Ontario

Ontario Energy Board
Commission de l’énergie de l’Ontario

DECISION AND ORDER

EB-2017-0269

NEWMARKET-TAY POWER DISTRIBUTION LTD.

MIDLAND POWER UTILITY CORPORATION

Application requesting approval for Newmarket-Tay Power Distribution Ltd. to purchase and amalgamate with Midland Power Utility Corporation

BEFORE: Ken Quesnelle
Presiding Member and Vice-Chair

Christine Long
Member and Vice-Chair

Cathy Spoel
Member

August 23, 2018

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1 INTRODUCTION AND SUMMARY

This is the Decision of the Ontario Energy Board (OEB) regarding an application filed by Newmarket-Tay Power Distribution Ltd. (NT Power) and Midland Power Utility Corporation (Midland Power)(collectively, the applicants). Approval is requested by the applicants for NT Power to purchase all of the shares of Midland Power and to amalgamate with Midland Power, following the share purchase.

As part of the application, approval is sought for: (a) transfer of Midland Power's distribution system to NT Power; (b) approval of the proposed earnings sharing plan; (c) approval of a variance account to track excess earnings; (d) transfer of Midland Power's rate order to NT Power; (e) cancellation of Midland Power's electricity distribution licence; (f) amendment of NT Power's electricity distribution licence; and (g) continued tracking of costs to the existing deferral and variance accounts.

Section 86 of the *Ontario Energy Board Act, 1998*[1](the Act) requires a transmitter or distributor to obtain leave of the OEB before disposing of its distribution or transmission system or amalgamating with another corporation.

The OEB has applied the no harm test in assessing this application, and has concluded that the proposed transaction meets that test. The OEB therefore approves the proposed transaction. The OEB also approves certain of the additional requests made by the applicants as described in this Decision.

[1] S.O. 1998, c.15 Schedule B

2 THE APPLICATION

NT Power and Midland Power are both licensed electricity distributors in Ontario. NT Power is owned 93% by Newmarket Hydro Holdings Inc. and 7% by Tay Hydro Inc. Midland Power is 100% owned by the Corporation of the Town of Midland.

NT Power intends to purchase all of the issued and outstanding shares of Midland Power for $27.6 million, consisting of a cash payment of approximately $22 million and the assumption of Midland Power's $5.6 million debt. NT Power will also pay Midland Power an additional fixed amount of $0.2 million in respect of Midland Power's transaction costs and expenses.

The applicants have selected a ten year deferred rebasing period and have proposed an earnings sharing plan for years six to ten of the deferred rebasing period.

The applicants seek approval under section 86 of the Act for the following transactions:

- Acquisition of all shares of Midland Power by NT Power
- Transfer of Midland Power's distribution system to NT Power
- Amalgamation of NT Power and Midland Power and to continue as Newmarket-Tay Power Distribution Ltd.

The applicants also seek approval for:

- Transfer of Midland Power's rate order to NT Power, under section 18 of the Act
- Cancellation of Midland Power's electricity distribution licence, under section 77(5) of the Act
- Amendment of NT Power's electricity distribution licence, under section 74 of the Act
- A ten-year deferral period for the rebasing of Midland Power's rates and the rates of the consolidated entity
- NT Power's proposed earnings sharing plan
- A variance account to track excess earnings in years six to ten of the deferred rebasing period
- Continued tracking of costs to each of the applicants' existing deferral and variance accounts
- Continuation with current rate riders approved by the OEB for each of the applicants

Process

The OEB issued a Notice of Application and Hearing on August 31, 2017, inviting intervention and comment. Capredoni Enterprises Ltd. (CEL) and School Energy Coalition (SEC) applied for intervenor status and eligibility for cost awards. The applicants objected to CEL's intervention request. The OEB requested additional information from CEL but this was not forthcoming, and the OEB subsequently denied CEL's request for intervenor status and cost eligibility. The OEB approved SEC as an intervenor and confirmed its eligibility to apply for an award of costs.

In Procedural Order No. 1 issued on October 30, 2017, the OEB provided for interrogatories on the application to be filed on November 17, 2017 and responses to be filed on December 8, 2017.

On January 29, 2018, OEB staff requested that the OEB provide for supplementary interrogatories to enable OEB staff to make submissions on whether or not the no harm test is satisfied. The OEB issued Procedural Order No. 2 on February 2, 2018 setting out a schedule for the filing of supplementary interrogatories, responses and submissions. Supplementary interrogatories and responses were filed on February 5, 2018 and February 23, 2018, respectively. The applicants filed their argument-in-chief on March 7, 2018 followed by the filing of submissions by SEC and OEB staff on March 8, 2018 and March 14, 2018, respectively. The applicants filed reply argument on March 21, 2018.

3 REGULATORY PRINCIPLES

3.1 The No Harm Test

The OEB applies the no harm test in its assessment of consolidation applications.[2] 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 application.

