

**OEB Staff Discussion Paper:
Evaluation of Policy on Utility Consolidations**

AMPCO Comments March 6, 2024

Background

On July 27, 2023, the OEB issued a letter launching its Evaluation of Policy on Utility Consolidations consultation. The OEB advised that the review will leverage experience to date of the approximately 20 consolidation-related decisions issued since the original MAADs Handbook was published in 2016 and is expected to identify and address any continuing barriers to consolidation, while ensuring customers are protected.

On February 8, 2024, the OEB Staff Discussion Paper (the Paper) was posted as the next step in the consultation to review and update the OEB's Handbook to Electricity Distributor and Transmitter Consolidations (MAADs Handbook), and associated Filing Requirements for Consolidation Applications. The Paper summarizes key comments heard on several consolidation-related topics considered in meetings held with electricity utilities and intervenors. OEB staff's proposals for potential changes to the MAADs Handbook and filing requirements resulting from consideration of the stakeholder comments are also outlined in the Paper.

Overall, OEB staff are not proposing any major changes to the MAADs Handbook and/or filing requirements for consolidation applications.¹ OEB staff placed importance on modifications to support OEB decision making, increase clarity and certainty of expectations for applicants, and increase regulatory efficiency.²

AMPCO provides the following comments addressed in the Paper.

No Harm Test

The OEB applies the no harm test when assessing applications under section 86 of the OEB Act. The OEB considers whether the no harm test is satisfied based on an assessment of the cumulative effect of the Transaction on the attainment of its statutory objectives. If the proposed Transaction has a positive or neutral effect on the attainment of these objectives, the OEB will approve the consolidation.³ Specifically, in past Consolidation Decisions, the OEB has

¹ p. 2

² p. 56

³ MAADs Handbook p. 3-4

assessed the effect of the proposed Transaction on attaining the following OEB objectives:

- Price, Economic Efficiency and Cost Effectiveness
- Reliability and Quality of Electricity Service
- Financial Viability

The OEB's objectives in the OEB Act have been revised since the MAADs Handbook was issued on January 19, 2016. AMPCO agrees with OEB staff that the updated version of the MAADs Handbook should reflect the OEB's updated objectives.⁴

AMPCO further agrees with OEB staff that 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.⁵

OEB Staff proposes that the no harm test should continue but be clarified in that both quantitative and qualitative information will be weighed to determine whether the proposed Transaction, on a net basis, has a positive or neutral effect on the attainment of the OEB's objectives.⁶ AMPCO agrees the no harm test should continue with further emphasis in the MAADs Handbook that both quantitative and qualitative information unique to each proposed Transaction will be considered by the OEB.

Cost Structures

OEB staff proposes that as part of a consolidation application, applicants be required to provide a revenue requirement analysis showing the expected revenue requirement both under consolidation, and under the status quo scenarios (for each utility) for the duration of the elected deferred rebasing period, and the post-consolidation rebasing year.⁷ OEB staff provided an example of a revenue requirement analysis for a merger between two utilities which elect a ten-year deferred rebasing period.⁸ If forecasting for the deferred rebasing period proves difficult, particularly if it extends to ten years, utilities should select a shorter deferral period.

At the time of the post-consolidation rebasing application, OEB staff proposes that the consolidated entity should file a similar revenue requirement analysis (as above) based on updated actuals to that point in time (and including forecasts for the bridge year (the last year

⁴ p. 12

⁵ p. 55

⁶ p. 13

⁷ p. 15

⁸ p. 16

of the deferred rebasing) and the rebasing test year on a best-efforts basis. This would include forecasts for the bridge year (the last year of the deferred rebasing) and the rebasing test year.⁹

In addition, OEB staff 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 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.¹⁰

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. This would include Documentation on differences in actual inflation and stretch factors, growth, unanticipated needed investments, and other matters as required, from what was forecast at the time of the MAADs, or details of additional actual costs (e.g., ICMs or Z-factors).¹¹

AMPCO supports OEB's staff's proposal and concurs that revenue requirement is an appropriate indicator for cost structure comparisons. AMPCO agrees a comparison and discussion of the MAADs application forecasts versus those filed in the post-consolidation rebasing application should be provided. This comparative analysis is essential to determine if there have been cost efficiencies, realized savings to be shared with customers and if the consolidation has been a success compared to the status quo. This analysis will assist OEB staff, intervenors and the OEB in assessing the success of the Transaction.

