Shepherd Rubenstein

BY EMAIL and RESS

Mark Rubenstein
mark@shepherdrubenstein.com
Dir. 647-483-0113

Ontario Energy Board
2300 Yonge Street
27th Floor
Toronto, Ontario
M4P 1E4

March 6, 2024
Our File: EB20230188

Attn: Nancy Marconi, Registrar

Dear Ms. Marconi:

Re: EB-2023-0188– Evaluation of Policy on Utility Consolidations – SEC Comments

We are counsel to the School Energy Coalition ("SEC"). Below are SEC's comments on the OEB Staff Discussion Paper: Evaluation of Policy on Utility Consolidations ("Discussion Paper").

General Comments

OEB Staff have concluded that no major changes are required to the MAADs Handbook, and/or the filing requirements for consolidation applications. As they note, stakeholders did not identify any major barriers to consolidation or major gaps in consumer protection from existing OEB policies.[1]

SEC agrees that no fundamental changes to the OEB MAAD policy are required at this time. However, a number of important clarifications and adjustments are definitely necessary to ensure that consumers are in fact protected.

One reason that stakeholders, more specifically consumer groups, may not specifically request major changes is the timing of the review. Most utilities that have been granted MAAD approval since the release of the OEB's Handbook[2] are still within their deferred rebasing period, and so a full analysis to determine if consumers are in fact not harmed by the transaction has yet to occur. Not a single consolidated entity that deferred rebasing for the maximum 10 years has rebased.[3] In essence, the jury is still out. SEC's comments on the Discussion Paper and OEB Staff's specific proposals should be considered in that light.

[1] OEB Staff Discussion Paper: Evaluation of Policy on Utility Consolidations ["Discussion Paper"], p.2
[2] Handbook to Electricity Distributor and Transmitter Consolidations (January 19, 2016)
[3] This includes Alectra (formerly Powerstream, Hydro One Brampton, Horizon Utilities, Enersource, and Guelph Hydro), Elexicon (formerly Veridian and Whitby Hydro), Entegrus (previously Entegrus and St. Thomas Energy), Grandbridge Energy (formerly Energy+ and Brantford Power), Enova Power (previously Kitchener-Wilmont and Waterloo North Hydro), Newmarket-Tay Power (formerly Newmarket-Tay and Midland Power), and Hydro One's purchases of Peterborough Distribution and Orillia Power.

No-Harm Test

SEC does not oppose the continuation of the use of the no-harm test in assessing proposed consolidations. However, SEC has become concerned over the years about the need to ensure that *ex post* any approvals, the OEB ultimately ensures that customers of utilities involved in a MAADs transaction are not harmed. The difficulty for the OEB is that it is assessing a transaction based on a forecast of what incremental savings and costs may occur. In SEC's experience, often the evidence filed is highly speculative, which is understandable considering the transaction has yet to occur, and so details of integration and internal cost allocation details have yet to be worked out. In addition, MAADs applicants have a natural incentive to overstate the expected benefits of a transaction compared to the status quo stand-alone scenario.

It is critical that the OEB does not simply approve a MAADs transaction without regard for whether the transaction actually results in harm to customers in the end.

The OEB was faced with the possibility that customers would be worse off in Hydro One's purchase of Orillia Hydro and Peterborough Distribution. In those two decisions, while granting leave for the transactions, the OEB approved a "goalpost" approach as a condition.[4] Under this approach, if the fully allocated revenue requirement for the new Orillia and Peterborough rate classes exceeded the status quo forecast, the excess costs would be borne by Hydro One's shareholders, not ratepayers.

The Discussion Paper does not support the suggestion made by one intervenor[5] that this approach should be applied more broadly.[6] OEB Staff takes the view that each consolidation is unique, and different mechanisms may be proposed by applicants or intervenors to support an approval. There should be flexibility in the MAADs policy to account for different circumstances and consolidations.

Respectfully, this misses the point. The issue is less about the specific mechanism, but rather the principle that the OEB, to fulfill its responsibility, has an ongoing duty to ensure customers are not harmed by a transaction. If harm occurs in the end, it should be eliminated or, if necessary, borne by the utility's shareholders.