The statutory objectives to be considered are those set out in section 1 of the Act:

1. To protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.

   1.1 To promote the education of consumers.

2. To promote economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity and to facilitate the maintenance of a financially viable electricity industry.
3. To promote electricity conservation and demand management in a manner consistent with the policies of the Government of Ontario.
4. To facilitate the implementation of a smart grid in Ontario.
5. To promote the use and generation of electricity from renewable energy sources in a manner consistent with the policies of the Government of Ontario, including the timely expansion or reinforcement of transmission systems and distribution systems to accommodate the connection of renewable energy generation facilities.

While the OEB has broad statutory objectives, in applying the no harm test the OEB has focused 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 consolidating utilities.

[2] The OEB adopted the no harm test in a combined proceeding (RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257) as the relevant test for determining applications for leave to acquire shares or amalgamate under section 86 of the Act and it has been subsequently applied in applications for consolidation.

The OEB considers this an appropriate approach, given the performance-based regulatory framework under which regulated entities are required to operate and the OEB's existing performance monitoring framework.

3.2 OEB Policy on Rate-Making Associated with Consolidation

To encourage consolidations, the OEB has put in place policies on rate-making that provide consolidating distributors with an opportunity to offset transaction costs with savings achieved as a result of the consolidation. The OEB's 2015 Report[3] permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction.

The OEB's Handbook[4] sets out that the extent of the deferred rebasing period is at the option of the distributor and no supporting evidence is required to justify the selection of the deferred rebasing period. Consolidating entities, must, however, select a definitive timeframe for the deferred rebasing period. This is to allow the OEB to assess any proposed departure from this stated plan. The Handbook states that when a consolidated entity has opted for a deferred rebasing period, it has committed to a plan based on the circumstances of the consolidation and that if it seeks to amend the deferred rebasing period, the OEB will need to understand whether any change to the proposed rebasing timeframe is in the best interest of customers.

The 2015 Report requires consolidating entities that propose to defer rebasing beyond five years to implement an earnings sharing mechanism for the period beyond five years to protect customers and to ensure that they share in increased benefits from consolidation.

[3] EB-2014-0138 Report of the Board on Rate-making Associated with Distributor Consolidation, March 26, 2015
[4] Handbook to Electricity Distributor and Transmitter Consolidation, January 19, 2016, pp. 12-13

4 DECISION ON THE ISSUES

4.1 Application of the No Harm Test

Price

In its review of a consolidation proposal, the OEB reviews the underlying cost structures of the consolidating utilities. As distribution rates are based on a distributor's current and projected costs, the OEB has stated that it is important for the OEB to consider the impact of a transaction on the cost structure of consolidating entities both now and in the future, particularly if there appear to be significant differences in the size or demographics of consolidating distributors.[5]

Electricity distribution rates are currently based on a return on the historic value of the assets. The Handbook sets out that if a premium has been paid above the historic value, this premium is not recoverable through distribution rates and no return can be earned on the premium. Shareholders are permitted to recover the premium over time through savings generated from efficiencies of the consolidated entity. The OEB has stated that in considering the appropriateness of purchase price or the quantum of the premium that has been offered, only the effect of the purchase price on the underlying cost structures and financial viability of the regulated utilities will be reviewed.[6]

The applicants have agreed on a purchase price of $27.7 million which includes a premium of $11.9 million.

The applicants have selected a ten year deferred rebasing period and indicated that the consolidated entity will rebase and harmonize rates in year 11. NT Power has projected that when rates are harmonized, residential customers of Midland Power will see a distribution rate reduction as a result of the lower residential distribution rates of NT Power and the efficiencies generated from the contiguous service areas of Tay and Midland. NT Power anticipates an increase in distribution rates for Midland Power's General Service (GS) customers when rates are harmonized but states that will be mitigated by applying the efficiencies and lower cost structures expected as a result of the proposed transaction.[7]

[5] Handbook, p.6
[6] Handbook, p.8
[7] OEB Staff IR 5(b)

Economic Efficiency and Cost Effectiveness

Cost Synergies/Efficiencies

According to the application, cost savings are anticipated to arise from efficiencies in business operations – reductions in management and staff through natural attrition (retirement and employee departures), reduced governance costs (i.e. single Board of Directors), the elimination of duplicate memberships and professional fees, reduced fleet maintenance and reduced consulting costs through redeployment of existing staff resources.[8] The applicants have not included potential savings from the opportunity to move to a direct connection to the grid for the Tay and Midland areas in their estimated OM&A cost savings.

