PALIARE ROLAND
BARRISTERS

Richard P. Stephenson
T 416.646.4325 Asst 416.646.7419
F 416.646.4301
E richard.stephenson@paliareroland.com
www.paliareroland.com

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VIA RESS FILING & COURIER

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
P.O. Box 2319
2300 Yonge Street, 27th Floor
Toronto, Ontario M4P 1E4

Dear Ms. Walli:

Re: Service Area Amendments and MAADs Rate-Making Policy Review (EB-2014-0138)

The Power Workers' Union ("PWU") represents a large portion of the employees working in Ontario's electricity industry. Attached please find a list of PWU employers.

The PWU is committed to participating in regulatory consultations and proceedings to contribute to the development of regulatory direction and policy that ensures ongoing service quality, reliability and safety at a reasonable price for Ontario customers. To this end, please find the PWU's comments with regard to Board staff's Discussion Paper, Review of the Board's Policies and Processes to Facilitate Electricity Distributor Efficiency: Service Area Amendments and Rate-Making Associated with Distributor Consolidation (EB-2014-0138).

We hope you will find the PWU's comments useful.

Yours very truly,
PALIARE ROLAND ROSENBERG ROTHSTEIN LLP

Richard P. Stephenson
RPS:pb
Encl.
c: John Sprackett (*via email*)
Kim McKenzie (*via email*)

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List of PWU Employers

Algoma Power
AMEC Nuclear Safety Solutions
Atomic Energy of Canada Limited (Chalk River Laboratories)
BPC District Energy Investments Limited Partnership
Brant County Power Incorporated
Brighton Beach Power Limited
Brookfield Power Wind Operations
Brookfield Renewable Power - Mississagi Power Trust
Bruce Power Inc.
Atlantic Power Corporation - Calstock Power Plant
Atlantic Power Corporation - Kapuskasing Power Plant
Atlantic Power Corporation - Nipigon Power Plant
Atlantic Power Corporation - Tunis Power Plant
Compass Group Corporation of the County of Brant
The Electrical Safety Authority
Entegrus
Erie Thames Powerlines
Erth Corporation
ES Fox
Great Lakes Power
Grimsby Power Incorporated
Halton Hills Hydro Inc.
Hydro One Inc.
Independent Electricity System Operator
Inergi LP
Innisfil Hydro Distribution Systems Limited
Kenora Hydro Electric Corporation Ltd.
Kinectrics Inc.
Kitchener-Wilmot Hydro Inc.
Lake Superior Power Inc. (A Brookfield Company)
London Hydro Corporation
Milton Hydro Distribution Inc.
New Horizon System Solutions
Newmarket Hydro Ltd.
Norfolk Power Distribution Inc.
Nuclear Waste Management Organization
Nuvia Canada
Ontario Power Generation Inc.
Orangeville Hydro Limited
Portlands Energy Centre
PowerStream
PUC Services
Rogers Communications (Kincardine Cable TV Ltd.)
Sioux Lookout Hydro Inc.
SouthWestern Energy
TransAlta Generation Partnership O.H.S.C.
Vertex Customer Management (Canada) Limited
Whitby Hydro Energy Services Corporation

EB-2014-0138

Service Area Amendments and MAADs Rate-Making Policy Review

Comments of the Power Workers' Union ("PWU")

I. INTRODUCTION

1. On February 11, 2013 the Ontario Energy Board ("OEB" or the "Board") issued a letter (the "February Letter") announcing an initiative to assess how the Board's approach to the regulation of electricity distributors may affect the ability of distributors to realize operational or organizational efficiencies that benefit consumers and that are incented under the Board's rate-setting mechanisms. The Board engaged Navigant Consulting Ltd. ("Navigant") to undertake a survey of stakeholders, including distributors and representatives of consumers, regarding their views on potential changes to the Board's regulatory requirements that may facilitate efficiency improvements. Navigant's findings were included in a report released on February 25, 2013, and were the subject of discussion at a Stakeholder Meeting held on February 27, 2013 ("February Consultation").

