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March 6, 2024 **VIA RESS**

Nancy Marconi
Registrar
Ontario Energy Board
2300 Yonge Street
Toronto, ON
M4P 1E4

Dear Ms. Marconi:

Re: EB-2023-0188 – Evaluation of Policy on Utility Consolidations
OEB Staff Discussion Paper
Comments of the Vulnerable Energy Consumers Coalition (VECC)

Please find attached VECC's comments on the above referenced matter, pursuant to the Board's letter of February 8, 2024.

VECC appreciates the opportunity to provide comments on OEB Staff's proposals and looks forward to participating further in the Board's evaluation of its policy on utility consolidations. Please contact me if any clarification is required (bharper.consultant@bell.net).

Yours truly,

William Harper
Consultant for VECC/PIAC

cc. J. Lawford, PIAC

EVALUATION OF POLICY ON UTILITY CONSOLIDATIONS (EB-2023-0188)

VECC'S COMMENTS RE: OEB STAFF DISCUSSION PAPER

1. INTRODUCTION

On July 27, 2023, the Ontario Energy Board (OEB) launched a consultation with stakeholders to review and update the OEB's Handbook to Electricity Distributor and Transmitter Consolidations (MAADs Handbook), and associated Filing Requirements for Consolidation Applications. During the latter part of 2023 OEB staff held a series of meeting with both utilities and intervenors designed to gather input regarding past experiences in filing and participating in consolidation applications and comments regarding the current elements of the OEB's MAADs Handbook and filing requirements.

Subsequently, an OEB staff Discussion Paper (the "Discussion Paper") was released on February 8, 2024 summarizing the comments received and setting out OEB staff's proposals for potential changes to the MAADs Handbook and filing requirements. Stakeholders were requested to provide feedback and to structure their comments in accordance with the headings as noted in the Paper.

Prior to setting out our detailed response to Board Staff's Discussion Paper we think it important to set out our general comments with respect to MAADs applications and policies to address them.

The first is that it is important to note that neither the Board, nor any other party has yet to provide a detailed and rigorous study which would demonstrate that there are economies of scale to be found in further consolidations of utilities in Ontario. In fact, as noted by the Auditor General in their Report of November 2022[1] it appears that on average smaller LDCs are actually more efficient than the larger. For those reasons we do not believe that Ontario utilities need to be provided regulatory incentives or any form of "enhanced" treatment that would have the Board depart from accepted regulatory practice in order to achieve further consolidation.

The second point is that the current and presumably the anticipated amended MAADs guidelines are not binding on any specific panel in any particular proceeding. That is, they are not promulgated under the Board's rule making authority and therefore individual panels retain the responsibility of determining the best course of action based on the facts at hand. This includes how many, if any, years of rate review exclusion ("rebasing deferral") is in the public interest. When the Board provides utility management with the expectation that they will not be subject to the normal rate making scrutiny it also makes a commitment to the public. If after 10 years it should become clear that a significant portion of ratepayers are now worse off then the public interest has been ill served. Ten years is a very long time.

Finally, as we note in the details of our submission VECC has two overarching concerns with what has become the current practice with regard to consolidations. The first is the deferral of the question of rate harmonization to a time after the approval of a consolidation. This is problematic and for two reasons. First, it provides ratepayers

[1] Ontario Energy Board:Electricity Oversight and Consumer Protection

with no understanding as to the likely eventual structure and level of the rates they will have to pay. The second, and more important, is that when the Board defers the question of harmonization it generally implicitly approves a future harmonization. This is because without Board direction as to the expected accounting there will be no financial record basis under which to create different rate zones. It is unclear to us why the Board would give its implicit (or explicit) approval to future harmonization, particularly in cases where the two utilities do not form a contiguous territory. Indeed, it is not clear to us why, with the appropriate foresight the service areas that are widely distant from each other should not form two separate rate zones. For example, after consolidation under the banner of Synergy North Corporation the service territories of Thunder Bay and Kenora remain 500 km away from each other. To make the point, had Manitoba Hydro purchased Kenora Hydro (only 200km away) we doubt the Board would assume rate harmonization was in order.