The applicants' evidence included a table reflecting cost synergies over the ten year deferred rebasing period (2018-2027) showing estimated OM&A cost savings ranging from $0.2 million in year one to $1.4 million in year 10.[9]

OEB staff submitted that by year 10, cumulative efficiencies would amount to $1.3 million. OEB staff questioned the applicants' expected efficiencies and whether they would be sufficient to mitigate rates as proposed by NT Power, given that NT Power anticipated using these efficiencies to finance the recovery of the premium as well. OEB staff expressed concern regarding debt incurred to finance the premium, which it argued should be a shareholder issue and not reflected in the realized return on equity (ROE) for regulatory purposes.

In reply submissions the applicants argued that OEB staff's understanding of the cumulative efficiencies is incorrect and that total estimated efficiencies over the 10 year period amount to $9.5 million.[10]

OEB staff submitted that the OEB should require NT Power to establish sub-accounts of Long-term Debt and Interest Expense accounts to separate the long-term debt and interest expense associated with the debt incurred to fund the purchase price premium from other debt and associated interest expense incurred for financing assets used to provide electricity distribution services to ratepayers. OEB staff further submitted that the consolidated NT Power should report RRR[11] and other reporting requirements,

[8] OEB Staff IR 7(b)
[9] Application, Exh.B/p. 23
[10] Newmarket-Tay Reply Argument, p. 4
[11] OEB Electricity Reporting and Record Keeping Requirements

including the achieved ROE on a regulated basis absent the impact of the debt incurred to finance the purchase price premium.[12]

In reply argument, the applicants stated that the premium will be funded by the cash payment of the purchase and the anticipated cost synergies between years 1 to 10 and any premium not recovered after year 10 will be funded from the consolidated entity's ROE. NT Power stated that it would report the financial impact of the premium remaining by the annual ROE reconciliation schedule with the RRR filings.

With respect to OEB staff's submission relating to the establishment of sub-accounts, NT Power submitted that it would use sub-accounts associated with the OEB's *Accounting Procedure Handbook* to track the portion of the purchase premium associated within short term debt, long term debt, interest expense and tax expense. In its view, this will facilitate reporting of ROE and provide assurance that funding of the premium is a shareholder responsibility.

OEB staff submitted that the OEB should order NT Power to submit a rate mitigation plan upon rebasing which would involve mitigating any cost increases to NT Power's GS customers by having NT Power's shareholders absorb more of the cost increase. NT Power submitted that such an order is inappropriate at this time as rate mitigation is a matter that would, if applicable, be addressed at the time of rebasing.

Continued Use of Midland Power Name and Brand

Section 6.16 of the Share Purchase Agreement (SPA) contemplates the continued use of the Midland Power name and brand following the amalgamation.

This was confirmed in response to interrogatories[13] where the applicants stated that they would continue using the Midland Power name and brand in Midland Power's current service territory during the deferred rebasing period. The continued use of the name and brand would be reflected on customer bills or invoices as well as signage existing at the closing date. The applicants also indicated that they will maintain separate websites for each of the predecessor utilities.

The applicants indicated that "the continued use of the Midland Power brand is intended to be a transitional mechanism … to provide Midland customers with reassurance that,

[12] OEB Staff Submission, p. 21
[13] OEB Staff IR 1-Staff-4

while ownership is changing, customers can expect to experience the same or improved quality of service…”.[14]

At the same time, the application requests approval for the cancellation of Midland Power’s electricity distribution licence, the amendment of NT Power’s licence to incorporate the Midland Power service area and the transfer of Midland Power’s rate order to NT Power.

The applicants submitted that branding and licensing are mutually exclusive, with branding used to identify and distinguish an organization for its customers, while licensing is a legal requirement.[15] The applicants asserted that continuing the Midland Power brand for 10 years will not create confusion for customers as all bills, correspondence and the Midland Power website will contain a statement that Midland Power is owned and operated by NT Power. In response to interrogatories,[16] the applicants claimed that no synergies are foregone as a result of its proposed Midland Power branding strategy.

OEB staff questioned the cost effectiveness of the applicants’ proposal and how it is reconciled to the OEB’s expectation that consolidating entities operating as one entity as soon as possible after the transaction is in the best interest of consumers.[17]

OEB staff also questioned the separate branding given that the Midland and Tay areas are contiguous and the applicants’ consolidation plans call for common operations, a future direct connection to the grid, and for Midland Power’s operations centre to be used to service Midland and Tay customers.

OEB staff submitted that, if the OEB approves the application, the OEB should not permit separate branding for the Midland Power service area as the applicants have not provided reasonable explanations for deviating from the Handbook and the separate brand strategy may lead to more customer confusion, rather than less.

In its reply argument, NT Power submitted that it intends to consolidate billing and maintenance and that only printed consumer bills will use the Midland Power brand. The applicants have proposed that as fleet vehicles and other physical assets bearing the Midland brand are replaced, they will bear the NT Power brand.

