



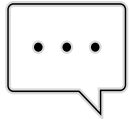
Evaluation of Policy on Utility Consolidations

Meetings Between OEB Staff and Stakeholders – Discussion Materials

Administrative Matters



Meetings will be recorded and OEB staff will take meeting minutes. Minutes will be summarized (without attribution).



All participants in the consultation (i.e., including those where one-on-one meetings were not scheduled) will have the opportunity to file comments on subsequent steps to occur in this consultation.

Context - Purpose of Update to Current Consolidation Policy

To consider and establish updates to OEB's consolidation policy, and document updated guidance to utilities and stakeholders

- Various applications/decisions in recent years have highlighted potential areas for policy clarification and/or evolution.
- [Chief Commissioner 2022-2023 Year-End Update letter](#) noted plan to review the OEB's Handbook to Electricity Distributor and Transmitter Consolidations (MAADs Handbook*). The OEB prioritized the consolidation/MAADs policy for action in its 2023-2026 Business Plan.
- The [Auditor General's November 2022 Value-for-Money](#) audit recommended the OEB:
 - Implement effective and timely monitoring of post-consolidation activities during deferred rebasing periods
 - Require acquired and merged entities to continue to report on key performance measures (e.g., reliability metrics) separate from the consolidated entities during deferred rebasing periods
 - **OEB response:** "The OEB will establish a minimum standard for reporting requirements during deferred rebasing periods that will balance the regulatory and financial requirements on utilities with increased transparency for customers. Subject to further analysis and consultations with stakeholders, those requirements might include steps taken toward integration of the consolidating Local Distribution Companies and performance reporting for legacy service areas. The OEB notes that conditions of approval and certain reporting requirements may be key issues in consolidation applications adjudicated by independent panels of OEB Commissioners."

Agenda



- ① Overview of OEB's Legislative Authority and Current Consolidation Policy
- ② The OEB's "No-Harm" Test
- ③ Recent History of Consolidation Applications
- ④ Items for Consideration During Discussions
- ⑤ Questions/Topics for Discussion

Overview of OEB's Legislative Authority and Current Consolidation Policy

- ✓ OEB approval is required for consolidation and change in control transactions described under sections 43 (natural gas) and 86 (electricity) of the OEB Act



The test the OEB applies in assessing consolidations is the **“no harm” test**

- Established in the decision on a combined proceeding in a 2005 (OEB decision RP-2005-0018/EB-2005-0234/EB2005-0254/EB-2005-0257) and currently remains in place.
- “...[I]n 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.”



OEB policies on rate-making associated with electricity distributor consolidation are set out in **two OEB reports**

- [2007](#) and [2015](#) : both called *Rate-making Associated with Distributor Consolidation*

MAADs Handbook

The MAADs Handbook (2016) provides guidance to applicants and stakeholders on applications to the OEB for approval of distributor and transmitter consolidations and subsequent rate applications.

- Applies specifically to applications under ss. 86(1)(a) and (c) and ss. 86(2)(a) and (b) of the OEB Act

Rate-Making considerations relating to consolidation that are addressed in the MAADs Handbook include:

- Deferred rebasing period
 - Elected by the applicant(s) for a specific number of years ranging from 0 to 10
- Early Termination of Pre-Consolidation Rate-Setting term
- Early Termination or Extension of Deferred Rebasing Period
- Rate Setting During Deferred Rebasing Period
- Off Ramp
- Earnings Sharing Mechanism
- Incremental Capital Investments During Deferred Rebasing Period
- Future Rate Structures
- Deferral and Variance Accounts



The MAADs Handbook includes Filing Requirements for Consolidation Applications

The OEB's intention is that an updated version of the MAADs Handbook resulting from this consultative process 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

The OEB's “No Harm” Test

“No Harm Test” considers whether transaction will have an adverse effect on the attainment of the OEB’s statutory objectives set out in section 1 of the OEB Act. Primary of these are objectives 1 and 2. If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.