The second practice we have come to see is the use of incremental capital modules to in essence "bridge the gap" when a utility is out from under the scrutiny of establishing cost of service rates. As we have noted in other proceedings ratepayers lose most if not all of the operating cost efficiencies during a deferral period while ways are seemingly found to ensure they pay for incremental capital requirements. While we think this to be a lose-lose situation for customers it may also be simply unreasonable to expect a utility to be able to accommodate 10 years' worth of changing capital needs, especially in the era of "energy transition." If so, this fact should be recognized by the Board.

Set out below are VECC's comments.

2. VECC'S COMMENTS

As requested, VECC's comments are provided based on the headings used in the Discussion Paper.

2.1. NO HARM TEST

In the Discussion Paper OEB staff indicates that it "*supports the continuation of the "no harm" test in assessing proposed consolidations*"[2]. However, the Discussion Paper goes on to state:

> *"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"[3].*

[2] Page 12
[3] Page 12

Accordingly OEB staff proposes that "*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*"[4]. It also calls for the MAADs Handbook to clarify 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*"[5].

The OEB statutory objectives include "to inform consumers and protect their interests with respect to prices and the adequacy, reliability and quality of electricity service"[6]. As a result, VECC agrees with OEB staff that the "no-harm test" needs to consider more than just the impact of the consolidated utility's cost structure and its implications regarding the price of electricity service. However, any other considerations included in the OEB's decision regarding the appropriateness of an application for consolidation must be linked to the OEB's statutory objectives. In this regard, VECC submits that considerations (of either a quantitative or qualitative nature) related to issues regarding the adequacy, reliability or quality of electricity service are all relevant.

As noted in the Discussion Paper[7], the consideration of a proposed consolidation's cost structures is important as these are ultimately translated into rates that will be borne by ratepayers. However, the consolidated utility's approach to rate harmonization will also impact the rates ultimately borne by ratepayers. In the sections of the Discussion Paper dealing with Future Rate Structures and Rate Harmonization 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."*[8]
>
> And
>
> *"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".*[9]

VECC agrees that the consolidation applications should include a statement indicating whether the consolidated utility intends to undertake rate harmonization at the time of

[4] Page 13
[5] Page 13
[6] Page 54
[7] Page 12
[8] Page 25
[9] Page 26

rebasing. In those circumstances where the applicant does not intend to undertake rate harmonization, the applicant should be required to maintain separate financial records for each of its rate zones and demonstrate that its plans regarding cost allocation will ensure that any benefits arising from reduced cost structures are fairly shared across all rate classes.

Where the utility does intend to harmonize rates, it is VECC's submission that, as well as requiring a brief description of the plan, the MAADs Handbook and filing requirements for consolidation applications should require applicants to demonstrate that either: i) its proposed plans for rate harmonization will not lead to higher rates for any customers than would have existed under the status quo or ii) where higher rates may occur for some customers this "harm: is more than offset by the other benefits of consolidation such that the "no-harm test" is satisfied in aggregate. Depending upon the adequacy of the applicant's evidence of "no harm" due to rate harmonization the Board should, if necessary, require the consolidated utility to maintain separate financial records for each of its rate zones. This will enable the Board to assess the implications of rate harmonization at the time of the consolidated utility's rebasing.

Finally, it is VECC's view that, in the case of non-contiguous service areas, the assumed default should be the maintenance of distinct rate zones with the consolidating utility having the obligation to demonstrate why rate harmonization is more appropriate.

2.2. COST STRUCTURES

The Discussion Paper notes that while the MAADs Handbook uses the term "cost structures", this term is not defined in either the MAADs Handbook or the filing requirements. However, the Discussion Paper notes that most utilities and intervenors consulted recognized revenue requirement as a suitable statistic for comparisons between the proposed consolidation and the "status quo" stand-alone scenarios when detailing cost structure analyses[10]. Overall, 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[11]. VECC agrees.