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[14] OEB Staff Supplementary IR -1 (a)
[15] *Ibid.*
[16] OEB Staff IR 2-Staff- IR 1 (c)
[17] 2015 Report, p. 7 and Handbook, p.13

NT Power argued that the proposed branding and website strategy was implemented when Newmarket Hydro Ltd. and Tay Hydro Electric Distribution Inc. merged in 2007 and that it received no customer complaints or any indication that there was confusion with respect to the corporate branding. NT Power also submitted that its proposal is more cost-effective and less confusing to customers.[18]

OEB Findings

The OEB accepts the applicants' statement that synergies resulting from the merger, including reductions in management and staff through natural attrition, reduced governance costs, the elimination of duplicate memberships and professional fees, reduced fleet maintenance, and reduced consulting costs will result in lower cost structures that ultimately benefit customers.

The OEB accepts NT Power's submission regarding the level of the projected savings and that OEB staff's interpretation of the evidence with respect to the total savings is incorrect.

OEB staff's proposals that arose due to its concern with what appeared to be insufficient savings potential to cover the cost of the transaction and premium are therefore not necessary.

The OEB accepts NT Power's commitment to report the financial impact of the premium remaining by the annual ROE reconciliation schedule with the RRR filings.

The OEB agrees with the applicants that a rate mitigation plan is not required until rebasing, at which time the need for mitigation can be considered.

With respect to the continued use of the Midland Power name and brand, the OEB does not consider the proposed plan to present the potential for undue harm to existing or new customers. NT Power's approach appears to have appropriately balanced the cost of a rapid makeover of its branding and outward facing customer engagement platforms against any potential confusion the legacy branding may cause.

The OEB need not consider what may be the best plan with respect to merging activities, but rather whether the proposed plan presents harm to customers in comparison to the status quo.

[18] OEB Supplementary IR 1(b)

Reliability and Quality of Electricity Service

NT Power anticipates that it will be able to maintain existing Midland Power service levels and quality standards and provided a comparison of SAIDI and SAIFI statistics for NT Power and Midland Power.

OEB staff observed that from 2014 to 2016, the SAIDI and SAIFI statistics for Midland Power were lower indicating better performance than NT Power. OEB staff also observed that in 2016, NT Power's SAIDI and SAIFI were at their highest levels and asked NT Power to explain how the no harm test is satisfied with respect to the expected reliability for Midland Power customers in light of the statistics provided.[19]

In its response, NT Power stated that its SAIDI and SAIFI statistics were better than Midland Power's with the exception of 2014 and 2015 when Midland Power had exceptionally good reliability. NT Power submitted that the amalgamation will provide opportunities to implement best practices from both NT Power and Midland Power.

NT Power stated that it is committed to retaining all of Midland Power's staff members, as well as continuing the existing level of operational capability in the Midland and Tay communities in order to continue providing the best possible service levels and quality standards to Midland Power's customers. The applicants submitted that this local knowledge, in combination with NT Power's Tay area operations and staff, will allow NT Power to operate the distribution system in a manner that is expected to maintain or improve reliability.[20]

In the application, NT Power stated that it sees an opportunity for improving reliability and expects lowered losses and costs for Midland and Tay customers through the direct connection to the grid that it expects to establish for the Tay and Midland areas, if the proposed amalgamation is approved. NT Power submitted that the direct grid connection enables the consolidated entity to use local resources to service certain outages instead of waiting for Hydro One to address an issue with its system. NT Power anticipates that a direct grid connection would lead to measurable improvements in outage durations. The application indicates that the Tay and Midland Power operations and administrative facilities will be consolidated which is expected to result in cost savings. In response to interrogatories,[21] the applicants clarified that Midland Power's

[19] OEB Staff IR 1-Staff-10
[20] Application, pp. 22 and 24
[21] OEB Staff IR 1-Staff-8

existing operations centre will serve Tay and Midland Power customers and that no new operations centre is contemplated.

The applicants submitted that these proposed changes make the most efficient use of the facilities with minimal transition costs and impact on Tay and Midland Power customers that require in-person contact with the distributor as the facilities are within six kilometers of each other.

In response to interrogatories inquiring about the filing of a Distribution System Plan (DSP) following the consolidation, the applicants confirmed that NT Power filed a DSP in December 2015. They also confirmed that a DSP will be filed for the Midland rate zone after the proposed consolidation closes and that a DSP for the consolidated entity will be filed by December 2020.[22]

OEB staff submitted that the amalgamated entity can reasonably be expected to meet service quality and reliability standards currently provided by each of the amalgamating distributors. OEB staff also submitted that the OEB is able to monitor performance of the amalgamated entity through performance scorecards as well as the OEB's RRR.[23] Similarly, SEC's submissions stated that both distributors have reasonably good reliability and customer service results, and there is no reason to believe that their performance in either case will decline after a consolidation.[24]

OEB staff submitted that the applicants' proposals for the filing of the DSPs for the Midland Power rate zone and for the consolidated entity are reasonable.