2. On November 4, 2013, the OEB issued a letter (the "November Letter") setting out details of two policy reviews in the context of its initiative regarding the facilitation of electricity distributor efficiency. The first policy review would focus on merger, amalgamation, acquisition and divestiture ("MAADs") transactions. The Board noted that distributors reported during the February Consultation that one of the reasons for not considering consolidation was the risk that transaction costs would not be recovered within the 5 year timeframe as per the current policy or that the shareholder would not benefit from any efficiency savings.

Distributors suggested that the Board should permit a longer delay for the first rebasing after a MAADs transaction to facilitate consolidation in the sector. Distributors also suggested that if merged distributors are permitted to delay the timing of their next full cost of service/rebasing application beyond 5 years, the Board should consider adopting policy changes that would address the capital investments made during that extended period. With the implementation of the new rate-setting mechanisms under the Renewed Regulatory Framework for Electricity Distributors ("RRFE") the Board considered it timely to review its policies regarding the rebasing of a distributor's rates following a MAADs transaction.

3. The second policy review announced in the November Letter would focus on service area amendments ("SAAs"), including long-term load transfer arrangements. The Board noted that distributors suggested during the February Consultation that there was potential for increased efficiencies if it were possible to expand their service territory to municipal boundaries and/or to assume a service territory that is immediately adjacent to their existing service boundaries. The Board stated that it considered it appropriate to review its principles and policy regarding SAAs given the changes in the sector and the implementation of the RRFE with a focus on efficiency and continuous improvement.

4. On March 31, 2014, the Board posted for comment a Board staff Discussion Paper entitled *Review of the Board's Policies and Processes to Facilitate Electricity Distributor Efficiency: Service Area Amendments and Rate-Making Associated with Distributor Consolidation* (the "Discussion Paper"). The Discussion Paper provides background on the Board's current SAA and MAADs rate-making policies, summarizes stakeholder input received in relation to those policies and sets out a much narrower objective with specific questions for stakeholder comment with respect to potential changes to the existing policies. The Board also indicated that it would review the policy related to long-term load transfer arrangements as a separate initiative in the near future.

5. The Power Workers' Union ("PWU") appreciates the opportunity provided by the Board for stakeholder comment on the Board's polices and processes to facilitate electricity distributor efficiency issues related to SAAs and rate-making associated with distributor consolidation or MAADs. The PWU's views stem from its energy policy statement:

> **Reliable, secure, safe, environmentally sustainable and reasonably priced electricity supply and service, supported by a financially viable energy industry and skilled labour force is essential for the continued prosperity and social welfare of the people of Ontario. In minimizing environmental impacts, due consideration must be given to economic impacts and the efficiency and sustainability of all energy sources and existing assets. A stable business environment and predictable and fair regulatory framework will promote investment in technical innovation that results in efficiency gains.**

II. POWER WORKERS' UNION'S COMMENTS

a) *PWU Position – SAAs*

6. The PWU's position is that the system that is currently in place is working very well and distributors should be left to manage their service areas in an economical and cost efficient manner that is in the public interest. The PWU remains of the view that applications for SAAs must be agreed on by the distributors concerned and that the status quo provides for SAAs that are based on deliberations on best outcomes, including efficiencies, and in the case of a contested SAA, provides for OEB oversight on the reasonableness and public interest of the SAA.

7. According to the Discussion Paper, the majority of the SAA applications that have come before the Board have been uncontested.[1] In this respect, there is little to be achieved from the proposed changes. In fact, the proposed changes would not only cause significant disruption thereby undermining overall economic efficiency, but would also require significant effort in terms of cost benefit analysis and regulatory oversight to ensure that reliability and service quality are

[1] Discussion Paper, Page 7

not compromised, existing and future customers are not adversely impacted, and efficiency is maintained or improved.

b) *PWU Position – MAADs*

8. The PWU's understanding of the objective of the current consultation relating to MAADs is to review the Board's policies regarding the rebasing of a distributor's rates following a MAADs transaction, seeking to remove any regulatory barriers to MAADs that would happen voluntarily and could deliver efficiency gains, but for these barriers. The Board's goal is to create a more predictable regulatory environment for distributors that are considering consolidation, thereby facilitating planning and decision-making and assisting distributors to determine the economic value of consolidation transactions.

