not rebased for more than five years. When it is apparent from the dates of the last OEB-approved revenue requirement that there has likely been a significant change, the OEB finds it reasonable to adjust the materiality threshold

⁸² *Report of the Board on 3rd Generation Incentive Regulation for Ontario's Electricity Distributors*, July 14, 2008, p. 34

⁸³ *Ibid*, Appendix, p. 5. The threshold must be met on an individual event basis to be eligible for potential recovery.

to recognize the likelihood of such change.⁸⁴ Specifically, the cumulative impact of IRM rate adjustments and growth in demand (customers, kWh and kW), should be reflected in the applicant's calculation of its materiality threshold. If an applicant does not believe such adjustments are warranted, it should provide justification.

OEB staff believes it is appropriate that consideration should be given in determining the appropriate materiality threshold for Z-factor applications when a predecessor utility has not rebased in more than five years.

Incremental Operations, Maintenance & Administration

One utility expressed interest in having incremental OM&A considered in the ICM or something akin to an ICM.

OEB staff views the potential for recovery of incremental OM&A as being confined to two distinct situations.

First is the situation of incremental funding for OM&A that is directly tied to a qualifying ICM request. There may be examples of situations where a qualifying ICM results in operating costs that the utility previously did not have. An example of this is where a utility builds a high voltage transformer station that is deemed a distribution asset but where the utility now must have high voltage-qualified staff for controlling and maintaining the high voltage equipment that it did not have previously. **OEB staff is of the view that stakeholders may raise this issue at the time the OEB undertakes its consultative process to review its ICM policy. Therefore, OEB staff is not proposing any change in this regard for consolidating utilities in the updated MAADs Handbook.**

The second situation is for incremental funding for OM&A unrelated to a qualifying ICM request. In this case, OEB staff sees no need for new tools beyond existing mechanisms already well-established by the OEB (i.e., Z-factors and DVAs). **OEB staff considers that these existing mechanisms are adequate for dealing with the potential funding of incremental OM&A needs, as appropriate, that may fall outside of what is currently being recovered through a utility's IRM-adjusted rates.** If consolidating utilities anticipate that there is additional risk for OM&A expense needs, the utility should take this into account when considering the length of the deferred rebasing period it elects.

⁸⁴ EB-2022-0317, Decision and Order, June 15, 2023, p. 16

[Timing of New MAADs Filing Requirements](#)

One utility commented that negotiation discussions may be occurring based on the OEB's current consolidation policies, and it will be important to consider the timing of applicability of any new requirements for MAADs applications.

If the OEB decides to adopt the changes proposed by OEB staff, given that the breadth of changes being proposed do not materially diverge from the OEB's current consolidation policies, **OEB staff believes that applicants should strive to reflect any updated filing requirements, to the extent possible, in their applications. For any updates not adopted (for consolidation transactions negotiated under the current Handbook), applicants should include an explanation as to why as part of the application. However, new reporting requirements arising out of the AG Audit Report should be applicable and required in all cases going forward (i.e., for future consolidations approved post-issuance of the updated MAADs Handbook).**

For certainty, OEB staff proposes that any consolidation applications filed one year or later from the issuance of the MAADs Handbook as finalized by the OEB as a result of this consultative process should comply with all applicable policies in the updated MAADs Handbook. Further, any rate applications filed during the deferred rebasing period or at the first rebasing application after consolidation, and one year or more from the issuance of the final MAADs Handbook, should comply with the policies in the updated MAADs Handbook. Any deviations from the updated policies or filing requirements should be documented with supporting reasons.

[Pro Forma Financial Statements](#)

The current filing requirements for consolidation applications state that applicants must "provide pro forma financial statements for each of the parties (or if an amalgamation, the consolidated entity) for the first full year following the completion of the proposed transaction."⁸⁵ The material provided to meeting participants questioned whether any additional requirements relating to pro forma financials for the first full year following consolidation should be required (e.g., provide relevant assumptions, show consolidation costs and savings separately).

One utility and intervenors commented that applicants should provide relevant assumptions/explanations used in pro-forma financial statements.

OEB staff proposes that an additional requirement be added to the existing filing requirements for consolidation applications that applicants should provide

⁸⁵ MAADs Handbook, p. 6 & 7

assumptions/explanations used in the pro forma financials, as well as the methodology used to forecast amounts. OEB staff notes this will increase clarity for the OEB and other stakeholders, while potentially reducing the number of interrogatories to applicants.

[OEB Act Language](#)

Section 1 of the OEB Act has been updated since the issuance of the MAADs Handbook. One intervenor commented that the MAADs Handbook should be updated to reflect the current language. **OEB staff agrees that all applicable references should be updated.** Further, the OEB should confirm which objectives are the focus in assessing a MAADs transaction.

The OEB's objectives under section 1 of the OEB Act that are outlined in the current MAADs Handbook are:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.
 - 1.1 To promote the education of consumers.
2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.
3. To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario, including having regard to the consumer's economic circumstances.
4. To facilitate the implementation of a smart grid in Ontario.
5. To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities.⁸⁶

The OEB's revised objectives in the OEB Act since the issuance of the MAADs Handbook, are:

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.