SEC submitted that there would appear to be little value in asking Midland Power to file a separate DSP when a consolidated DSP will be filed in a reasonable time-frame. SEC also submitted that the applicants' commitment to file a consolidated DSP by the end of 2020 should be made a condition of approval of the amalgamation. SEC noted that the applicants' plans for a direct grid connection for the Midland and Tay areas could have significant positive benefits but could also result in an Incremental Capital Module (ICM) application.[25] SEC submitted that the filing of a consolidated DSP by the end of 2020 allows the applicants to consider the direct grid connection changes in the context of their overall system and will give the OEB and customers visibility as to the changes proposed.[26]

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[22] SEC IR 15(d) and 20; OEB Staff IR 2-Staff-14
[23] OEB staff submissions, p.16
[24] SEC submissions, p.3
[25] OEB Staff IR 9
[26] SEC submissions, p.5

In reply argument, the applicants agreed with SEC's submission that the filing of a consolidated DSP by December 2020 be made a condition of approval.

OEB Findings

The OEB finds that it is reasonable to expect that service levels experienced by customers of the proposed merged entity can be maintained at existing levels. Both utilities have historically had good reliability indicators and satisfactory customer service results. There is no indication in the application as proposed that would lead the OEB to determine that service levels would decline as a result of the merger.

The OEB's determination is not dependent on the realization of the possible direct grid connection referenced in the evidence, but as noted below considers its possible benefits in the context of good planning.

The OEB expects utilities to continuously and effectively plan for the management of their distribution systems. In the absence of the proposed acquisition of Midland Power, the OEB would have expected Midland Power to demonstrate that the welfare of its customers was being considered in an effective planning process. The OEB notes that NT Power agrees with SEC's proposal to include the filing of a consolidated DSP by December 2020 as a condition of approval.

In order to ensure the customers of Midland Power receive the same level of consideration from a planning perspective as they otherwise would have in the absence of the proposed acquisition, the OEB will include such a condition.

Financial Viability

Purchase Price Premium and Financing of the Transaction

The purchase price that has been agreed upon by the consolidating distributors is $27.7 million which includes a premium of $11.9 million. NT Power has indicated that the transaction costs and expenses amount to $1.2 million, which includes $0.2 million that NT Power has agreed to pay in respect of Midland Power's transaction costs and expenses.[27]

[27] OEB Staff Supplementary IR 3(a)

NT Power explained that it is financing the acquisition cost consisting of Midland Power's book value, premium and transaction costs and expenses through cash (10%) and new term debt (90%) which will be amortized over twenty-five (25) years. The cash portion of the acquisition cost will be used to partially fund the premium and transaction costs and expenses. NT Power will account for the debt in two components: 1) a premium, transaction costs and expenses component, and 2) a book value component.

NT Power stated that during the deferred rebasing period, efficiencies will increase the applicants' ROE and this increase will be used to fund the amortization of the premium, transaction costs and expenses component. The residual amortization of the premium and transaction costs and expenses component from year 11 onwards will continue to be funded from ROE. In NT Power's view, this accounting treatment will ensure that ratepayers will pay no portion of the premium, transaction costs and expenses.

OEB staff inquired how the applicants' proposal to recover the premium from the consolidated entity's ROE beginning in year 11 is consistent with the OEB's expectation that the transaction costs, including the premium, are recovered from efficiencies generated during the deferred rebasing period. The applicants responded that there is no OEB requirement that a premium must be fully recovered from efficiencies generated during the deferred rebasing period and that this is a shareholder issue that does not impact electricity distribution ratepayers.[28] The applicants submitted that the consolidated entity has the financial capacity to fund the new term debt (up to $50 million of financing capacity available) over the 25-year amortization period.

OEB staff made submissions on the understanding that the efficiencies gained from the proposed consolidation amount to $1.3 million over the 10 year deferred rebasing period. OEB staff submitted that if the proposed consolidation is approved, the OEB should make clear in its decision that it expects NT Power to track recovery of the acquisition premium, given that a large proportion of the premium is expected to be recovered after rebasing of the consolidated entity.

In its reply argument, the applicants submitted that OEB staff has misunderstood the applicants' evidence regarding the estimated efficiencies and asserted that they will amount to $9.5 million over the ten year deferred rebasing period, not $1.3 million as understood by OEB staff. The applicants also submitted that the purchase price premium of $11.9M is 12% of NT Power's 2016 net fixed assets.

[28] OEB Staff IR 2-Staff-5

OEB Findings

The OEB accepts NT Power's submission regarding the level of the projected savings and that OEB staff's interpretation of the evidence with respect to the total savings is incorrect.

OEB staff's concerns that arose due to its understanding that there were insufficient savings potential to cover the cost of the transaction and premium are therefore unwarranted.

The OEB does not consider the financial viability of NT Power to be at risk as a result of the proposed acquisition.

4.2 Rate-making Considerations

Deferred Rate Rebasing

The applicants requested approval for a ten year deferred rebasing period for Midland Power and for the consolidated entity.