The principle is not new and was applied as recently as last year. In EPCOR Electricity Distribution Ontario Inc.'s first rebasing application after its MAADs transaction, the OEB found, based on the evidence, that customers were worse off as a result of the transaction.[7] The OEB panel reduced the proposed OM&A expenses, in part, on that basis. If EPCOR cannot, in fact, reduce its OM&A expenses in line with what was approved, then its shareholders will bear those costs.[8] This was the correct outcome and approach.

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[4] *Decision and Order* (EB-2018-0270), April 30, 2020; *Decision and Order* (EB-2018-0242), April 30, 2020

[5] While not named, we can say that it was SEC.

[6] Discussion Paper, p.13-14

[7] *Decision and Order* (EB-2022-0028), June 15, 2023, p.23: "Having reviewed the actual results presented in this proceeding against those forecasts, it appears that the forecast savings did not materialize. Furthermore, the Test Year OM&A costs appear to be higher than what one would expect if the acquisition had never occurred in the first place. This is borne out by the analyses presented in the submissions made by SEC, VECC and OEB staff. The OEB is of the view that approving the proposed OM&A budget would decrease the incentive to achieve the savings that were originally identified and impose harm on the ratepayers as a result of the acquisition." [emphasis added]

[8] *Decision and Order* (EB-2022-0028), June 15, 2023, p.23

This principle should be explicitly set out in the OEB's MAADs policy and relevant documents such as the MAADs Handbook, so that utilities considering MAADs transactions understand the consequences if customers end up being harmed.

No-Harm Test – Cost Structures vs. Rates

The Discussion Paper correctly notes that the OEB has assessed the price, or cost component, of the no-harm test, by accessing the "cost structure" of the consolidated utility as opposed to rates.[9] This has historically meant, and reaffirmed in the Discussion Paper, that a comparison between the revenue requirement of the consolidated utility versus the combined revenue requirements of two (or more) utilities under a status quo standalone scenario, is suitable.

The OEB has justified this approach by noting that a comparison does not reveal the potential for lower-cost delivery, as the two entities may have dissimilar service territories, customer mix, and rate class structures.[10] The Discussion Paper further discusses that comparing rates is problematic, given factors such as rate design, host and embedded distributor relations, and distribution high-voltage assets.[11]

All of this is correct, but to not consider customers' rates is an abrogation of the OEB's responsibility in assessing a MAADs application—will those customers be harmed by the transaction? Customers pay rates, not revenue requirements. The fact that there may be complications in making those comparisons is not a valid reason to disregard any consideration of rates. Section 1 of the *Ontario Energy Board Act* speaks to protecting customers' interests with respect to prices, not costs.[12] Costs are a component of prices (i.e., rates).

To use a simple example, consider two distributors (Utility A and Utility B) that are roughly equal in size but have materially different rates (Utility A's rates are 20% higher than Utility B's). Upon rebasing after an approved merger, if rates are harmonized, excluding merger savings, Utility A's rates would decrease by 10% and Utility B's rates would need to increase by 10%. Utility B's customers are undoubtedly harmed by the transaction. To avoid harm in this scenario, the merger savings would need to be sufficient to offset any increase in Utility B's rates (and would have to be allocated to Utility B's customers). Mergers may bring savings, but they are unlikely to be so high as to reduce the cost structure (i.e., revenue requirement) enough to avoid an increase in rates for one of the merging parties. The fact that the total consolidated entity's revenue requirement is lower than the combined revenue requirements of the two utilities under a status quo standalone scenario means little to the utilities' customers whose rates will be higher upon rebasing as a result of the transaction.

The question is, how to address it? SEC submits that the OEB must consider both revenue and rates. The way to ensure there is no harm for customers of one utility, even if there is no harm by looking at the consolidated entity's overall revenue requirement compared to the status quo standalone scenario, is by focusing on the question of the appropriateness of rate harmonization. While this will primarily be an issue for rebasing, it is important that there is some discussion of this during the MAADs application process, so that, at the very least, the utilities are considering the issue.