With respect to consolidation applications, the OEB staff proposes that:

> *"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"[12].*

The Discussion Paper also proposes that:

> *"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. Utilities should also document any assumptions*

[10] Page 14
[11] Page 15
[12] Page 15

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"[13].

VECC considers both of these proposals to be appropriate. In particular, requiring applicants to fully document the assumptions underlying the revenue requirement forecasts under the consolidation and status quo scenarios will assist both OEB staff, intervenors and, ultimately, the OEB Panel considering the application in assessing the reasonableness of the associated revenue requirement forecasts. In addition, as noted below, it will also assist parties (again including the OEB) in understanding any variances between the forecasts provided with the consolidation application and future forecasts submitted at the time of the consolidated utility's rebasing application.

The Discussion Paper notes that some utilities raised concerns about preparing forecasts for the deferred rebasing period, particularly given the changing environment (e.g., energy transition)[14]. To help address this concern, OEB staff proposes adding the following paragraph to the updated MAADs Handbook[15]:

"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."

VECC has no issues with this proposed addition. However with respect to the concern utilities expressed regarding the ability to forecast costs over the deferral period, VECC notes that: i) it is the responsibility of the applicant to demonstrate the proposed consolidation is consistent with the OEB's objectives and ii) the choice[16] of the deferral period rests entirely with the applicant. If the applicant feels unable to reasonably forecast costs for a 10 year deferral period, then it is open to the applicant to propose a shorter or no deferral period.

OEB staff also 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"[17].

[13] Page 17
[14] Page 18
[15] Page 18
[16] Page 21
[17] Page 19

At pages 16-17 of the Discussion Paper OEB staff has provided an example of the revenue requirement analysis it would expect applicants to provide. However, VECC notes that, with the exception of the COS years, the analysis does not provide the anticipated future revenue requirements for the consolidation and status quo (i.e. standalone) scenarios based on forecast costs. Rather for the ICM years the analysis sets out an implicit revenue requirement based on assumed load and customer growth and assumptions regarding future annual IRM adjustments. The result is that there is no individual year for which a comparison of the revenue requirements under that status quo and consolidation scenarios can be made based on forecast costs. To address this shortcoming the applicant should be required to also provide forecasts of the annual cost based revenue requirements under both scenarios up to and including the future rebasing year. At the same time, VECC also sees value in the analysis proposed by OEB staff. Of particular value is the anticipated increase in the revenue requirement at the time of the consolidated entity's next rebasing.

The Discussion Paper also notes[18] that, 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*".

VECC strongly supports this proposal and agrees with that such information is critical in addressing relevant questions such as those noted in the Discussion Paper[19] as to:

- 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?

2.3. DEFERRED REBASING PERIOD

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"***. However, for purposes of clarity, 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*". For example, for a consolidation that is completed sometime in 2024, with a five-year deferral period, the applicants would indicate whether rebased rates would be effective for 2028 or 2029.[20]

VECC concurs with the need for clarity, at the time of the consolidation application, as to when the applicant proposes to next rebase.

OEB staff's rationale for not limiting the rebasing period to less than 10 years is based on the fact that as OEB has yet to adjudicate on a rebasing application following

[18] Page 19
[19] Page 19
[20] Page 21

consolidation in which a ten-year deferred rebasing period had been elected, it is premature at this time to do so.

In VECC's view a more telling indication of whether the rebasing period should be limited to less than 10 year would be to analyze the recent reported returns on equity that have been achieved by those utilities that have consolidated more than five years ago.

Furthermore, VECC notes that a number of consolidated utilities (e.g., Alectra Utilities: EB-2023-0004) have found it necessary to apply for ICMs during their extended rebasing period. This not only suggests that 10 years is probably too long but also leads to a situation where ratepayers do not fully benefit from any of the efficiencies achieved during this period but are required to pay for incremental capital investments. To address this VECC recommends that, going forward, consolidating utilities requesting deferral periods of longer than five years be required to provide evidence demonstrating why a longer deferral period is required in order to allow them to recover the costs of consolidation.