These objectives may be summarized as:



Objective 1

Protect consumers with respect to price and the adequacy, reliability and quality of electricity service



Objective 2

Promote economic efficiency and cost effectiveness and facilitate the maintenance of a financially viable electricity industry

“No-Harm” Test Continued



Price, Economic Efficiency and Cost Effectiveness

Price - Applicants are required to show that there is a reasonable expectation based on underlying cost structures that the costs to serve customers following a consolidation will be no higher than they would otherwise have been. While the rate implications to all customers will be considered, for an acquisition, the primary consideration will be the expected impact on customers of the acquired utility.

The impact on **economic efficiency and cost effectiveness** will be assessed based on the applicant's identification of aspects of utility operations where it expects sustained operational efficiencies, both quantitative and qualitative.



Reliability and Quality of Electricity Service

In considering the impact and whether the “no harm” test has been met, the OEB is informed by, among other things, the **metrics provided by the distributor in its annual reporting to the OEB and published in its annual scorecard**.



Financial Viability

Impact of a proposed transaction on the acquiring utility's financial viability (acquisition), or on the financial viability of the consolidated entity (merger), will be assessed from the following perspectives:

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

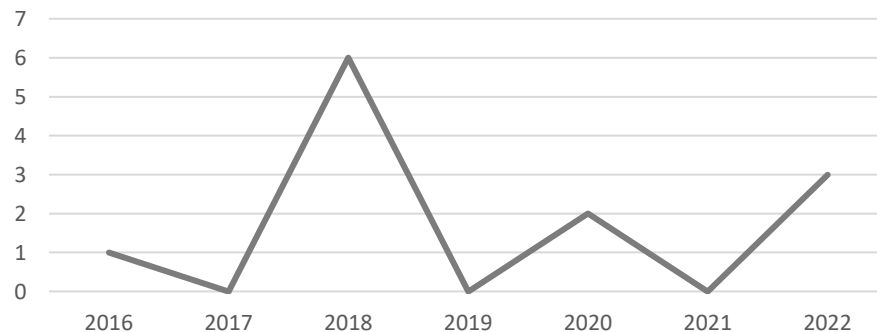
Recent History of Consolidation Applications

Since the issuance of the current MAADs Handbook, there have been...

21 consolidation applications filed with the OEB*

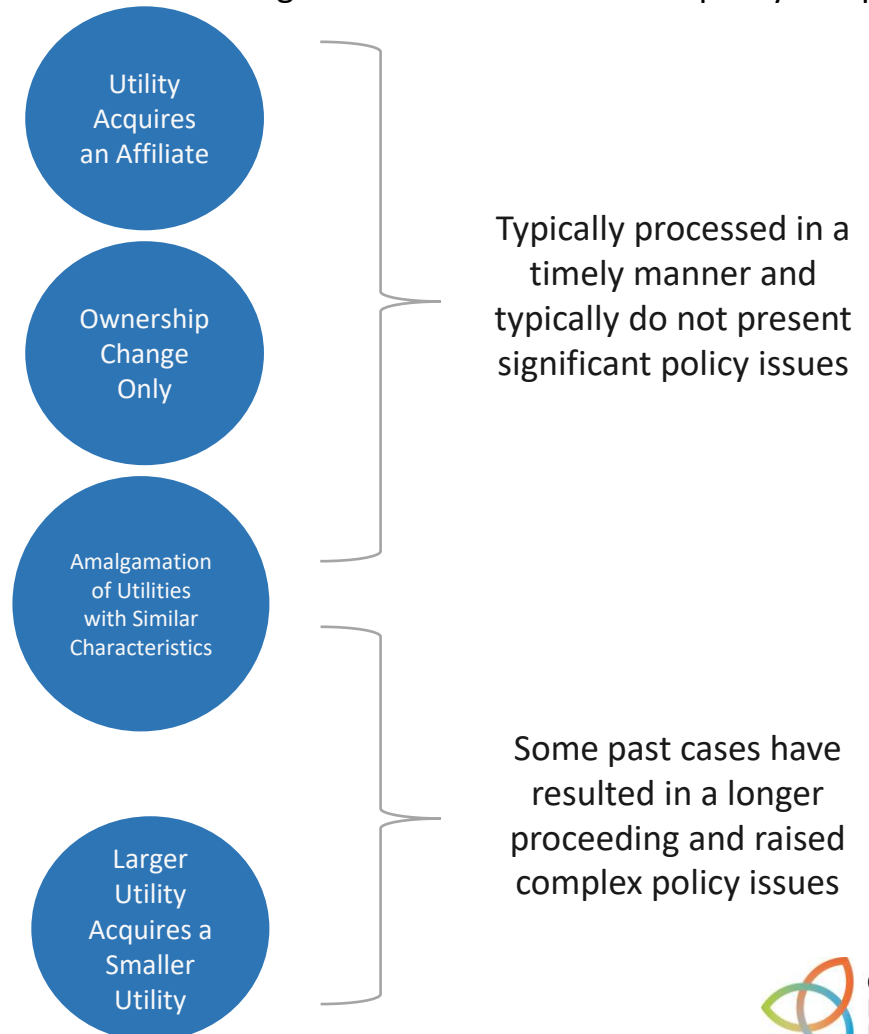
12 of which have resulted in a reduction in the # of electricity distributors (*see graph below*)