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[9] Discussion Paper, p.14-15
[10] Handbook to Electricity Distributor and Transmitter Consolidations (January 19, 2016), p.6
[11] Discussion Paper, p.15
[12] *Ontario Energy Board Act*, section 1(1)1

This is why the proposal in the Discussion Paper that the filing requirements be updated to provide the opportunity, although not the obligation, for utilities in MAADs applications to discuss preliminary plans for rate structures and harmonization is insufficient.[13] The OEB should require all MAADs applications to include such information. The application should show a viable plan, to ensure that rates for neither utility's customers will be higher as compared to the status quo standalone scenario.

At the same time, since the question of whether rates should or should not be harmonized, and if so, how and when, will ultimately be decided at rebasing, it is important that the MAADs Handbook make it clear that the rebasing decision will also be infused with the no-harm principle even though it will be part of a rates proceeding. If the OEB is not willing to do so, then it must consider the issue upfront during the MAADs application process to properly discharge its duty, but that will result in its own issues.

Deferred Rebasing Period

The Discussion Paper notes that one of the key takeaways from meetings with utilities is that they seek greater flexibility to change their initially chosen deferred rebasing period. In response, OEB Staff points to the existing wording in the MAADs Handbook, which provides that a consolidated entity may request to rebase earlier than it had proposed as part of its MAADs Application, or even later (if the deferred rebasing period was less than 10 years).[14] It has also proposed some clarifying language.

The current policy, as set out in the MAADs Handbook, and the proposed re-wording, are both unfair to customers. A consolidated entity is being given the opportunity to request to rebase early, presumably because of the need to increase rates, and also given the opportunity to request to defer rebasing and the need to pass on merger savings to customers. For the consolidated entity, it can seek to rebase or defer when it suits them vis-a-vis its customers. This is entirely unfair. The OEB allows a consolidated entity, during the MAADs approval, without a requirement for any justification, to determine its deferred rebasing period, up to 10 years. Absent, extraordinary circumstances, it should be held to the period it sought.

SEC accepts that some flexibility is required to deal with an unlikely situation where the deferred rebasing period has a significant impact on reliability or quality of service, and without the necessary funds it would put the financial viability of the consolidated entity at risk. Both the current and proposed wordings do not provide any guidance. Since the Discussion Paper seems to indicate that some utilities are seeking broad leeway to change the deferred rebasing period, the OEB should outline its expectations that a change will require exceptional circumstances.

With respect to extending the deferred rebasing period, if a period of less than 10 years was initially chosen, similarly, there may be circumstances where that should be permitted. However, as that is likely to result in further delay in passing on merger savings to customers, as a matter of fairness, additional ratepayer protection mechanisms may need to be implemented in such a situation. For example, the ESM deadband (300 basis points) or level of sharing (50/50) may need to be adjusted. This should also be set out in any MAAD Handbook revisions.

[13] Discussion Paper, p.27
[14] Discussion Paper, p.20-22

Group 2 DVA Disposition and Accounting Policy Changes

Group 2 Disposition Timing. OEB Staff proposes that if a deferred rebasing period is longer than five years, a utility should bring forward a plan as part of the MAADs application for disposition during the deferred rebasing period (e.g., at the midpoint) to mitigate intergenerational equity concerns. For utilities with deferred rebasing periods less than 5 years, they would have flexibility to propose disposition before they rebase.[15]

SEC agrees that the length of the deferred rebasing period is an important consideration for when Group 2 DVAs should be disposed of, but just as important is how long since the consolidated utilities last rebased. Often, consolidated utilities have already been on IRM for a number of years and have accumulated significant Group 2 DVA balances. As part of the MAADs application, all utilities should provide a plan for Group 2 DVA disposition, in light of both existing and forecast account balances. The OEB should also require, as part of the MAADs application, information on existing account balances. As a matter of regulatory efficiency, the OEB could in many cases leverage the MAADs proceeding itself to dispose of existing Group 2 balances.

Accounting Policy Changes. The OEB Staff proposes that as part of all MAADs applications, the default expectation is that a consolidated utility will be required to establish an account to record the impact of accounting policy changes.[16] After the consolidated entity has completed its assessment of accounting changes, it may propose to close the account in the next IRM where the audited balance is not material.[17]

SEC agrees with the requirement to establish such an account but disagrees that the account should be closed, even if the amounts included are not material, through an IRM application. At that point, intervenors will not be given an opportunity to assess what accounting changes had or should have occurred, and what balance should (or should not) be included in the account. Upon review, it may be determined that the account should have included a material balance, for example, through a credit to ratepayers that a utility had not included.