SEC submitted that while the applicants have proposed a ten year deferred rebasing period, NT Power also proposed that it be allowed to choose whether to continue on the ten year deferral or not, in effect having an unfettered discretion to file a cost of service application at any time. SEC submitted that the OEB should make it clear that the ten year deferral period, if allowed, is a fixed period and cannot be shortened by the applicants and the consolidated entity except under the normal rules for early rebasing.[29]

SEC noted that the applicants have not had a recent detailed OEB review of their costs as Midland Power last rebased in 2013 and NT Power last rebased in 2010, and the applicants have now proposed a ten year deferral period, during which utility operations and management will be increasingly opaque to the OEB. SEC submitted that the OEB should consider whether to require additional reporting, or perhaps even a shorter deferred rebasing period, so that the OEB's ability to regulate the applicants effectively is not compromised by lack of timely and thorough information.[30]

[29] SEC submissions, p. 3
[30] SEC submissions, p. 4

NT Power responded in its reply argument that it is not proposing that it could choose whether or not to continue on the ten year deferral that it has proposed for Midland Power and for the consolidated entity. However, despite this ten year deferred rebasing proposal, NT Power considers that it can at any time migrate from its existing rate plan (Annual IR) to a different option, potentially rebasing for the current NT Power service territory only arguing that this is permitted by the Handbook and 2015 Report.[31]

As part of its interrogatories and in its submissions,[32] SEC provided a table comparing NT Power's and Midland Power's annual distribution bills. SEC argued that NT Power's rates for the GS>50 class are 32.5% above the provincial average primarily because cost allocation and rate design was last done for NT Power in 2010 and, while NT Power's revenue to cost ratio was within the OEB's then maximum level, that would not be the case today. SEC further argued that this matter would normally have been addressed if NT Power had rebased in 2014 or 2015 but since it did not rebase, this matter was not addressed.

SEC submitted that given the applicants' proposed ten year deferred rebasing period, the cost allocation and rate design would remain out of date for a total of twenty years and by that time, the load shapes would be twenty-five years old. SEC argued that this results in the GS>50 class overpaying for incorrectly allocated costs and transmission charges and that the GS>50 class will continue to do so until the allocation is addressed. SEC submitted that the applicants should be required to update their cost allocation models within twelve months of completing the proposed transaction and file this with the OEB, together with a proposal to adjust over time any rates that are too high or too low relative to the OEB's cost allocation policies.[33]

NT Power responded stating that SEC's proposal regarding cost allocation is not appropriate because this is a section 86 proceeding relating to the approval of the applicants' proposed sale/purchase and amalgamation and not a cost of service rate proceeding.

[31] NT Power Reply Argument, p. 13
[32] SEC IR 5 and submissions, p.2
[33] SEC submissions, pp.6,7

OEB Findings

The Handbook states that consolidating entities must select a definitive timeframe for the deferred rebasing period and that the term selected should be based on the entities' assessment of the circumstances surrounding the consolidation. Distributors may propose a change to their selected deferred rebasing period, however, the change must be supported by rationale that identifies the need for the change. This requirement, the Handbook states, is to provide the OEB with the ability to assess the merits of any proposed departure from the selected term and whether the proposed change is in the best interest of customers.

NT Power will therefore not be permitted to deviate from its selected ten year deferred rebasing period unless it can demonstrate the need for such a change and it is subsequently determined by the OEB to be in the best interest of customers.

The OEB notes that the Handbook states that rates will not be considered in a MAADs application. The OEB's focus in a MAAD's application is on the underlying costs of the merging entities. However in the application of the "no harm" test the OEB considers what customers would have expected in the absence of the proposed merger. In this particular case, customers have not had their rates considered from a cost allocation perspective for several years (NT Power and Midland Power's last cost of service proceedings were for 2011 and 2013 rates, respectively). Customers that are potentially overpaying now should not be expected to continue to overpay for an additional 10 years when in the absence of this merger their rates would have been adjusted sooner.

SEC submitted that the applicants should be required to update their cost allocation models within twelve months of completing the proposed transaction and file this with the OEB, together with a proposal to adjust over time any rates that are too high or too low relative to the OEB's cost allocation policies. The OEB accepts SEC's proposal and makes it a condition of approval.

Earnings Sharing Mechanism

NT Power plans to implement an earnings sharing mechanism (ESM) starting in year six of the deferred rebasing period to share earnings in excess of 300 basis points above the OEB's established regulatory ROE for the consolidated entity, on a 50:50 basis between the consolidated entity and its customers. As NT Power's proposed

ESM is not entirely consistent with the OEB's policy, it requested approval of its proposed ESM.