Number of Electricity Distribution Consolidation Cases Since MAADs Handbook Issuance



Note: breakdown based on year decision was issued


Consolidation applications have generally come in a variety of forms and have involved different degrees of administrative and policy complexity




*Of these applications, only one was denied. A revised version of the denied application was filed and, ultimately, approved.

Some Items to Consider When Updating MAADs Policy and Filing Requirements

 Clarifying and/or amending what **information** needs to be included in a MAADs application, **the form of that information** and **what it should demonstrate**

 Monitoring/reporting of post-consolidation activities during deferred rebasing periods
(recall slide 3 for OEB response to Auditor General Recommendations)

 **Updates to filing requirements** should also target information that tends to be requested through interrogatories, undertakings, etc. for regulatory efficiency (e.g. comparison tables, historic information, spreadsheets)

Is there a cost/benefit trade-off for information to be filed in a consolidation application or for information to be monitored/reported post-consolidation up to the next rebasing application of the consolidated entity?

Areas for Discussion and/or Evolution

OEB staff has identified potential areas for discussion and/or evolution based on, among other matters, a review of cases completed since the issuance of the MAADs Handbook, and general review of the current language of the MAADs Handbook.

In considering potential areas for discussion, OEB staff assumed continued applicability of the following general overarching principles that guide the review and determination of consolidation applications:

Factors considered in approving a s. 86 application are those factors outlined in s.1 of the *OEB Act*

Test applied to assessing consolidation applications is the “no-harm” test (see *Note*)

Setting rates for after consolidation will generally not be part of a consolidation application

Topics and Questions for Discussion

The following section outlines questions to guide discussions, as applicable (i.e., certain questions may only be applicable to utilities).

Questions are divided into the following headings:

- General
- “No Harm” and Cost Structures
- Performance Metrics and Reporting
- Financial Viability
- Future Rate Structures
- Deferred Rebasing Period
- Cost Allocation
- Incremental Capital During Deferred Rebasing Period
- Earnings Sharing Mechanism
- Tax and Accounting Implications
- Review Process for Different Types of Consolidation Applications

Based on the topics arising during the discussion, additional questions may be asked by OEB staff.