OEB staff believes the current wording in the MAADs Handbook referencing cost structures should remain and the wording in the updated Filing Requirements should be revised to replace "comparative cost structure analysis" with "comparative revenue requirement analysis".¹² In AMPCO's view both the MAADs Handbook and the Filing Requirements should be updated to clarify what is meant by cost structures. OEB staff further indicates utilities should be encouraged to augment revenue requirement comparisons with other cost-related analysis that they may have done in support of the proposed consolidation.¹³ AMPCO submits the MAADs Handbook and updated Filing Requirements should clarify what is meant by "other cost-related analyses".

OEB staff also proposes the following paragraph be added to the updated MAADs Handbook:

⁹ p. 19

¹⁰ p. 17

¹¹ p. 19

¹² p. 15

¹³ p. 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.¹⁴

AMPCO supports this additional wording in the MAADs Handbook.

Goalpost Test

AMPCO strongly agrees with OEB staff's view that there should be flexibility in the MAADs policy to account for different circumstances and different utility consolidations.¹⁵ Each proposed Transaction will have quantitative and qualitative aspects that are unique to the situation. However, with respect to the "goalpost" test, AMPCO does not fully accept OEB staff's position that the MAADs policy should not adopt the OEB's decision which required that the acquiring utility's shareholder absorb any costs above a status quo "goalpost." In AMPCO's view the MAADs policy should go beyond a comparison and discussion of costs at rebasing and include a mechanism to ensure customers are no worse off as a result of the Transaction.

As a result of any proposed Transaction, there is the potential for cost savings (OM&A and Capital) for both acquired customers and legacy customers. For example, for a utility that opts for a ten-year deferred rebasing period, these savings are forecast to be reflected in the cost structures that will be present in year 11 following the Transaction. These anticipated savings provide the basis for the case that both the acquired and legacy customers will suffer no harm as a result of the Transaction. For the post-consolidation rebasing year, the utility should identify the forecast net savings that will flow to customers at that time. However, there is the potential for a depletion of these projected savings based on a number of factors including the difficulty in projecting costs ten years in advance and unexpected impacts on cost structures due to an evolving energy sector that weren't contemplated at the time of the Transaction.

In AMPCO's view, the Handbook should include a dedicated section and process that addresses the scenario where savings do not materialize as planned and the post-consolidation rebasing year revenue requirement is higher than the status quo. Applicants should be aware that shareholders could bear the risk if explanations provided by the applicant for this scenario are unsatisfactory. The acquiring utility's shareholder could be required by the OEB to absorb any costs above a status quo "goalpost" as was the case in EB-2018-0270. To demonstrate "no harm", applicants must show that there is a reasonable expectation that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have

¹⁴ p. 18

¹⁵ p. 14

been.¹⁶ At rebasing, if this is not the case, customers must be protected and there needs to be a process to address the situation and accountability if the proposed savings do not materialize as planned and customers are worse off.

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. To provide certainty to the consolidated utility, the OEB and other stakeholders, OEB staff recommends that the applicants specifically identify the rate year that rebased rates would be effective in the consolidated utility's rebasing application.¹⁷ AMPCO agrees with the need for clarity.

OEB staff points out that to-date, the OEB has yet to adjudicate on a rebasing application following consolidation in which a ten-year deferred rebasing period had been elected. OEB staff is of the view that it is premature to limit rebasing to less than ten years until greater experience is gained by utilities, other stakeholders and the OEB.

In the absence of OEB decisions on consolidation applications with ten-year deferred rebasing periods, AMPCO does not object to a maximum ten year deferral period in the short term but once case specific analysis is available and experience is gained, AMPCO believes the length of time over which rebasing of a consolidated entity's rates can be deferred should be re-examined by the OEB. In AMPCO's view, there should be a provision or option added to the MAADs Handbook for the deferred rebasing period issue to be reopened for review and adjustment if required, once the OEB has adjudicated on three consolidation applications with ten year deferred rebasing periods.

In addition, given the potential cost and policy impacts due to an evolving energy sector, and the expected changes that will occur over the next decade, a ten-year deferral may no longer be appropriate. AMPCO submits for new consolidation applications approved going forward, the OEB should now require evidence to justify the selection of a ten-year deferred rebasing period and the MAADs Handbook and Filing Requirements should be revised to include language that defines this requirement. The current policy to not require supporting evidence to justify the selection of ten years may no longer be sufficient given the rapidly changing energy landscape.