OEB staff proposes that the wording in the MAADs Handbook be changed to make it clear that consolidated utilities have the option to, with supporting rationale, request either earlier rebasing (after year four) than proposed in its consolidation application or extension (up to 10 years overall) of the deferral period proposed in its consolidation application.

VECC's concern with the proposed wording changes is that the original wording made specific reference the OEB needing to "to understand whether any change to the proposed rebasing timeframe is in the best interest of customers"[21] and this point does not appear to have been carried over in the revised wording.

The Discussion Paper also addresses the matter the deferred rebasing period in the case 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). OEB staff proposes that this issue be dealt with on a case-by-case basis and that[22]:

> "*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*

[21] Page 22
[22] Pages 23-24

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."

VECC believes that applicants should not be able to "stack up" rate deferral periods. This is especially true in the case where the utilities are of very unequal size. It seems to us that the Board's decision on this must include the relative size of the transacting parties. For example, on the face of it there is little rationale to argue that a utility of say 500,000 customers should receive cost of service deferral for 10 years because of its consolidation with one of 5,000 customers.

We also hold that the time between transactions is an important input in the Board's consideration. To make the point utilities undergoing consolidations over a short term of year of two are very different from one that is 9 years apart. At a minimum the Board's guidelines should make clear that multiple deferrals would be the exception. .

2.4. FUTURE RATE STRUCTURES

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*."[23]

In VECC's view consolidation applications should be required to address the issues related to future rate structures (i.e., new rates classes) or cost allocation (i.e., plans for unique treatment of certain classes) where such plans are anticipated to impact the applicant's ability to satisfy the "no harm" test. As discussed previously, in VECC's view consideration of the no harm test requires consolidation applicants to demonstrate that either: i) their proposed plans for rate harmonization will not lead to higher rates for any customers than would have existed under the status quo or ii) where higher rates may occur for some customers this "harm: is more than offset by the other benefits of consolidation such that the "no-harm test" is satisfied in the aggregate.

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."*[24]

Again, as previously noted, it is VECC's view that in instances where the intent is to ultimately harmonize rates the no harm test requires consolidation applicants to demonstrate that either: i) their proposed plans for rate harmonization will not lead to

[23] Page 25
[24] Page 26

higher rates for any customers than would have existed under the status quo or ii) where higher rates may occur for some customers this "harm: is more than offset by the other benefits of consolidation such that the "no-harm test" is satisfied in aggregate

In cases of consolidation of non-contiguous service areas the onus should be on the parties to demonstrate why rate harmonization, if this is proposed, is thought to superior to accounting on a rate zone basis.

2.5. PERFORMANCE METRICS AND REPORTING

This section of the Discussion Paper addresses two issues raised in the November 2022 Audit Report prepared by the Office of the Auditor General ("AG Audit Report"): i) monitoring of post-consolidation activities and ii) separate reporting on key performance measures.

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. The Report noted that 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[25].

In the Discussion Paper OEB staff agrees that monitoring of post-consolidation activities before the end of the deferred rebasing period is warranted and can be beneficial. At the same time, OEB staff acknowledges the burden that imposing additional requirements on consolidated entities can create. In balancing these considerations, the 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. 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."*[26]

VECC supports the OEB staff proposal. Further, while not specifically addressed in the Discussion Paper VECC submits that for consolidated entities that have elected to defer rebasing for five years or less a similar report should be required to be submitted as part of the consolidated utility's first rebasing application.

[25] Page 29
[26] Page 30

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 records, OEB staff generally agrees, but believes it is challenging to be prescriptive with a requirement which would apply in all cases. As such OEB staff proposes that[27]:

> *"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."*

Again, VECC supports the OEB staff's proposal for the reasons cited in the Discussion Paper.

