

March 6, 2024

Nancy Marconi  
Registrar  
Ontario Energy Board  
2300 Yonge Street  
P.O. Box 2319  
Toronto, Ontario  
M4P 1E4

Dear Ms Marconi:

**EB-2023-0188 – Evaluation of Policy on Utility Consolidations - Submissions of the Consumers Council of Canada**

Please find, attached, the Submissions of the Consumers Council of Canada pursuant to the above-referenced consultation process.

Please feel free to contact me if you have questions.

Yours truly,

**Julie E. Girvan**

Julie E. Girvan

CC: All parties

## **SUBMISSIONS OF THE CONSUMERS COUNCIL OF CANADA**

### **RE: OEB STAFF DISCUSSION PAPER – EVALUATION OF POLICY ON UTILITY CONSOLIDATIONS**

**EB-2023-0188**

#### **INTRODUCTION:**

On July 27, 2023, the Ontario Energy Board (OEB) issued a letter establishing its Evaluation of Policy on Utility Consolidations consultation. Following a series of meetings with industry stakeholders during August and September 2023, on February 8, 2024, the OEB posted an OEB Staff Discussion Paper (the Paper) as the next step in the consultation to review and update the OEB's Handbook to Electricity Distributor and Transmitter Consolidations (MADDs Handbook) and associated Filing Requirements for Consolidation Applications.

In the Paper OEB Staff are not proposing any major changes to the MADDs Handbook and or filing requirements for consolidation applications. The proposals are primarily related to areas of clarification on current policy, evolving language and additional detail required as part of MADDs applications. In addition, net new requirements have been proposed to address recommendations outlined in the Auditor General of Ontario's Value for Money audit report, Ontario Energy Board: Electricity Oversight and Consumer Protection dated November 9, 2022 (AG Audit report).<sup>1</sup>

These are the submissions of the Consumers Council of Canada (Council). The Council has organized its submissions according to the headings set out in the Paper after setting out some general observations. The Council is generally supportive of the changes proposed by OEB staff, and the approach to largely clarify the current MADDs Handbook and Filing Requirements with a few exceptions.

#### **SUBMISSIONS:**

##### **General Comments:**

- OEB staff notes 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. OEB staff concludes, "while consolidation is not the only way to meet these challenges, enhancing utility capabilities may be either addressed through the economies of scale resulting from further consolidation in the electricity sector. It is

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<sup>1</sup> The Paper, dated February 8, 2024, p. 2

with this perspective that OEB staff has formed its recommendations.” While some utility consolidations may result in efficiencies and improved customer service the Council submits that at times this may not be the case. Consolidation does not necessarily lead to lower cost structures and reduced rates. This is important in the context of revising the MADDs Handbook and Filing Requirements as they pertain to consolidations. The OEB should only approve consolidations and acquisitions if the applicant or applicants can clearly demonstrate and commit to the principle that the utility customers will be better off and at a minimum not worse off following the transaction. Each transaction must be considered on a case-by-case basis and it should not be assumed that larger utilities are necessarily better for customers.

- The Council is of the view that utility acquisitions and consolidations should be clearly about benefitting ratepayers and not undertaken to enhance the returns of the regulated utilities at the expense of their customers. Consumer protection must be a paramount consideration for the OEB when considering whether to approve a transaction.
- The Council is of the view that Earnings sharing mechanisms (ESMs) should be a requirement for all utilities that undergo an acquisition or consolidation. As set out below an asymmetric ESM should be put in place in the first year of the deferred rebasing period as an important consumer protection mechanism. It will ensure that savings achieved by the transaction are appropriately shared between the utility and its ratepayers prior to rebasing.
- The Council does not support continuation of a 10-year rebasing period. The maximum allowable period should be five years. There has been no clear evidence that LDCs need 10 years to fully recover transition and transaction costs. Also, in the context of a changing energy landscape much will change over the next 10 years, and the OEB will need to assess the underlying cost structures of the LDCs to ensure rates are just and reasonable.
- The Council supports a fresh look at the OEB’s Incremental Capital Module (ICM) policy. It has evolved since it was initially developed, yet in many cases the ICM requests are disputed and litigated. If greater clarity was established the need for such litigation would be significantly reduced.