9. The PWU has always supported consolidation on a commercial and voluntary basis and left to "willing sellers/willing buyers." The PWU also believes that voluntary consolidations that are based on mutually agreeable and advantageous business terms, including efficiencies and a focus on local value, and which provide for OEB oversight on the reasonableness and public interest of the consolidation, are desirable. Significant consolidation has occurred under the status quo model and where circumstances are right, further voluntary consolidation can be expected.

10. On the other hand, it is the PWU's view that the OEB must be realistic about the efficiency gains (e.g. cost savings) that the distribution sector can achieve, be it through MAADs or SAAs, while maintaining service reliability and safety performance levels that customers expect and value. Realistic expectations about efficiency gains resulting from proposed regulatory policy changes or code amendments should inform the Board whether or not the proposed changes are worth the effort required to implement the changes, including the potential regulatory burden on the Board, distributors and consumers, and the risks, foreseen or unforeseen, associated with them. Unrealistic efficiency gains should not be the basis for changes that could result

in uncertainty and compromise the network investment planning process which in turn could result in service quality (i.e. customer service and service reliability) deterioration and future catch up.

11. Economies of scale have long been held as a source of efficiency in the distribution sector. The PWU maintains that evidence does not support this assumption as an inevitable outcome. The best course of action to achieve operational efficiency is to increase the scope of a distributor's operation to allow for the provision of non-distribution services (e.g., water & wastewater operations, street lighting, etc.) and to increase the scale of a distributor's operation (e.g., providing services to other distributors) without compromising service quality and safety. Allowing LDCs to undertake other related activities in tandem with the business of distributing electricity will provide the distributors with economies of scope (i.e. lower average cost by producing multiple products) associated with multiple outputs that will result in efficiency gains.

12. The PWU notes that during the February Consultation many distributors indicated that engaging in additional activities would permit them to spread the fixed-cost elements of their operation over a greater number of customers, thus making per-customer cost lower for all, and would also enable them to use new and more effective technologies which require a larger customer base in order to be economic. In the PWU's view, the Board's desire to see improved efficiency is best addressed by allowing LDCs to undertake other activities and achieve economies of scope.

13. The PWU also reiterates its position that reduction of line losses constitutes the other major source of increased distribution sector efficiency that deserves the Board's consideration.

c) *Board Staff Questions – SAAs*

1) ***What are the benefits of an "open for competition" approach to un-serviced areas? How would the Board implement such an approach in light of section 28 of the Electricity Act, 1998 and existing licence***

conditions? Under an "open for competition" approach: (i) how will the Board ensure that all prospective new customers will receive an offer to connect on fair and reasonable terms; and (ii) how should the interests of Incumbent Distributors and their ratepayers be taken into consideration?

14. The PWU does not support an "open for competition" approach to the so-called "un-serviced" areas.

15. To begin with, the very notion of "un-serviced areas" is misleading, effectively suggesting there is no Incumbent Distributor. The current scheme (embodied in the *Electricity Act,* the *OEB Act,* and the Distribution System Code ("DSC")) does not allow for any part of the province to be without an Incumbent Distributor.

16. The concept of "open for competition" simply ignores the different positions of the licensed Incumbent Distributor and the licensed non-incumbent distributor within the incumbent's service territory. Incumbent and non-incumbent distributors are simply not similarly situated. The *Electricity Act,* the *OEB Act,* and the DSC each impose obligations on the incumbent to customers and potential customers within its service territory (e.g., the obligation to serve customers that "lay along" existing lines, and to offer service to potential customers who do not in accordance with the DSC). Non-incumbent distributors have no such obligations (outside their licensed service territories).

17. The presumption that the Incumbent Distributor is the appropriate entity to service new customers is simply the corollary of the fact that it is the entity with the existing legal *obligation* to that new customer. This presumption can be discharged by a non-incumbent distributor demonstrating that it is economically efficient for them to do so.

18. The existence of "boundary disputes" from time to time between neighbouring LDC's does not call for the adoption of any new or special rules. It may well be that, as a matter of fact, such circumstances may make it relatively easy for a non-incumbent LDC to demonstrate the economic efficiency of

servicing those customers. However, that outcome will be driven by the facts, as they exist on the ground, as distinct from the application of any special rule.