Question Guide

General

1. What are your experiences in filing and/or participating in a consolidation application(s)? Did anything stand out specifically?
2. What motivations and incentives (or disincentives) does the current MAADs policy create?
 - a) Are these motivations and incentives aligned with ratepayer interests?
 - b) How do you think these motivations and incentives / disincentives have promoted or limited the ability to consolidate?
Can you identify examples?
 - c) What other obstacles to consolidation need to be removed or amended while ensuring a fair allocation of risks/benefits between shareholders and ratepayers?
3. What do you see as the major strengths and weaknesses of the current MAADs policy?
 - a) What opportunities exist to improve current policy?
 - b) Do you believe there is still an interest or appetite for utilities in Ontario to consolidate?
 - i. If interest is there, what is preventing utilities from pursuing consolidation opportunities?
 - ii. What changes to existing policy would increase utility interest in consolidating?
 - c) Are barriers or elements preventing consolidation the result of the OEB's MAADs policy or from other external factors?
What are these other factors?
4. How can the OEB encourage effective consolidations that provide generally equitable benefit to both customers and the utility?

“No Harm” and Cost Structures

Cost Structure

1. Should the MAADs Handbook provide more guidance on what “cost structure” means?
 - a) In your view, what do you consider is an appropriate definition of cost structure (e.g., is it both revenue requirement and rates)?
2. What are the metrics most relevant in assessing underlying cost structure?
3. Are there rates and cost structure indicators that can be relied on in absence of a comprehensive rates hearing?

Ratepayer Protection

1. If an Applicant believes there may be the potential for “harm”, should the MAADs Handbook require that applications propose mechanisms to protect ratepayers to insulate customers from any possible rate effects attributable to a proposed transaction? If yes, what could those mechanisms look like?

Other

1. Should consideration be given to emerging issues like Energy Transition? If so, how?
2. Should estimated post-consolidation rates, rate impacts, or revenue requirements be included in a MAADs application?
 - a) If so, what would such a test look like in a revised MAADs policy?
 - b) What rate indicators/information will help the OEB in its assessment of a MAADs application?
 - c) If so, to what degree, if at all, should utilities be held to the estimated post-consolidation rates/rate impacts?

Performance Metrics and Reporting

Monitoring of Post-Consolidation Activities During Deferred Rebasing Periods

1. What present practices do LDCs employ to ensure that conditions of consolidation are met, as applicable?
2. What key milestones do LDCs track to ensure the integration plan is achieved? Do LDCs feel that these milestones are reportable? If not, why?
3. Should distributors involved in consolidation applications be required to report actual savings achieved v. forecasted during the selected deferred rebasing period?
 - a) If not, why?
 - b) If yes, how should LDCs report on realized savings during the chosen deferred rebasing period due to consolidation? What form would this take?
 - c) How much incremental work/cost would this be for the consolidated distributor?

Reporting on Key Performance Measures Separately

1. Should consolidated entities be required to track and report reliability and/or service quality performance metrics separately and be prepared to demonstrate (at the time of rebasing) that neither deteriorated as a result of the consolidation(s)? If yes, which metrics should be reported separately and why? If not, why not?
2. Are there metrics that should continue to be reported on a consolidated basis? If yes, which ones and why?

Financial Viability

Transaction/Transition Costs

1. Should the MAADs Handbook provide further guidance for specific circumstances under which transaction or transition costs may be recoverable?

Assessment of Financial Viability

1. A utility may have previously consolidated with another utility – in this case, should, and if so, how should financial viability be assessed (i.e., cumulative v. incremental)?
2. Are there any additional requirements relating to pro-forma financial statements for the first full year following consolidation that should be required (e.g., provide relevant assumptions, show consolidation costs and savings separately)?
3. Is there a need for further clarity on what constitutes financial viability (e.g., which ratios to consider and the percentage/ratio that could signal financial viability issues)?

References: Transaction/Transition Costs - Algoma/Dubreuil [EB-2018-0271]; Financial Viability – (1) not specific to a case, the issue is raised more generally in consideration of utilities who may be active consolidators; (2) analysis revealed recent cases contained numerous interrogatories regarding pro-forma financial statements. Additional requirements upfront may reduce the number of interrogatories; (3) not specific to a case, the issue is raised more generally to potentially provide further clarity.