#### **No-Harm” Test:**

OEB Staff supports the continuation of the “no harm” test in assessing proposed consolidations. In the Paper OEB staff states:

- OEB Staff acknowledges that “to demonstrate ‘no harm’ the requirements of the 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”, 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 consolidations costs 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 enhances utility capabilities.<sup>2</sup>

OEB staff, in acknowledging that both quantitative and qualitative benefits should be considered in the now harm test propose that the MADDs Handbook be updated to include language which clarifies that quantitative and qualitative information included in an 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.<sup>3</sup>

The Council supports the continuation of the “no harm” test and the inclusion of qualitative considerations. As part of the “no harm” test the OEB should look at what may happen upon rebasing. There is a concern that upon rebasing the lower cost utility customers may see rate increases if rate harmonization is proposed. The OEB should be explicit about the fact that the “no harm” test will be assessed in the context of potential rate harmonization. Utilities must demonstrate that under rate harmonization customers will not have higher rates than they would have had the status quo prevailed – and be prepared to commit to this upon rebasing. The OEB needs to consider “no harm” when approving the transaction as well as upon rebasing, particularly if the OEB maintains the option for a 10-year deferred rebasing period.

### **Cost Structures:**

OEB staff points out “cost structures” has not been defined in the MADDs Handbook. OEB staff also states 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 have done in support of the proposed consolidation. Accordingly, OEB staff has proposed, “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.”<sup>4</sup>

In addition, OEB staff is proposing a requirement for applicants to provide year over year comparative revenue requirement analysis for the proposed transaction comparing the costs of

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<sup>2</sup> Ibid, p. 12

<sup>3</sup> Ibid, p. 13

<sup>4</sup> Ibid, p. 15

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.<sup>5</sup>

The Council supports the OEB recommendations regarding the year over year revenue requirement analysis. This should include forecasts of the annual cost based revenue requirement under the status quo and under a consolidation scenario. That will allow for an appropriate comparison for the OEB at the time of the application and upon rebasing. In addition, the OEB should require the LDCs to present rate analyses. At the time of rebasing LDCs should be required to demonstrate that the rates proposed are not higher than the rates that would have resulted under a status quo approach. If the rates under a consolidated scenario are higher than those that would have resulted from the status quo, the OEB may make adjustments to ensure the “no harm” principle is adhered to.

### **Deferred Rebasing Period**

The current OEB policy permits consolidating distributors to defer rebasing for up to 10 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 10 years). No supporting evidence is required to justify the selection.<sup>6</sup>

OEB staff is proposing to maintain this policy. The OEB notes that it has yet to adjudicate on a rebasing application following consolidation in which a ten-year deferred rebasing period has been elected. OEB staff is of the view that the current policy strikes an appropriate balance between the incentives provided to utilities and the protection provided to customers<sup>7</sup>. The Council disagrees.

The Council is of the view that there is no evidence that LDCs need 10 years to recover their transaction and transition costs. To the extent these are recovered and savings are generated the savings largely accrue to the shareholders. It is only if, after year 5, the return on equity exceeds the approved ROE by 300 basis points that customers share in any savings. We are not aware of any case where this threshold was exceeded and the ESM triggered. The ESM as structured does nothing for customers.

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<sup>5</sup> Ibid, p. 15

<sup>6</sup> Ibid, p. 20

<sup>7</sup> Ibid, p. 21

OEB staff is also proposing to change the wording in the MADDs Handbook to make it less rigid in terms of selecting a different deferred rebasing period than what was approved in the transaction proceeding. A utility that selected a ten-year rebasing period can apply to come in earlier as long as it provides a sufficient reason for the request. In addition, consolidated entities can to extend its selected deferred rebasing period.<sup>8</sup>

The Council submits that the ability for LDCs to change their deferred rebasing period advantages the LDCs at the expense of their ratepayers. If LDCs choose to rebase earlier than proposed they are likely doing so to increase rates. It is obviously not because they want to pass on savings to their customers earlier or reduce rates. If they are choosing to delay their rebasing beyond their selected period it is likely because they have efficiencies and savings beyond what they expected and are seeking to delay passing on those savings to their ratepayers.

In addition, the proposal allows utilities to choose an earlier or later rebasing, but not their ratepayers. Ratepayers are definitely at a disadvantage in this regard, and potentially subject to higher rates sooner than expected or denied access to the savings generated by the transaction. Only in exceptional circumstances should the LDCs not be held to their proposed deferred rebasing period.

#### **Future Rate Structures:**

The MADDs 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.”

OEB Staff proposes that the MADDs Handbook and filing requirement for consolidation applications be undated 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 the 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<sup>9</sup>.