⁸⁶ MAADs Handbook, p. 4

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.⁸⁷

The current MAADs Handbook states:

...in applying the “no harm” test, the OEB has primarily focused its review on impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the electricity distribution sector. The OEB considers this to be an appropriate approach, given the performance-based regulatory framework under which all regulated distributors are required to operate and the OEB's existing performance monitoring framework.”⁸⁸

The current MAADs Handbook confirmed that the OEB was satisfied that the attainment of the previous objectives 3, 4 and 5 will not be adversely affected by a consolidation. given the instruments implemented by the OEB that ensure regulated utilities continue to meet their obligations. As such, no further detailed review as part of the OEB's consideration of the consolidation transaction was required.

OEB staff believes it continues to be appropriate that 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 electricity distribution sector.

With respect to the revised objective of the OEB to facilitate innovation in the electricity sector, the OEB's 2023-2026 Business Plan highlights that the OEB will deliver on the strategic goal to facilitate innovation by implementing programs and activities to drive the actions from the OEB's strategic plan.⁸⁹ Given the OEB's work to facilitate innovation in the electricity sector broadly, OEB staff does not consider that the attainment of this objective will be adversely effected by a consolidation. In fact, it may be the case that consolidation can help facilitate innovation by enabling distributors to address challenges in an evolving electricity industry through increased access to resources (human, capital, operating etc.).

⁸⁷ [Ontario Energy Board Act, 1998, S.O. 1998, c. 15, Sched. B](#)

⁸⁸ MAADs Handbook, p. 6

⁸⁹ OEB 2023-2026 Business Plan, pp. 40-45

While OEB staff proposes that the focus in assessing MAADs transactions does not change from current practice, this does not preclude applicants from detailing in their applications how the proposed consolidation would facilitate innovation in the electricity sector generally.

Licence Application

The filing requirements for consolidation applications outline additional requests made to the OEB in previous consolidation applications which have formed part of the OEB's determination of a consolidation application. A licence amendment and cancellation, for example, is one of those matters.⁹⁰

As part of the meetings held in this consultation, one utility commented that it should be made clear that a licence application for the newly consolidated entity should be included as part of a consolidation application.

OEB findings on consolidation applications since the issuance of the MAADs Handbook have addressed licence-related matters. OEB staff agrees that the licence application should be considered by the OEB concurrently with the request for leave to amalgamate. OEB staff's position is based on the OEB's findings that a request for leave to amalgamate cannot be granted in the absence of a related license application.⁹¹ OEB staff notes that licensing matters will only be completed if the proposed consolidation is approved and when the utility informs the OEB that an approved consolidation is completed (i.e., per existing procedure for associated licensing changes).

OEB staff proposes the language in the filing requirements for consolidation applications be updated to make it clear that licence applications should be included as part of consolidation applications.

Conclusion

Generally, in considering updates to the MAADs Handbook and filing requirements for consolidation applications, OEB staff placed importance on areas for modification that, if addressed, should:

- ✓ Support OEB decision making.
- ✓ Increase clarity and certainty of expectations for applicants.
- ✓ Increase regulatory efficiency.

⁹⁰ Filing Requirements for Consolidation Applications, p. 7

⁹¹ EB-2016-0025, Enersource Hydro Mississauga Inc., Horizon Utilities Corporation & Powerstream Inc. MAADs Application, Oral Hearing Transcript Volume 4, p. 65

At the same time, OEB staff has also had to consider the needs and expectations for the OEB, as well as the needs and expectations of other stakeholders for information to be able to assess the impacts of consolidation in the Ontario electricity sector to deliver benefits for the sector as a whole; individual firms and their shareholders; and ratepayers, and that benefits are reasonably distributed to all impacted parties. The recommendations in the November 2022 AG Audit Report are a clear example, but was not the only consideration.

OEB staff has considered emerging and evolving issues such as energy transition, technological advancement, and climate change to name a few, and recognizes that utilities' operations and activities, including consolidation, do not occur in a vacuum. These provide challenges and opportunities which consolidating utilities must deal with while transitioning their operations as a result of a consolidation. However, this situation is not new. In the nearly 25 years since energy restructuring in Ontario, with the enactment of Bill 35 on April 1, 1999, consolidations have occurred under similar significant changes, such as rate unbundling, incorporation and preparation for market readiness and market opening (1999-2002), smart meters (2008-2013), and the Renewed Regulatory Framework (started in 2012).

In OEB staff's assessment, recommendations and proposals are informed by the feedback received from interviewed utilities and intervenors, as well as OEB staff's own learnings from sector reviews and from decisions and other documents in many MAADs cases, particularly those since 2015.

OEB staff's proposals attempt to make the MAADs Handbook clearer and more current, while maintaining a balance of ensuring regulatory efficiency and effectiveness to facilitate rational consolidation in the Ontario electricity sector.

OEB staff thanks those utilities and intervenors that have provided feedback to date, and looks forward to comments from remaining stakeholders.