Deferred Rebasing Period

Treatment of Compounding Deferral Periods

1. Future consolidations may involve the possibility of multiple successive consolidation transactions by a single consolidated entity – how should compounding deferred rebasing periods be treated? (i.e., should the MAADs Handbook specify the OEB’s approach to cascading deferred rebasings?)
2. What are stakeholders’ views of cascading deferred rebasing periods? If this is left to be determined on a case-by-case basis, what effect does this have on regulatory certainty?
3. How should the notion that applicants should not lose the benefit of the full proposed ten-year deferral period be balanced against the interests of the customers in the current consolidated utilities’ existing rate zones, in not having any of the benefits of a previous consolidation diminished?

Next Rebasing Date

1. Should the MAADs Handbook and/or associated filing requirements require that the applicants explicitly note when the consolidated entity will be applying to rebase rates (i.e., effective for what date)?

Future Rate Structures

Rate-Setting and/or Harmonization Details

1. How much detail, if any, should applicants be required to file at the time of a consolidation application of rate-setting or rate harmonization plans? What details should be filed?

New Rate Classes

1. The MAADs Handbook currently allows consolidating utilities to place acquired customers into existing or new rate classes. Is the current policy regarding the ability to create new rate classes appropriate?
 - a) If so, what type of rationale/information should applicants provide (for each utility) to support a proposal for a new rate class(es)?
 - b) What should be done with this information in the next rebasing application post consolidation?
2. In most cases, there will not be equal rates benefits for all affected customers. However, in some instances there may be no benefits, or even rate disbenefits for some customers/customer classes. Should this be identified early on and, if so, what information should be provided to identify and explain these situations?

Other

1. Are there certain elements in base rates that need to be adjusted for upon consolidation (e.g., certain elements that were smoothed in base rates (CCA, regulatory expense))

Cost Allocation

Cost Allocation Proposals (primarily for next rebasing)

1. How much detail should be provided in a consolidation application regarding cost allocation proposals for the next rebasing application (i.e., to support an applicant's claim and evidence that there will be "no harm")
2. If some details are to be provided, should the MAADs Handbook confirm and/or clarify that proposals should be consistent with OEB cost allocation principles, approaches, and policies? If not consistent, should rationale be provided by the distributor as part of a consolidation application?

Incremental Capital During Deferred Rebasing Period

OEB Letter: Incremental Capital Modules During Extended Deferred Rebasing Periods, February 10, 2022

says:

- “...to provide a further incentive for distributors considering consolidation, the OEB is updating the existing ICM policy for responding to capital investment needs of electricity distributors that select an extended deferred rebasing period (beyond five years) under the OEB’s current MAADs policy. Specifically, the OEB is providing additional flexibility for these electricity distributors 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)...”
- Demonstration of certain criteria required (see letter for details)
- Update MAADs Handbook to include all recent OEB correspondence re: ICM availability

Tax and Accounting Implications

Timing of Disposition

1. Should Group 2 account balances be required to be the subject of disposition applications at certain times if the utility selects a certain deferred rebasing period?

Accounting Policy Changes

1. Should an account be established to record the impacts of accounting policy changes post-consolidation?
 - a) Should guidance be provided on the mechanics of the account (e.g. Account 1576 approach to capture rate base impact, with return applied or record all revenue requirement impact, any materiality consideration)?

Tracking

1. Should DVAs be tracked on a rate zone or consolidated basis?
 - a) Should utilities be required to consolidate DVAs at a certain time?

Other

1. Should there be a requirement to discuss tax implications (e.g. departure or transfer tax, any associated regulatory impacts)?

