

# BRIEFING NOTE

**To:** Rosemarie Leclair

**From:** Bob Huggard

**Date:** February 24, 2016

**CC:** Tina Arvanitis, Avi Lipsitz

**Subject:** OEA Positions on Regulatory Barriers to LDC Consolidation

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## BACKGROUND

There continue to exist a number of regulatory barriers to the consolidation of Ontario's electricity LDCs, and the OEB should continuously review the barriers to LDC consolidation with an eye to reducing or eliminating them.

The OEA had previously made five recommendations on resolving the regulatory barriers to consolidation. The OEB addressed two of those five items (the financial incentives for consolidation arising from the OEB's ratemaking process and the need for stability in capital structure and return on equity policies) in its March 26, 2015 report *Rate-Making Associated with Distributor Consolidation* and its January 22, 2016 supplemental report *New Policy Options for the Funding of Capital Investments*. These changes send a positive signal to industry about the OEB's intentions for regulatory reform, but from amongst the OEA's initial five regulatory recommendations the three most vital issues are still outstanding:

## EQUAL TREATMENT OF ALL LDCs REGARDLESS OF SIZE

LDC regulation in Ontario has tended to reduce burdens on smaller LDCs as compared to larger LDCs, which has reduced the incentives for small LDCs to seek consolidation. OEB cost allocation policies, scrutiny of rate applications, required participation in OEB processes, accommodation of limited capacity to deliver on conservation priorities and other mechanisms should be reconsidered in light of systemic efficiency and incentives for consolidation. Efforts should be made to align the accountabilities of all LDCs towards the highest standards of regulatory excellence.

## ELIMINATING DE FACTO SUBSIDIZATION OF ELECTRICALLY EMBEDDED UTILITIES

A number of small LDCs across the province receive all or much of their electricity at low voltages from other distributors, rather than maintaining their own connections to the province's transmission grid. The fees charged to such embedded distributors do not reimburse the providers for the fully loaded cost of the service, and are effectively much, much less than the cost of owning and operating a direct connection to the transmission grid. The result is that electrically embedded utilities can maintain customer rates which are much lower than the

neighbouring utility that is providing low voltage power, therefore reducing the incentive to consolidate (consolidation would result in the loss of the effective subsidy, and therefore higher rates for customers). As long ago as 2004 the OEB recognized that electrically embedded distributors should not be present in the system, and banned the creation of any new such distributors. However, no action has been taken to eliminate or actively discourage the continued existence of pre-existing electrically embedded distributors.

### **OEB CAPACITY TO EFFICIENTLY PROCESS CONSOLIDATION TRANSACTIONS**

Over the past few years several consolidation transactions have been considered by the OEB, often requiring upwards of a year to process from the date of application. However, if the government eliminates barriers to consolidation, the OEB could be faced with a comparative flood of transaction applications, potentially leading to disastrous delays in transaction execution. It is imperative that the OEB be prepared with a full complement of Board members, a cadre of knowledgeable staff who can address applications, and a streamlining of the policies and procedures to efficiently review transactions.