19. Secondly, it is not clear how the interests of the Incumbent Distributors and their rate payers are considered in reality in the context of the concept of "open for competition." The idea of "open for competition" presupposes the use of some criteria by which some agency, presumably the Board, evaluates the applications of the competing parties. If the Incumbent Distributor takes the position that its interests and that of its ratepayers would be adversely affected by an SAA, it means that the Incumbent Distributor is opposed to the SAA. If on the other hand it does not contest the SAA because it does not affect its interest and that of its ratepayers, it would be willing to handover the "un-serviced area" to the Applicant Distributor. There is a system currently in place to address both scenarios – contested and uncontested SAA applications. In this regard, the introduction of an "open for competition" approach would not save the Board from reviewing impacts on the Incumbent Distributor and ratepayers or the Incumbent Distributor and the Applicant Distributors from preparing the relevant evidence. Therefore, there are no efficiency gains from the new approach. In the PWU's view, the interests of Incumbent Distributors and their ratepayers are best considered and protected in the context of an SAA amendment only when there is agreement between the Incumbent Distributor and the Applicant Distributor and any affected customers that a realignment of the boundary would be economically efficient, consistent with system planning needs and in the public interest, and when the Board confirms that to be the case.

20. The PWU agrees that any service area policy should consider its impact on the Incumbent Distributor and its rate payers. In EB-2012-0047 Hydro One noted that the impact on an incumbent LDC and its rate payers of awarding its territory to another LDC has many detrimental effects that need to be taken into consideration when considering service area policy:

> ***...there is a loss to an incumbent LDC and its ratepayers if its territory is awarded to another LDC. It is not just poles and wires that are lost. It is the loss of future customers and a future income stream from them. It is the underused feeder positions at the transformer station that were built with the support of a $7M contribution to the Transmitter for greater***

capacity to serve load that may never materialize or may materialize many, many years later than modelled. It is the feeders already framed and in various degrees of completion that will be underused. It is a lost opportunity to Hydro One customers to benefit from lower unit costs of back-office systems and processes, such as Hydro One's Customer Information System, the call centre, the grid control centre, the GIS system, the AMS system, part of the smart grid project, etc. In addition, Hydro One's evidence is that this Hydro One licensed service territory is on a very near-term path to becoming zoned as urban from a rate class perspective, so for the incumbent to lose the growth opportunity that may deprive customers in the area of the benefit of the pending reclassification.[2]

21. Thirdly, the "open for competition" approach to 'un-serviced areas' could distort a distributor's investment decision process, potentially resulting in decisions that are not economic and cost-effective. Given that such factors as cost, proximity to existing infrastructure, reliability and type of technology, etc. are presumably some of the criteria that would determine the outcome of such competition, it is possible for distributors to engage in building or overbuilding unnecessary infrastructure with the intent of achieving an edge in a competition for an un-serviced area.

22. The PWU also notes that an "open for competition" approach would require changes to legislation, existing licence conditions and a process would have to be introduced to ensure that the distributor with the most economically and cost efficient proposal that is in the public interest is selected. This would create unnecessary regulatory burden. As indicated earlier, according to the Discussion Paper the majority of the SAA applications that have come before the Board have been uncontested. The system that is currently in place is working, and distributors should be left to make decisions on whether a SAA, consolidation or some other arrangement might be its best alternative resulting in the most economic and cost efficient choice to be made in the public interest.

2) Should the Board's SAA policy facilitate SAAs that have the effect of aligning a distributor's service area with municipal planning boundaries and, if so, in what way? What are the benefits and risks of such an approach for Incumbent Distributors, Applicant Distributors and their

[2] EB-2012-0047. Hydro One written submission. February 21, 2013.

respective ratepayers? What role should municipal planning, community energy plans and regional planning have in the SAA process?