OEB staff proposes that the MADDs 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 entity 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.

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<sup>8</sup> Ibid, p. 22

<sup>9</sup> Ibid, p. 25

From the Council's perspective utilities should be required, in the transaction application make clear its intent with respect to rate harmonization. This will assist in the assessment of the "no harm" test as set out above.

### **Performance Metrics and Reporting:**

With respect to performance metrics and reporting OEB staff referred to the AG Audit Report. In that report the AG recommended the OEB:

- 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
- Require acquired and merged entities to continue to report on any key performance measures (for example, reliability metrics) separate from the consolidated entities during deferred rebasing periods to create greater transparency.<sup>10</sup>

OEB staff supported monitoring of post-consolidation activities before the end of the deferred rebasing period as being warranted and beneficial. OEB staff proposed a mid-term report for those LDCs that elect to defer rebasing for more than five years. OEB staff set out the following:

- 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 toward 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. 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.<sup>11</sup>

In addition, OEB staff recommended that 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 applications.<sup>12</sup>

The Council supports these recommendations. In addition, the Council supports the proposal to provide feeder level reliability information as proposed by OEB staff where possible. With

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<sup>10</sup> Office of the Auditor General – Value for Money Audit: Ontario Energy Board Electricity Oversight and Consumer Protection, November 2022, pp. 43-44

<sup>11</sup> The Paper, p. 30

<sup>12</sup> Ibid, p. 31

respect to service quality metrics the Council supports reporting on service quality by predecessor utility throughout the term of the plan. This will assist parties at the time of the consolidated entity's rebasing application to determine if any degradation in the metrics occurred post consolidation. This is also consistent with the proposal to include qualitative considerations in the implementation of the "no harm" test.

### **Cost Recovery Treatment for Transaction, Transition/Integration Costs**

It is OEB policy that incremental transaction and integration costs are not generally recoverable through rates because consolidation proposals are primarily a business decision of management of utilities involved and affected ratepayers have little, if any, input or control of the proposed transaction. OEB staff noted that exceptions have been approved despite the overall policy. Accordingly, OEB staff are recommending:

- 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.<sup>13</sup>

The Council supports maintaining the principle that incremental transaction and integration costs should not generally be recoverable through rates. Although exceptions may be granted the onus will clearly be on the utility to demonstrate why ratepayers should be required to fund these costs.

### **Incremental Capital Funding Availability to Consolidated Utilities**

The Council agrees with the OEB staff proposal to include an additional filing requirement to note any known or reasonably anticipated future ICM in a consolidation application. This would include a description of the nature of the project and the expected timing.<sup>14</sup> The Council also agrees with the proposal to include language to the MADDs Handbook to note if, during its deferred rebasing period, a consolidated utility finds that it has significant capital needs that cannot be accommodated by an ICM it should consider rebasing<sup>15</sup>.

The OEB intends to consider the ICM policy in its entirety as part of a separate consultation. The Council fully supports this and is of the view it should be done as soon as possible. The application of the ICM has changed over the years and evolved significantly since it was first developed. A wholesale review of what the purpose of the ICM is, its applicability and whether it represents an appropriate ratemaking tool is appropriate.

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<sup>13</sup> Ibid, p. 36

<sup>14</sup> Ibid, p. 39

<sup>15</sup> Ibid, p. 40



## Earnings Sharing Mechanisms (ESMs)

The current ESM is structured so that excess earnings that are to be shared with customers on a 50:50 basis for all earnings more than 300 basis points above the allowed ROE. This is to be done annually. The MADDs Handbook also noted that applicants are invited to propose an alternative ESM that better achieves the objective of protecting consumer interests during the deferred rebasing period. The Council is not aware of any utility on a deferred rebasing plan that has shared earnings under an ESM. In addition, the Council is not aware of any alternative ESM proposals.

OEB staff supports the continued form of ESM as set out in the MADDs Handbook as the default method and supports the flexibility for utilities to propose an alternative ESM that better achieves the objective of protecting customer interests during the deferred rebasing period.<sup>16</sup>

The Council is of the view that ESMs should be a requirement for all utilities that undergo an acquisition or consolidation. An asymmetric ESM should be put in place in the first year of the deferred rebasing period as an important consumer protection mechanism. Earnings beyond 100 basis points should, from our perspective be shared on a 50:50 basis. It will ensure that savings achieved by the transaction are appropriately shared between the utility and its ratepayers prior to rebasing.

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<sup>16</sup> Ibid, p. 47