What balances, if any, to include in an accounting policy changes deferral account have been contested?[18] Once the account is closed, the presumption against retroactive ratemaking applies, and it may be too late to make a correcting adjustment. The appropriate time to consider closure of any accounting policy changes deferral account is at rebasing, not before.

Service Quality Reporting

In contrast to its proposal with respect to reliability reporting, the Discussion Paper proposes that service quality metrics be reported on a consolidated basis amalgamation. It appears to propose this on the basis that cost of tracking and reporting service quality metrics outweighs the potential benefits. It is difficult to understand this conclusion.

It is not apparent to SEC that the additional costs to track service reliability by rate zone come close to being material and that they outweigh the benefits. All that changes is that existing data would be

[15] Discussion Paper, p.43
[16] Discussion Paper, p.43
[17] Discussion Paper, p.44-45
[18] See for example, *Decision and Order* (EB-2017-0024), April 6, 2018, p.77-82; *Decision and Order* (EB-2022-0200), December 21, 2023, p.101-107

split by rate class. As all service quality data derives from specific customers, and the utility has the rate zone of that customer readily available as it needs it for billing purposes during the deferred rebasing, there is no need for expensive new systems or anything of that nature. The benefit is to track service quality pre and post consolidation. In support of the lack of benefit of such tracking, the OEB states that it would "be difficult for consolidated distributors to determine if any decrease in achieved results are because of the consolidation or because of some other factor".[19] It is not clear why that would be any different than any other rate zone specific reporting, including reliability, which the OEB Staff proposes to require be done on such a basis. The Auditor General's recommendations for merging entities to report on their performance metrics separately from the consolidated basis were not specific to only reliability.[20]

Tracking

The OEB should explicitly require utilities, where it can reasonably be done, to track costs incurred during the deferred rebasing period by rate zone, not simply on a consolidated basis. This information is not just important regarding the impact of any harmonization of accounting policies, but for future rate harmonization. Once utilities consolidate reporting, it becomes very hard, if not impossible, to properly segregate asset costs which may be important if post-deferral period, the consolidated is required to charge different rates by rate zone.

As an example, in Synergy North's first cost-of-service application after its deferred rebasing period, it proposed to harmonize the rates of its predecessor utilities (Thunder Bay and Kenora). Since Synergy North did not track costs on a rate zone basis, it was essentially impossible to consider other ratemaking options. When asked what it would do if the OEB ordered it to operate as two separate rate zones, Synergy North explained that it would have to retroactively separate all spending by UsoA Account for the two rate zones, which would be costly and difficult.[21]

SEC recognizes that with respect to certain costs, it may be difficult to track on a rate zone basis with perfect specificity, for example centralized OM&A programs. However, with respect to capital assets put in-service and rate base, that information can be done more easily. For those other types of costs, allocations can be developed to reasonably approximate to which rate zone they should be attributed.

Earning Sharing Mechanism

An ESM remains an important mechanism as part of any MAADs approval to ensure that customers are protected from a utility earning an inappropriately large return, and thus no longer becoming unjust and unreasonable. An ESM is especially important in a framework that allows the consolidating utilities the ability, without any justification, to defer rebasing for up to 10 years.

The one aspect of the current framework that warrants re-examination is the requirement for the ESM, only, if a consolidating entity defers rebasing beyond 5 years. If the policy, as OEB Staff says, is "balances the opportunity for the consolidated utility to accrue some net savings to shareholders while still protecting ratepayer interest," then there is no reason that this only begins in year 6 after the merger.[22] This is especially true when utilities coming into an amalgamation have not rebased in a

[19] Discussion Paper, p.35
[20] Office of the Auditor General - Value for Money Audit: *Ontario Energy Board: Electricity Oversight and Consumer Protection*, November 2022, p.33
[21] See EB-2023-0052, Interrogatory Response 8-SEC-28(d)
[22] Discussion Paper, p.47

number of years, and are delaying passing on to customers any savings that were achieved separately before then. The ability for a distributor to keep net savings is still achieved by the very high 300 basis point deadband.

SEC therefore believes that the ESM should be required for all years after a MAADs approval.