23. As indicated in the foregoing discussion, the PWU's view is that the Board's SAA policy should remain the status quo. Aligning a distributor's service area with municipal boundaries, which amounts to a sweeping redrawing of the existing service areas, does not contribute to the public interest in the electricity sector or the Board's objective of improving efficiency. It could in fact be disruptive, complex and difficult to implement. The OEB addresses the issue of aligning service areas with municipal boundaries in its Decision in RP-2003-0044 and the PWU believes that this reasoning remains relevant:

> **Similarly, proposals to align service areas with municipal boundaries are ill-considered unless the proponent can *provide concrete evidence that the extended area is needed to provide service to actual customers in the area* using assets and capacity in a manner that optimizes existing distribution assets, and *does not prejudice existing customers of the utility. Amendments need to be anchored by real customers*, with an economic case for the extension that is convincing. Some parties argued that aligning the service areas with municipal boundaries advances distribution system planning. *The Board does not regard such alignment to be inherently beneficial.* It is apparent that the decoupling of the electrical utilities from municipal government, which is one of the signal reforms in the recent development of the electricity market, will continue to evolve. It is not unlikely that the pursuit of efficiencies will lead to the continuing consolidation of the distribution industry in Ontario, and any alignment of service areas to specific municipalities will be increasingly irrelevant.**[3]
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> ...
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> ***...Service Area amendments should not result in the Board-mandated transfer of customers from one distributor to another. Such transfers should be the subject of bilateral arrangements between distributors, wherein all of the issues engaged by such transfers can be addressed. Such issues involve appropriate compensation for any assets stranded as a result of the arrangement. In this way, the interests of the customers of the surrendering distributor can be reasonably protected. An applicant should file evidence to demonstrate all the effects on customers in the amendment area.* Evidence on aspects such as service quality and reliability should be quantitative, not anecdotal.**[4]

[3] RP-2003-0044, Decision with Reasons, February 27, 2004, Paragraph 241
[4] RP-2003-0044, Decision with Reasons, February 27, 2004, Paragraph 267

24. A very real risk of aligning a distributor's service area with municipal boundaries is massive customer discontent. From the customer perspective, there are winners and losers as a result of rate rationalization associated with aligning a distributor's service area with municipal boundaries. Customers of the distributor with higher rates experience rate decreases while customers of the distributor with lower rates experience rate increases. Voluntary SAAs would include local deliberations on the impact of rate rationalization; mandatory SAAs would not. In addition to enduring rate increases related to a mandatory SAA, these customers will need to endure the bill increases related to electricity supply, aging infrastructure and the smart grid. On the other hand, a mandatory SAA without rate rationalization would result in unfair rate subsidization among customers.

25. The cumulative effects of SAAs must also be considered when contemplating revisions to service area policy. If an Incumbent Distributor is subjected to multiple SAAs due to service area policy that aligns a distributor's service area with municipal planning boundaries, then the remaining customers may be unfairly left with costs for stranded assets as well as capacity that were provided for in a system plan that included the customers lost in the SAAs.

26. Hydro One has adjacent boundaries with approximately 60 or so of the 75 LDCs representing over 100 territories.[5] This puts Hydro One and its customers in a very precarious position if the Board's SAA policy facilitates aligning a distributor's service area with municipal planning boundaries.

27. Any revisions to SAA policy must ensure that the short and long-term interests of all customers are understood and quantified based on empirical analysis. In its Decision with Reasons, RP-2003-0044, the Board found that the interests of the larger group of consumers affected by any service area amendment application must be protected and take precedence over the preference of any individual consumer:

> **It was argued by some that the third objective reinforces the importance of customer preference in service area amendments. However, in the**

[5] EB-2012-0047. Hydro One written submission. February 21, 2013.

Board's view, the protection of consumer interests encompasses broader considerations than the immediate and narrow interest of a given consumer at a given point in time. In our view the term requires the Board to consider the protection of the interests of other consumers in the proposed amendment area, the remaining customers of each utility, and the interests of electricity consumers throughout the province, over a time period that includes more than the short-term implications of any given action. Individual customer preference must be balanced with the interests of all consumers with respect to prices and the reliability and quality of electricity service. The preference of a particular customer or group of customers cannot be relied upon to yield results that are necessarily in the overall public interest.

The Board finds that the protection of the interests of the larger group of consumers affected by any service area amendment application must take precedence over the preference of any individual consumer. The more general interest of consumers will be protected through the rational optimization of existing distribution systems.

28. Coordinating regional planning, municipal planning and community energy plans with the SAA process may be very appealing in theory. In reality, however, it can complicate or prolong the process and possibly hinder the Incumbent Distributor from meeting its mandated timelines for connecting a customer. It is also possible that coordination with the various entities (regional planning, municipal planning, and community energy plans) could lead to Board policy that requires reconfiguring the entire system which would be very costly and unnecessary.