The OEB's policy requires that earnings are assessed each year once audited financial results are available and that excess earnings beyond 300 basis points will be shared with customers annually.[34]

NT Power requested that the OEB approve a variance account (ESM Account) in which NT Power will place 50% of any earnings above 300 basis points in years six through ten of the deferred rebasing period. NT Power proposed that at the end of year 10, any amounts in the ESM Account first be used for any rate mitigation required for Midland Power's GS customers at the time of re-basing of the combined entity. If rate mitigation is not required, any amounts in the ESM Account would be disbursed to all customers. NT Power submitted that, since all the customers of the proposed consolidated entity are anticipated to benefit from consolidation, all customers should be considered to benefit from any amounts that have accrued in the ESM Account.

OEB staff submitted that NT Power's proposal to use any overearnings for rate mitigation is not consistent with OEB policy and is tailored to respond to the bill impact analysis conducted by the utility for the post-deferral period. OEB staff further submitted that NT Power has attempted to propose a remedy to deal with the rate differentials between utilities and, while OEB staff is not opposed to the approach, it is an indication of the less than ideal analysis and planning conducted with respect to NT Power's anticipated savings over the deferral period. OEB staff argued that the forecast of savings in the order of $1.3 million represents approximately 1.3% of OM&A over the 10-year period.

NT Power submitted that the estimated savings are 10.5% of OM&A and not 1.3% as stated in OEB staff's submissions. NT Power argued that the no harm test does not involve speculation around theoretical and abstract constructs of what is "ideal" as appears to be proposed in OEB staff submissions. NT Power submitted that the question is whether a reasonable expectation exists, based on underlying cost structures, that the costs to serve acquired customers following a consolidation will be no higher than they otherwise would have been.

[34] Handbook, p. 16

OEB staff interrogatories[35] inquired why the ESM account is requested in this application instead of when the account is needed in year six and asked NT Power to provide a draft accounting order for the requested account. NT Power replied that it is willing to request the account when needed in year 6 if this is the OEB's preferred approach.

OEB staff submitted that NT Power can be required to establish the ESM account closer to year six of the deferred rebasing period and provide a draft accounting order at that time. NT Power responded that it understood that the OEB would consider and approve the ESM account as part of its approval of NT Power's proposed earnings sharing plan, but that it seeks the OEB's direction on the appropriate timing to set up the ESM account. NT Power stated that it will provide a draft accounting order if the OEB determines that the ESM account is considered part of this proceeding.

SEC submitted that the applicants' proposals to redirect amounts from the ESM account to mitigate any rate adjustments required on harmonization is inappropriate. SEC argued that rates are supposed to be set based on cost causality and that ROE would normally be one of the costs that is allocated. SEC also disagreed with the applicants' proposal that disproportionate amounts of the earnings sharing should be allocated to some customers at the expense of other customers.

SEC argued that deferring payment of any amounts in the ESM account is justified only if the applicants' rate mitigation proposal is accepted; otherwise this should be reimbursed to customers annually after it is calculated, and should be allocated on the same basis as ROE.

In its reply argument, NT Power stated that if the OEB directs, it will follow the earnings sharing mechanism exactly as set out in the Handbook.

OEB Findings

The OEB does not consider there to be any compelling reason to depart from the Handbook in this case.

NT Power's request to retain 50% of earnings above 300 basis points in years six through ten of the deferred rebasing period in a deferral and variance account, and at the end of year ten to utilize any amounts in the account for rate mitigation at the time of

[35] OEB Staff IR 19(a)

rebasing (or to reimburse customers if rate mitigation is not required), is therefore denied.

NT Power will be required to implement an ESM in a manner consistent with the 2015 Report and Handbook – i.e., to share excess earnings with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the consolidated entity's annual ROE, and to share these earnings annually with customers once audited financial results are available.

As NT Power's proposed earning sharing plan has been denied, NT Power can request a variance account at a future date when it is required.

Other Requests

In addition to the proposed transactions, the applicants also requested OEB approval of the following:

- Transfer of Midland Power's distribution system to NT Power
- Transfer of Midland Power's rate order to NT Power
- A ten-year deferral period for the rebasing of Midland Power's rates and the rates of the consolidated entity
- NT Power's proposed earnings sharing plan
- A variance account to track excess earnings in years six to ten of the deferred rebasing period
- Cancellation of Midland Power's electricity distribution licence
- Amendment of NT Power's electricity distribution licence
- Continued tracking of costs to each of the applicants' existing deferral and variance accounts
- Continuation with current rate riders approved by the OEB for each of the applicants

OEB staff submitted that while it does not have any concerns with these requests if the application is approved, it does not believe that approval to continue with rate riders is required as rate riders are part of the rate orders. NT Power replied that it has no concerns with this approach.