Mid-Term Progress Report

SEC supports the requirement that utilities electing to defer rebasing for more than 5 years provide a detailed mid-term progress report.[23] The report should be made available to the public on both the OEB and the consolidated entities' websites.

While SEC takes no issue with the OEB Staff's suggested information to be included in that report, missing from the list is information on its actual costs as compared to what is forecasted as part of its MAADs application. The OEB should require the consolidated entity to provide its actual revenue requirements, on the same basis that OEB Staff is recommending it be required to justify that it has met the no-harm test (see p.17 of the Discussion Paper). The consolidated entity should also provide a variance analysis to explain any material differences. This is important for both the public and the OEB to monitor progress, and as an early warning sign of trouble. Providing progress on efficiency forecast vs. achieved is important, but so is understanding if the merger has brought upon additional costs that were not part of the MAADs application forecast.

Z-Factor Materiality Threshold

The Discussion Paper appropriately proposes that when a consolidating utility, and its predecessors, have not rebased for more than 5 years, the materiality threshold for a Z-Factor should be adjusted to reflect the impact of IRM adjustments and growth in demand.[24] Yet, it does not provide a specific mechanism that would do so, it simply says that an Applicant for a Z-Factor should reflect it in its materiality threshold. While that is easy to do with respect to IRM adjustment, it is more complicated when calculating growth in demand.

SEC submits one approach is to apply the OEB's defined materiality thresholds to a utility's previous year weather-normalized revenue, which would be a proxy for its consolidated most recent Board-approved revenue requirement adjusted for the impacts of IRM and demand growth.

ICM Materiality Policy

The OEB Staff is seeking comments, in advance of its broader review of the ICM Policy, on a potential need to change the inflation rate used to calculate the ICM materiality threshold value.[25] The issue arises because of the nature of the ICM model, which assumes that the current year OEB inflation value is the same and had been part of each Price Cap Index adjustment since rebasing. In the past, this was close to being correct. As a result of the recent higher-than-historic inflation rates, the materiality threshold may not reflect what can be funded in base rates.[26]

[23] Discussion Paper, p.47
[24] Discussion Paper, p.40
[25] Discussion Paper, p.41-42
[26] *Decision and Order* (EB-2023-0004), February 13, 2024, p.10

SEC submits that no changes should be made to the ICM materiality threshold calculation in advance of the expected full policy review. The Price Cap Index adjustment in the ICM materiality threshold calculation is not the only simplification in the ICM model, and not the only way that it assumes long-term stability as opposed to short-term volatility. If changes are going to be ordered to the model to increase eligible ICM capital, it is likely also appropriate to review whether there are other changes to the model that should be considered, particularly if they would decrease eligible ICM capital or would also be driven by changing economic circumstances.

In its recent decision in Alectra's ICM application, the OEB came to a similar conclusion. In denying Alectra's proposal to use the geometric mean for the inflation factor, it noted that the "inflation factor is but one parameter in a complex formula" and that it was "not prepared to alter a single parameter in isolation."[27] Notwithstanding those findings, it provided what it recognizes as an "exceptional remedy in these specific circumstances" and removed the required materiality threshold.[28]

This is the correct approach. OEB panels, as they always can, can provide exceptional remedies and deviate from OEB policy when the circumstances arise in an application based on specific evidence.

The OEB has already significantly expanded ICM eligibility for consolidated entities recently, with the ability for incremental funding for annual capital programs during years six to ten of the deferred rebasing period under certain criteria.[29] Further expansion through a change in the ICM materiality threshold is not needed.

Summary

SEC believes that several changes are required to the OEB's MAADs Handbook and policy to ensure customers are protected from utility consolidations. Implementation of these changes will ensure that customers are not harmed and have the opportunity to benefit.

Yours very truly,
Shepherd Rubenstein P.C.

Mark Rubenstein
2024.03.06 14:21:59-05'00'

Mark Rubenstein

cc: Brian McKay, SEC (by email)

[27] *Decision and Order* (EB-2023-0004), February 13, 2024, p.10
[28] *Decision and Order* (EB-2023-0004), February 13, 2024, p.11
[29] OEB Letter Re: Incremental Capital Modules During Extended Deferred Rebasing Periods (February 10, 2022), p.2