Earnings Sharing Mechanism

Recording Details

1. Is there conflicting guidance on Earnings Sharing Mechanisms (ESMs) between the MAADs Handbook and Rates Handbook (2016)?
 - a) Should ESM be calculated on an annual basis, or on cumulative basis from years six until rebasing?
 - b) Should the ESM be disposed annually or at rebasing?
 - c) If there are different approaches, with reasons, for ESMs, what information should be provided to support the proposed approach to aid the OEB in assessing the appropriateness of the proposed ESM and in ensuring equitable treatment for affected ratepayers?

Mechanics

1. Should there be guidance for the specific mechanics of the ESM?
 - a) If the consolidation occurs mid-year, how should the ESM be considered and calculated in the stub-year?
 - b) How should the deemed consolidated return on equity (ROE) be determined?
 - c) When should the specific mechanics of the ESM, including the accounting order be determined (e.g. year six or upon review for disposition, at time of disposition)?
 - d) Should the ESM exclude all transactions and integration costs, and include savings?

Review Process for Different Types of Consolidation Applications

1. Do all consolidation applications need the same extent of procedural involvement?
2. Should the OEB have different performance standards for processing consolidation applications depending on the type of transaction?
3. How should the level of procedural involvement be assessed before an application has been filed ?
 - a) How would this be reasonably assessed?

End of Question Guide

Next Steps >>

The next steps in this consultative process will be communicated by the OEB following the conclusion of the meetings between OEB staff and participants as outlined in the OEB Initiation Letter.

Appendix A

Reference Guide



“No Harm” and Cost Structures References

The MAADs Handbook states:

- The “no harm” test considers whether the proposed transaction will have an adverse effect on the attainment of the OEB’s statutory objectives...If the proposed transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the application.” (p. 4)

Under the “Price” heading, the MAADs Handbook states:

- “A simple comparison of current rates between consolidating distributors does not reveal the potential for lower cost service delivery.” (p. 6)
- “...the OEB will assess the underlying cost structures of the consolidating utilities” (p. 6)
- “As distribution rates are based on a distributor’s current and projected costs, it is important for the OEB to consider the impact of a transaction on the cost structure of consolidating entities both now and in the future, particularly if there appear to be significant differences in the size or demographics of consolidating distributors.” (pp. 6-7)
- “...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.” (p. 7)



Financial Viability References

The MAADs Handbook states:

- The selling price of a utility is relevant only if the price paid is so high as to create a financial burden on the acquiring company (p. 8)
- OEB will test the financial ratios and borrowing capacity of the resulting entity, as the improvement in financial strength is one of the expected underlying benefits of consolidation (p. 8)
- The impact of a proposed transaction on the acquiring utility's financial viability for an acquisition, or on the financial viability of the consolidated entity in the case of a merger will also be assessed. Primary considerations include: effect of the purchase price, including any premium paid above the historic (book) value of assets involved, financing of incremental (transaction and integration costs) to implement transaction. (p. 8)



Future Rate Structures References

The MAADs Handbook states:

- For acquisitions, distributors may place acquired customers into existing or new rate classes (p. 18)
- OEB expects rates will reflect the cost to serve, whichever rate class option is adopted (p. 18)
- Consolidation applications do not have to include details of rate setting or rate harmonization proposals (p. 17)
- Rate-setting will not be addressed in consolidation application unless it is an integral aspect (p. 11)
- Rate-setting will be addressed in a separate rate application, in accordance with OEB rate setting policies (p. 11)



Earnings Sharing Mechanism References

The MAADs Handbook states:

- Consolidating utilities that propose to defer rebasing beyond five years must implement an earnings sharing mechanism (ESM) for the period beyond five years (i.e., during years six to ten) (p. 16)
- Excess earnings above 300 basis points are to be shared with consumers annually (p. 16)
- Utilities may share excess earnings using the form outlined in the policy or may propose something of their own (p. 16)

2016 Handbook for Utility Rate Applications states:

- “If a utility proposes an earnings sharing mechanism as its mechanism to protect customers against excess earnings, it should be based on overall earnings at the end of the term, not an assessment of earnings in each year of the term, consistent with the approach to limiting mid-term updates.”