29. Finally, to the extent that the Board's objective is to help LDCs increase efficiencies through consolidations that are voluntary and based on mutually agreeable and advantageous business terms, aligning a distributor's service area with municipal boundaries is not an effective model to achieve the objective. Voluntary consolidations that are mutually beneficial and commercially advantageous happen through the merger of operations and ownership regardless of the existing service boundaries of the merging entities. Moreover, expansion to municipal borders is not an effective interim measure, likely to facilitate the achievement of a more efficient end state. To the contrary, expansion to municipal boundaries is likely to create even greater balkanization and rigidity, and act as an impediment to voluntary consolidation that should always be left to "willing sellers/willing buyers."

3) ***For either proposed change to the Board's current policy: (i) How should the Board approach its analysis? (ii) What criteria should be used by the Board and what type of evidence would be necessary? (iii) How can the Board ensure that the proposed change would not adversely affect overall economic efficiency in the sector? (iv) How should the Board assess the impact on existing and future customers in terms of cost and the reliability and quality of electricity service? (v) How can the Board be satisfied that the process will ensure that the connection of new customers proceeds in a timely manner?***

30. The PWU submits that the very nature of the questions raised by Board staff indicate how difficult the implementation of the proposed changes would be, which in turn raises the question of whether the expected benefits or outcomes from the proposed changes, if any, would be worth the efforts required to implement the changes.

31. The PWU submits that there are principles that should govern any sound SAA policy including the following:

- Based on empirical analysis, understand and quantify the short and long-term benefits, costs and risks;
- Ensure ongoing/improved service quality, safety and rate stability;
- Ensure benefits outweigh costs and risks are manageable;
- Assess impact on LDCs ability to carry on with their legislated and regulatory requirements;
- Obtain customer support through broad consultations;
- Assess the impact of any transfer of wealth;
- Ensure the ongoing financial viability of the incumbent LDCs; and
- Analyze customer rate impact (customers of both the Incumbent and Applicant Distributor).

32. In the PWU's view, adherence to these principles as well as objectives subsumed in the questions raised by Board staff such as ensuring overall economic efficiency and the interest of existing and future customers are not adversely impacted in terms of cost, service quality and reliability point to the

significant work that the proposed changes would entail and the kind of disruption they could cause to the current policy which is working reasonably well.

33. Over the last 15 years the electricity distribution sector has been continuously pressed with major, disruptive and costly mandated undertakings which together with other factors have significantly marred the LDCs efficiency performance. Unless the Board has empirical evidence that indicates the status quo is materially detrimental to economic efficiency and not in the public interest, the Board should refrain from any changes to the current SAA policy.

34. The PWU submits that the current criteria established by the Board in the Combined Hearing[6] were sensible when they were first enumerated by the Board, and remain so today. There is simply no compelling reason for the Board to revisit them.

d) *Board Staff Questions – MAADs*

1. What are the merits and risks of allowing a consolidated entity to set its own rebasing deferral period? Should the Board establish a "default" minimum deferral period and, if so, what should the length of that deferral period be?

35. Allowing a consolidated entity to set its own rebasing deferral period can provide the consolidated entity with greater flexibility to reasonably assess the benefits and costs of the consolidation transaction and determine the appropriate rebasing time that is consistent with its individual circumstances such as the size of the transaction, the time the entity needs to recover costs including out of pocket/transaction costs, acquisition premiums and restructuring costs and reap efficiency gains from the transaction, the entity's expected needs for capital investment and the type of rate setting option the entity is on.

36. On the other hand, allowing every consolidated distributor to set its own rebasing deferral period could increase regulatory burden at a time when

[6] RP-2003-0044, Decision with Reasons, February 27, 2004 (the Board's principles and policy with respect to SAAs in relation to nine separate service area amendment applications)

distributors and consumers are just beginning to understand the overall impact of the Board's RRFE and the associated rate-setting options. Similarly, as indicated in the Discussion Paper, allowing the consolidated distributor to set its own rebasing deferral period could be perceived as unfair from the point of view of ratepayers in that a distributor that is able to reduce its costs could keep the savings by delaying rebasing, whereas a distributor could rebase immediately if it experiences increased costs in order to pass those incremental costs on to consumers.