Separate Reporting on Key Performance Measures

Currently, post-consolidation, most Reporting and Record-keeping Requirements (RRR) information is filed with the OEB on a consolidated basis. However, the AG Audit Report concluded that[28]:

> *"… 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*."

In the case reliability, OEB staff sees value in being able to make comparisons between rate zones for a consolidated utility during the deferred rebasing period. To achieve this 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*

[27] Pages 30-31
[28] Discussion Paper, page 31

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."[29]

VECC is concerned that the additional reporting requirements the proposal imposes on consolidating entities that voluntarily provide feeder level reliability information will encourage those utilities considering consolidation to not provide such information even when it is available. VECC notes that OEB staff's proposal for a mid-term report by those consolidated entities that defer rebasing for more than five years requires a "qualitative discussion on enhanced reliability as a consolidated distributor" and expects that such reporting would need to demonstrate improvements at the rate zone level. Also, in VECC's view where reliability considerations were a key factor in determining whether or not the proposed transaction satisfied (per page 13 of the Discussion Paper) the no-harm test, monitoring and reporting of reliability performance on a rate zone basis should be a requirement that is specifically addressed by the MAADs Handbook.

With respect to service quality metrics, OEB staff proposes that:

"the current practice of consolidated distributors reporting service quality metrics on a consolidated basis post-consolidation continue."[30]

VECC notes that, in this instance, part of the OEB staff's rationale[31] is that a component of its proposal for filing a mid-term report calls for such reports to include "a qualitative discussion on enhanced service quality as a consolidated distributor". VECC submits that proposed requirements for the mid-term report should make it clear that the qualitative discussions should address reliability and service quality by rate zone and be supported by quantitative data to the extent possible.

2.6. COST RECOVERY FOR TRANSACTION AND TRANSITION/INTEGRATION COSTS

The Discussion Paper notes that while the general policy is that incremental transaction and integration costs are not generally recoverable through rates, exceptions have been approved[32]. On this basis OEB staff states 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"[33].

The OEB staff then goes on to propose that:

[29] Page 33
[30] Page 35
[31] Page 35
[32] Page 36
[33] Page 36

> *"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"*[34]

VECC notes that the precedent cited in the Discussion Paper (i.e., an application for approval for Dubreuil Lumber Inc. to sell its distribution system to Algoma Power Inc.) represented a very unique situation in that[35]:

a) Dubreuil was likely to fail in meeting its obligation to supply electricity to customers in Dubreuilville and that continued operation of the system by Dubreuil was not a viable option,
b) Algoma had been appointed the interim operator of the Dubreuil distribution system due to Dubreuil being unable to provide distribution services as a result of financial and staffing issues,
c) Algoma noted that it would be able to implement investments and improvements to the Dubreuil service area more efficiently and at a lower cost upon acquiring the Dubreuil distribution system than it would as the interim operator, and
d) Algoma had stated that it will not have an opportunity to recover its transaction and integration costs through efficiencies because investments in the Dubreuil distribution system will be required to ensure compliance with regulatory requirements.

As a result, while VECC acknowledges that there may be circumstances where it is appropriate for the OEB to allow transaction and transition cost to be recoverable from ratepayers, such circumstances will be the exception and applicants should be required to demonstrate that this is truly the case. Indeed, in such extreme circumstances it is questionable whether what, if any, of the MAADs guidelines might apply.

The Discussion Paper also notes that while transaction and transition costs have generally been treated as expensed costs, the topic of "integration capital" costs, or capitalization of integration costs has arisen[36]. To address this 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".*[37]

There are two issues here. The first is the question of whether a transaction/transition cost should be expensed or capitalized. In VECC's view this is an accounting matter and resolution should rely on the application of generally accepted accounting

[34] Page 38
[35] EB-2018-0271, Decision and Order, pages 3, 14-15 and
[36] Page 38
[37] Page 39

standards as applicable to electricity distribution utilities. The second question is whether such costs should be recoverable from ratepayers. In VECC's view the same principles should be applied as those applicable to transaction/transition expenses (i.e., only recoverable under very unique/exceptional circumstances).