OEB Findings

Given that the OEB has approved the Applicants' proposed transactions, the OEB also grants approval of the following requests, which are intended to facilitate the creation of a new amalgamated entity, namely:

- Transfer of Midland Power's distribution system to NT Power
- Transfer of Midland Power's rate order to NT Power
- A ten-year deferral period for the rebasing of Midland Power's rates and the rates of the consolidated entity
- Cancellation of Midland Power's electricity distribution licence
- Amendment of NT Power's electricity distribution licence
- Continued tracking of costs to each of the applicants' existing deferral and variance accounts
- Continuation with current rate riders approved by the OEB for each of the applicants

As indicated in the preceding section of this Decision, the OEB does not approve NT Power's proposed earnings sharing plan and will require NT Power to implement an ESM in a manner consistent with the 2015 Report and Handbook. NT Power can request a variance account at a future date when it is required.

5 CONCLUSION

The OEB concludes that the transaction proposed by NT Power and Midland Power for the purchase of all of the shares of Midland Power by NT Power and the subsequent amalgamation with Midland Power meets the no harm test and therefore the OEB approves the applicants' requests for the following under Section 86 of the Act:

- Acquisition of all shares of Midland Power by NT Power
- Transfer of Midland Power's distribution system to NT Power
- Amalgamation of NT Power and Midland Power and to continue as Newmarket-Tay Power Distribution Ltd.

The OEB also approves the applicants' related requests as set out in this Decision and Order relating to:

- Transfer of Midland Power's rate order to NT Power, under Section 18 of the Act
- Cancellation of Midland Power's electricity distribution licence, under section 77(5) of the Act
- Amendment of NT Power's electricity distribution licence, under section 74 of the Act
- A ten-year deferral period from the rebasing of Midland Power's rates and the rates of the consolidated entity
- Continued tracking of costs to each of the applicants' existing deferral and variance accounts
- Continuation with current rate riders approved by the OEB for each of the applicants

As noted above, NT Power's proposed earning sharing plan is denied and NT Power will be required to implement an ESM in a manner consistent with the 2015 Report and Handbook. As NT Power's proposed earning sharing plan has been denied, NT Power can request a variance account at a future date when it is required.

6 ORDER

THE ONTARIO ENERGY BOARD ORDERS THAT:

1. Newmarket-Tay Power Distribution Ltd. is granted leave to acquire all the shares of Midland Power Utility Corporation.

2. Midland Power Utility Corporation is granted leave to transfer its distribution system to NT Power.

3. Newmarket-Tay Power Distribution Ltd. and Midland Power Utility Corporation are granted leave to amalgamate and continue as Newmarket-Tay Power Distribution Ltd.

4. The leave granted in paragraphs 1-3 above shall expire 18 months from the date of this Decision and Order. If the transaction has not been completed by that date, a new application will be required in order for the transaction to proceed.

5. The applicants shall promptly notify the OEB of the completion of the transactions referred to in paragraphs 1-3 above.

6. Once the notice referred to in paragraph 5 is provided to the OEB, the OEB will transfer the rate order of Midland Power Utility Corporation to Newmarket-Tay Power Distribution Ltd.

7. Once the notice referred to in paragraph 5 has been provided to the OEB, the OEB will amend the electricity distribution licence of Newmarket-Tay Power Distribution Ltd. (ED-2007-0624) to include the service area formerly served by Midland Power Utility Corporation and to include Midland Power Utility Corporation’s CDM targets.

8. When the OEB amends the electricity distribution licence of Newmarket-Tay Power Distribution Ltd., it will cancel the electricity distribution licence of Midland Power Utility Corporation (ED-2002-0541).

9. The applicants are granted approval to continue to track costs to the deferral and variance accounts currently approved by the OEB for each of the applicants.

10. Newmarket-Tay Power Distribution Ltd. shall file a consolidated distribution system plan by December 31, 2020. The consolidated distribution system plan shall

consider the entirety of the amalgamated entities service territory (i.e., the current service areas of Newmarket-Tay Power Distribution Ltd. and Midland Power Utility Corporation).

11. Newmarket-Tay Power Distribution Ltd. Shall update their cost allocation models and file these models with the OEB no later than twelve months following Newmarket-Tay Power Distribution Ltd.'s acquisition of all shares of Midland Power Utility Corporation. This filing shall also include a proposal that demonstrates how rates that are too high or too low relative to the OEB's cost allocation policies will be adjusted over time.

12. The School Energy Coalition shall file with the OEB and forward to the applicants its respective cost claim no later than 7 days from the date of issuance of this Decision and Order.

13. The applicants shall file with the OEB and forward to the School Energy Coalition any objections to the claimed costs of the School Energy Coalition within 17 days from the date of issuance of this Decision and Order.

14. The School Energy Coalition shall file with the OEB and forward to the applicants any responses to any objections for its cost claim within 24 days from the issuance of this Decision and Order.

15. The applicants shall pay the OEB's costs of and incidental to, this proceeding immediately upon receipt of the OEB's invoice.

DATED at Toronto August 23, 2018

ONTARIO ENERGY BOARD

Original Signed By

Kirsten Walli
Board Secretary