37. The PWU refrains from commenting on the proposal for a new "default" minimum deferral period and leaves the issue for distributors to comment on.

38. However, as a general proposition, the PWU believes that the Board should balance the objective of providing clarity with respect to the regulatory treatment of consolidation transactions with that of providing flexibility so that the different types of consolidations that could potentially take place are accommodated. In this respect, the PWU considers the Board's 2007 policy with regards to rate issues associated with MAADs transactions,[7] to be a good starting point. Under the 2007 Policy, when a distributor applies for approval of a MAADs transaction it may propose to defer rebasing of the rates of the consolidated entity for up to 5 years from the date of the closing of the transaction. The Discussion Paper also indicates that:

> **In the five distributor consolidation proceedings that have occurred since the 2007 Policy was established, four rebasing deferrals were granted.5 However, of those, in only one case did the merged entity opt to defer rebasing for the full five years allowed under the Policy.[8]**

39. In addition, the relevance of the deferral of rebasing period to distributors that are in the three different RRFE rate-setting options is not the same. For distributors on the Annual Index option, there is no need for a deferral period as the distributor would continue to operate under the Annual Index option. Similarly, the Discussion Paper states that it would be consistent with the 2007 Policy for distributors that are on the Price Cap option at the time of consolidation

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[7] *Report of the Board regarding Rate-making Policies Associated with Distributor Consolidation*
[8] Discussion Paper, Page 12

to continue to have their rates adjusted under the same mechanism until rebasing. Therefore, it is for distributors that are under Custom IR that the situation is more complicated.

40. The conclusion from all the above is that a small number of cases will come the Board's way relating to the deferral of the rebasing period. In this respect, the best approach is to continue the current policy of 5 year deferral and for those seeking a longer period; the Board should consider their application on a case by case basis, supported by evidence. The PWU submits that the review of such applications should make service quality, reliability and safety a major issue in that without the appropriate treatment or recognition by the Board of needs for capital investments during the extended rebasing period, distributors may refrain from making the necessary capital investments and simply delay rebasing just to realize the benefits of consolidation.

2. Should the consolidated entity be required to elect its rebasing deferral period at the time of the MAADs application (as is the case under the 2007 Policy), or should the entity be allowed to address this at a later date and, if so, when? What information should a consolidated entity provide to support its proposed rebasing deferral period?

41. While keeping in mind the PWU's response to question #1, it is the PWU's view that the consolidated entity should be afforded some flexibility with respect to when it should apply for or elect, as the case may be, its rebasing deferral period. The distributors in Ontario are very diverse (e.g. location, number of customers, growth potential, etc...) and the opportunities for consolidation are varied (e.g. multi-step transactions, partial transactions, transactions that require significant upfront expenditures, etc...). While it is possible for some consolidated entities to elect or apply for rebasing deferral at the time of the MAADs application, others may need some time to assess the need for a rebasing deferral application and to determine the duration of the deferral appropriate to their circumstances.

42. The PWU defers to distributors to comment on the question of exactly how long a consolidated entity could wait after a MAADs application to apply for rebasing deferral. The PWU provides the following example as a demonstration of how this could work: the Board could allow a consolidated entity up to one year after the MAADs application to apply for or elect the rebasing deferral, as the case may be. If the consolidated entity has been on a rate-setting option and less than a year is left before rebasing, then that could be the duration of time the entity is allowed to wait after a MAADs application to apply for rebasing deferral.

3. Once a consolidated entity has proposed a rebasing deferral period, should it be required to wait for the entire period before applying for a rebasing of its rates, or should it be allowed to apply for rebasing at any time within the proposed period? What are the merits and risks of each approach?

43. A consolidated entity should be allowed to apply for rebasing at any time within the proposed rebasing deferral period. In fact, to require a consolidated entity to wait for the entire period before applying for a rebasing of its rates conflicts with the Board's rate-setting principles under the RRFE which provides for an application for rebasing under certain circumstances that are unforeseen by the distributor. Rebasing is a rigorous undertaking based on the utility's need to maintain adequacy, reliability, safety, and quality of electricity service. The PWU believes that a consolidated entity will only rebase if it is necessary, and is able to demonstrate that need with evidence.