2.7. INCREMENTAL CAPITAL FUNDING AVAILABILITY TO CONSOLIDATED UTILITIES

The Discussion Paper sets out a number of OEB staff proposals related to the Incremental Capital Module (ICM) available to distribution utilities in regards to consolidation applications and the subsequent deferral period. Specifically, OEB staff proposes that[38]:

- "*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*."
- "*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*".
- "*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*."

In the Discussion Paper OEB staff notes that the materiality threshold formula's use of the current IPI to proxy annual inflation adjustments for rates since rebasing has not generally been an issue due to the short periods of time between rebasing applications and the fact inflation rates (up to the first year of COVID) were generally around 2%. However, with the longer periods before rebasing associated with consolidation applications and the higher inflation rates recently experience, OEB staff indicates in the Discussion Paper[39] that it 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*."

In VECC's view, the issues raised by Board Staff regarding the basis of the materiality threshold are only part of the larger issue regarding the ability of consolidated utilities to apply for ICMs, particularly during deferral periods lasting more than five years. VECC agrees with OEB Staff's proposal that applicants should be required to note any known or reasonably anticipated future ICMs in their consolidation application. Further, the anticipated impacts of such ICMs should be addressed as part of the application's consideration of the "no-harm" test. Any additional incremental capital needs should be addressed through a rebasing application that includes an updated capital plan.

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2.8. ACCOUNTING MATTERS

The Discussion Paper addresses a number of issues related to deferral and variance accounts (DVAs).

Disposition Timing

The Discussion Paper notes that, in accordance with current policy/practice, Group 1 DVAs are reviewed and subject to disposition if they meet a pre-set threshold during the IRM term. However, Group 2 DVAs required a prudence review and are subject to disposition in a rebasing application, which is typically every five years. The issue is that rebasing periods can be up to ten years, resulting in a significant balances being accumulated during the period. To address this 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*."

VECC agrees with this proposal. As well as addressing issue of inter-generational equity it serves to mitigate what could be significant bill impacts for customers at the time of rebasing if balances are allowed to continue to accumulate.

Tracking of Accounts

The issue here is whether consolidated utilities should be required to track DVAs by rate zone or whether they can be tracked on a consolidated basis. For Group 1 accounts the OEB staff proposes that utilities be encouraged "*to consolidate the accounts as soon as possible*".[40]

In the case of 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 in order to enable those accounts to be disposed to the group of customers that contributed to the balance of those accounts. However, the OEB staff also note that there could also be some accounts where tracking on a rate zone basis may not be warranted post-MAADs transaction. 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*."[41]

VECC agrees with the OEB staff proposals regarding the tracking of Group 1 and Group 2 accounts.

Accounting Policy Changes Deferral Account

OEB staff notes 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,

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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"*[42].

OEB staff also proposes that[43]:

> *"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 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."*
>
> And
>
> *"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. The distributor must also file evidence demonstrating how the eligibility criteria of causation, materiality, and prudence have been met".*

VECC generally agrees with the OEB staff's proposals. However, there is an inconsistency between the first and the last proposal set out above. The first proposal requires the consolidated utility to establish the account unless it can demonstrate it is not needed while the last proposal requires the utility to file evidence demonstrating how eligibility criteria of causation, materiality, and prudence have been met (i.e., that the account is needed). In VECC's view, if the OEB's policy is to require the consolidated utility to establish the account then there should be no need for it to justify why the account is needed.

2.9. EARNINGS SHARING MECHANISMS (ESM)

In the Discussion Paper OEB staff notes that it[44]:

- "*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*".

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- "*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*".

With respect to the determination of the ESM OEB staff proposes that:

a) "*for purposes of ESM calculations, calendar year data is used regardless of the actual closing data of the consolidation*". More specifically, 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.
b) "*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*."
c) "*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*."
d) "*an accounting order should be established in the MAADs proceeding, with the effective date when the MAADs transaction closes*". 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.