With respect to OEB staff's proposal to update language in the current MAADs Handbook in the section "Early Termination or Extension of Selected Deferred Rebasing Period", AMPCO submits whether the consolidated entity seeks to rebase earlier than its elected deferral period or seeks to extend the deferred rebasing period, the consolidated entity must explain how the change to

¹⁶ MAADS Handbook p. 7

¹⁷ p. 21

the proposed rebasing timeframe is in the best interests of customers. This language should be included in the MAADs Handbook under both scenarios.

With respect to multiple Transactions, AMPCO agrees the issue should be dealt with on a case-by-case basis, and AMPCO supports OEB Staff's proposal that the MAADs Handbook and Filing Requirements include new language in the event of consecutive consolidations by the same distributor.¹⁸

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.¹⁹

With respect to rate harmonization, OEB staff proposes that the MAADs Handbook and filing requirements for consolidation applications be updated to include language indicating that while details of any rate harmonization plan are not required in a consolidation application, a statement indicating whether the consolidated utility intends to undertake rate harmonization at the time of rebasing or, if not, an explanation for not doing so, should be included. Where the utility does intend to harmonize rates, a brief description of the plan should also be provided.²⁰

AMPCO supports the above OEB staff proposals regarding future rate structures.

Performance Metrics & Reporting

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

¹⁸ p. 24

¹⁹ p. 25

²⁰ p. 26

consolidated utility, updates to this information should be provided including for any period not covered by the initial mid-term report.²¹

AMPCO supports the filing of a mid-term report as a requirement of new consolidation applications going forward. A mid-term report provides an opportunity for applicants to assess progress and make any modifications as required. Specifically, AMPCO submits the applicant should be required to include a progress update on the key evidence the OEB relied on in its Decision to approve the consolidation with respect to the impact of the proposed Transaction on the OEB's first two statutory objectives.

In response 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 proposes that any reporting requirements on adherence to any conditions of approval and/or the maintenance of records during the deferred rebasing period should be considered by, and established at the discretion of, the panel of OEB Commissioners assigned to decide each consolidation application. OEB staff is of the view that the OEB should determine an appropriate level, and frequency, of reporting on these matters from applicants during deferred rebasing periods, by the OEB panel considering the application. AMPCO submits this approach is reasonable.

Service Quality Metrics

OEB staff proposes that the current practice of consolidated distributors reporting service quality metrics on a consolidated basis post-consolidation continue.²²

With respect to incremental transaction and integration costs that are not generally recoverable through rates OEB staff believes that the approach to deal with exceptions on a case-by-case basis, based on the circumstances and where adequately supported, should continue. If an applicant considers that it has unique circumstances which may warrant recovery of transaction and/or transition costs, evidence should be brought forth in the consolidation application for OEB consideration.²³

AMPCO considers both of these proposals to be appropriate.

Incremental Capital Funding Availability to Consolidated Utilities

OEB staff proposes the following:

- 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

²¹ p. 30

²² p. 35

²³ p. 36

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 OEB²⁴ 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.²⁵

AMPCO agrees with the above three proposals, in particular the first one. It is important for applicants to flag known or reasonable anticipated future ICMs at the time of the proposed consolidation application as assumptions regarding ICM need to be factored into the cost structure (revenue requirement) analysis.

ICM Policy

OEB staff is seeking comments on whether the OEB should implement any changes to the inflation rate(s) used in calculating the materiality threshold for incremental capital funding prior to the OEB considering the ICM policy in its entirety as part of a separate consultation, given that inflation is only one component of the calculation. If a change is proposed, what inflation rate(s) should be used. OEB staff is seeking comments on these matters to assist the OEB in determining how to proceed.²⁶

The OEB uses the current IPI as a proxy for all years since the last rebasing, for administrative simplicity. Instead of the current IPI, perhaps the OEB's historical approved IPIs could be used in the formula for the years since last rebasing to address issues with the current formula as inflation increases. Any major adjustments to the ICM policy should be considered as part of the OEB's pending ICM review.

Accounting Matters

Disposition Timing

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

²⁴ OEB's February 2022 Letter

²⁵ p. 39-40

²⁶ p. 41

disposition of Group 2 account balances, if warranted and supported.²⁷

To mitigate intergenerational inequity, as well as the potential for large balances (and bill impacts) at the time of rebasing, AMPCO supports this proposal.

Tracking of Accounts

For Group 1 accounts, OEB staff proposes to encourage utilities to consolidate the accounts as soon as it is practical.