44. The PWU notes the concern of consumer groups reported in the Discussion Paper that a consolidated entity might delay rebasing in order to keep any cost savings that they achieve or a consolidated entity that experiences increased costs could choose to rebase immediately in order to pass those incremental costs on to consumers. The PWU submits that in a situation where a consolidated entity decides to rebase immediately, there is a process in place for rebasing applications by which the Board determines if the consolidated entity's request for rebasing and the requested rates are just and reasonable.

4. ***In the case of a distributor that is on Custom IR at the time of consolidation, how should its rates be set for the duration of the rebasing deferral period following completion of the Custom IR period?***

45. If a consolidated entity wants to maintain the Custom IR rates it should be able to continue with the Custom IR for the duration of the rebasing deferral period or rebase at the end of the Custom IR period.

5. ***What are the merits and risks of the suggestion that a newly consolidated entity apply for new rates under the Custom IR option that recognize both costs and projected efficiency savings, (e.g. an efficiency carryover to allow the distributor to recoup transaction costs)? Is this complimentary to or a substitute for an approach that allows the deferral of rebasing?***

46. In the PWU's view, there are two major problems or risks with the proposed approach. First, if the Board adopts an approach that would require a newly consolidated entity to apply for new rates under the Custom IR option, the result would be that every consolidation transaction would trigger a new rates application even in circumstances where the consolidated entity is already on one of the three rate-setting options. Secondly, the transition and integration costs of a MAADs transaction, although largely upfront costs, can continue for many years after the completion of the transaction, whereas it could take the consolidated entity some time to arrive at a reasonable forecast of efficiency gains and savings resulting from the transaction. The complexity of any given consolidation will vary based on the unique circumstances of the consolidated entity and forecasting costs and efficiency savings may be very difficult for a newly consolidated entity. To conclude, the proposed approach would increase regulatory burden.

6. ***What are the merits and risks of using a modified ICM (which allows broader eligibility of expenditures) to address the recovery of capital investments during any rebasing deferral period? How should the Board evaluate an ICM request under this scenario to ensure that any***

financing is for investments that are incremental to the capital amount built into rates?

47. The PWU is very concerned that the extension of the rebasing period for consolidated entities without the appropriate treatment of capital investments during the extended incentive rate-making period could adversely affect service quality, reliability and safety. It is unlikely that a distributor would be able to operate over an extended rebasing period without incorporating normal capital expenditures into rate base. If capital additions cannot be incorporated into rate base, financing for capital investments would be adversely impacted. As the Discussion Paper indicates, distributors expressed their concern in this regard during the February Consultation:

> **Distributors also expressed concern that they will be forced to choose between early rate rebasing to address capital spending, or delayed rebasing in order to enhance the viability of a MAADs transaction. In their view, this may have a dampening effect on consolidation because the recovery of transaction costs will come at the expense of foregoing the recovery of capital expenditures. By contrast, if distributors who are considering a MAADs transaction know that they have the ability to apply to the Board for the inclusion of on-going capital investments into rate base during the extended rebasing period that is necessary to earn savings, they may be more willing to consider consolidation.** [9]

48. The PWU's paramount concern is that in pursuit of the objective of realizing savings from consolidation, distributors could delay capital investments because otherwise they would be forced to rebase before they realize the full savings from consolidation.

49. An obvious risk of using a modified ICM to address the recovery of capital investments during any rebasing deferral period is that the Board could reject the request for ICM unless the modification that would be built into the ICM provides certainty of cost recovery for some types of capital investments. In the past, the ICM mechanism, which is available now only to distributors that have chosen the Price Cap option, allowed seeking funding for significant and extraordinary

[9] Discussion Paper, Pages 13-14

capital investments during the incentive regulation term. The threshold for application as well as approval has been very complicated and risky to undertake.

50. Allowing merged distributors who are under any of the three rate setting methodologies to use the ICM model during a deferral period, and modifying the model by expanding the ICM eligibility criteria to include normal capital investments would go some distance in addressing the issue of capital investment during the rebasing deferral period; but only if the modified ICM provides clarity and certainty that distributors need to make effective decisions.

All of which is respectfully submitted.