In VECC's view the MAAD's Handbook should avoid being overly prescriptive regarding the specifics of the ESM mechanism (e.g., the period for which the ESM would apply, the nature of the sharing and whey sharing would occur). Rather the details should be left to the Board Panel dealing with the transaction and depend on the facts specific to the transaction concerned.

With respect to item (d) the Discussion Paper indicates that in its filing for the accounting order "the distributor must also file evidence demonstrating how the eligibility criteria of causation, materiality, and prudence have been met"[45]. VECC questions why this is necessary if the ESM is a requirement for consolidated utilities with deferral periods greater than five years. Also VECC has some reservations about using the deemed equity components of each utility's rate based from their last rebasing (per item (c)) given that there could be a material difference between years in which each occurred. However, at this time, VECC is unable to suggest a readily applicable alternative.

2.10. PERFORMANCE STANDARDS FOR MAADS APPLICATIONS

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The Discussion Paper notes[46] that:

> *"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."*

However, OEB staff notes that the current performance standards for section 86 applications are determined by hearing type (i.e., oral or written) while for other application types the OEB has adopted performance standards based on the complexity of the application. As a result, OEB staff suggests that[47]:

> *"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."*

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

Pending future review of the matter, VECC submits that the hearing type (oral vs. written) provides a reasonable indication as to the complexity of a consolidation application.

2.11. OTHER

This section of the Discussion Paper deals with a number of issues that were either brought to OEB staff's attention during its consultation with utilities and intervenors or that OEB staff considers as needing to be addressed.

Z-Factor – Materiality Calculation

OEB staff proposes a new section related to Z-Factor materiality thresholds for consolidated utilities be added to the 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 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".* (emphasis added)

VECC submits for purposes of clarity the highlighted portion of the proposal should be dropped.

Incremental Operations, Maintenance and Administration (OM&A) Costs

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The Discussion Paper identifies two distinct situations where the issue of incremental OM&A costs could arise.

The first situation is where the incremental funding for OM&A is directly tied to a qualifying ICM request. 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[48]. VECC agrees that this situation is directly related to the ICM policy and should be dealt with as part of that review. Furthermore, the consultative process for review the OEB's ICM policy will also need to consider those circumstances where the incremental capital spending leads to a reduction in OM&A costs.

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.[49] Again, VECC agrees.

Timing of New MAADs Filing Requirements

In terms of when consolidating utilities should be comply with any changes to the MAADs filing requirements eventually adopted by the OEB, OEB staff proposes that[50]:

> *"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."*

VECC considers the timeframes proposed by OEB staff to be reasonable.

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." OEB staff proposes that an additional requirement be added to the existing filing requirements for consolidation applications that:

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"applicants should provide assumptions/explanations used in the pro forma financials, as well as the methodology used to forecast amounts"

VECC agrees with OEB staff's proposal and the supporting rationale that this will increase clarity for the OEB and other stakeholders, while potentially reducing the number of interrogatories to applicants.

OEB Act Language

The Discussion Paper notes that Section 1 of the OEB Act (Board Objectives, Electricity) has been updated since the issuance of the MAADs Handbook and OEB staff notes that all applicable references in the Handbook should be updated accordingly[51].

OEB staff also states that[52]:

"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, 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.).

VECC believes the issue that may arise is the argument of some applicant that consolidation is not necessarily one of cost efficiency effort but rather needed in order to ensure the demands of "energy transition" can be met by a particular (smaller) electricity distributor. In VECC's view there is no evidence to date to support the case (or the suggestion by Board Staff) that larger utilities are better able to facilitate innovation. The Board should avoid making such assumptions and/or accepting such statements by consolidating utilities without clear supporting evidence.

Licence Application

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[53].

VECC agrees. As the Discussion Paper notes, OEB findings on consolidation applications since the issuance of the MAADs Handbook have addressed licence-related matters.

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