For Group 2 accounts, OEB staff 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.²⁸

AMPCO agrees with the above proposals regarding Group 1 and Group 2 accounts.

Accounting Policy Changes

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.

OEB staff proposes that once the consolidated utility has completed its assessment of accounting policy changes required, the consolidated utility may propose to close the account in the next IRM application where an audited balance in this account is available, if the impacts of the accounting policy changes are not material. In such cases, OEB staff suggests that no disposition would be required. OEB staff proposes that materiality be based on the 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.

OEB staff further proposes that an accounting order should be established in the MAADs proceeding, with the effective date on the close of the Transaction date. Consistent with the filing requirements for cost of service applications, the accounting order must include a description of the mechanics of the account, and provide examples of general journal entries, and the proposed account duration. The distributor must also file evidence demonstrating how the eligibility criteria of causation, materiality, and prudence have been met.²⁹

AMPCO agrees with the above proposals.

²⁷ p. 43

²⁸ p. 44

²⁹ p. 44-45

Earnings Sharing Mechanisms (ESM)

With respect to ESM:

- OEB staff continues to support the rationale for an ESM as stated in the current MAADs policies and the requirement to establish an ESM for a deferred rebasing period longer than five years.
- OEB staff supports the continued form of ESM as set out in the MAADs Handbook as the default method, including the 50:50 sharing for all earnings that are more than 300 basis points above the consolidated entity's allowed ROE.
- OEB staff proposes that for purposes of ESM calculations, calendar year data is used regardless of the actual closing data of the consolidation.
- 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 they be included in the ESM calculation for the years ESM is calculated.
- At the time of consolidation, the consolidating utilities may also have differing deemed ROEs. The most appropriate way to determine a deemed ROE for the purposes of the ESM calculations for the consolidated entity would be to weight the approved ROEs for each utility from their last rebasing application, by the deemed equity component of the rate base of each utility in their last rebasing application.
- OEB staff further proposes that an accounting order should be established in the MAADs proceeding, with the effective date when the MAADs Transaction closes.³⁰

AMPCO supports the rationale for a continued ESM to protect ratepayers, and AMPCO considers the above OEB staff proposals regarding the determination of ESM to be reasonable. In particular, AMPCO agrees calculating EMS on a calendar-year basis, regardless of when the MAADs Transaction closed is efficient and practical as the data required aligns with the consolidated utility's financial reporting and has the benefit of being audited annually.

Performance Standards for MAADs Applications

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.

OEB staff suggest the OEB undertake a review to align the section 86 performance standards with changes to other application types by converting from a written versus oral hearing

³⁰ p. 47-49

structure to a short form versus complex structure, following the issuance of the updated MAADs Handbook.³¹

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

Other

Z-Factor – Materiality Threshold Calculation

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

Adjusting a distributor's revenue requirement to set the materiality threshold may be appropriate when predecessor utilities, or a consolidated utility's rate zones, have not rebased for more than five years. When it is apparent from the dates of the last OEB-approved revenue requirement that there has likely been a significant change, the OEB finds it reasonable to adjust the materiality threshold 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.³²

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

Incremental Operations, Maintenance & Administration

OEB staff considers that 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.³³

In AMPCO's view, this approach is appropriate.

Timing of New MAADs Filing Requirements

³¹ p. 50

³² p. 51

³³ p. 52

OEB staff believes that applicants should strive to reflect any updated filing requirements, to the extent possible, in their applications. For any updates not adopted (for consolidation Transactions negotiated under the current Handbook), applicants should include an explanation as to why as part of the application. However, new reporting requirements arising out of the AG Audit Report should be applicable and required in all cases going forward (i.e., for future consolidations approved post-issuance of the updated MAADs Handbook).³⁴

AMPCO agrees with OEB staff's proposals with respect to when consolidating utilities should comply with any changes to the MAADs filing requirements.

Pro Forma Financial Statements

OEB staff proposes that an additional requirement be added to the existing filing requirements for consolidation applications that applicants should provide assumptions/explanations used in the pro forma financials, as well as the methodology used to forecast amounts.³⁵

AMPCO agrees this will increase clarity for the OEB and other stakeholders, while potentially reducing the number of interrogatories to applicants.

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.³⁶

AMPCO agrees that the licence application should be considered by the OEB concurrently with the request for leave to amalgamate.

³⁴ p. 53

³⁵ p. 53

³⁶ p. 56