

June 30, 2022

Ontario Energy Board approves Kitchener-Wilmot Hydro and Waterloo North Hydro amalgamation: Future cost savings projected for merged utility

On June 28, 2022, the Ontario Energy Board (OEB) approved an application from Kitchener-Wilmot Hydro Inc.¹ (Kitchener-Wilmot Hydro) and Waterloo North Hydro Inc.² (Waterloo North Hydro) to amalgamate into a single electricity distribution company, referred to as LDC MergeCo until a name is established for the amalgamated company.

Following the proposed amalgamation, LDC MergeCo will be indirectly owned by the City of Kitchener (53.4%), the Township of Wilmot (4.5%), City of Waterloo (30.1%), the Township of Woolwich (8.5%) and the Town of Wellesley (2.8%). LDC MergeCo will serve more than 157,000 customers and maintain operations centres in Kitchener and Waterloo.

Background

Kitchener-Wilmot Hydro is a licenced electricity distribution company that serves approximately 99,000 customers in the City of Kitchener and the Township of Wilmot.

Waterloo North Hydro is a licenced electricity distribution company that serves approximately 58,000 customers in the City of Waterloo, the Townships of Woolwich and Wellesley.

On January 12, 2022, the municipalities, Kitchener-Wilmot Hydro, Waterloo North Hydro, the parent holding companies and their affiliates entered into a Merger Participation Agreement. An application seeking OEB approval of the proposed amalgamation was filed on January 31, 2022.

Assessing the Application

The OEB will not approve an application for utility consolidation unless it is satisfied that the proposed transaction will have a positive or neutral effect on the attainment of the OEB's objectives under the *Ontario Energy Board Act, 1998* (OEB Act). The OEB refers to this as the "no harm" test.

The Ontario electricity sector has more than 50 electricity distributors ranging in size from about 1,000 customers to well over one million customers. To encourage consolidations, the OEB introduced policies on rate-making that provide consolidating distributors with an opportunity to offset transaction costs with savings achieved as a result

¹ Kitchener-Wilmot Hydro is owned by Kitchener Power Corp. (KPC), a holding company owned by the City of Kitchener and the Township of Wilmot. Kitchener-Wilmot Hydro is affiliated with Kitchener Energy Solutions Inc., which is 100% owned by KPC and provides non-regulated energy services, including streetlight maintenance.

² Waterloo North Hydro is owned by Waterloo North Hydro Holding Corporation (Waterloo Holdco), a holding company owned by the City of Waterloo, the Township of Woolwich and the Township of Wellesley. Waterloo North Hydro is affiliated with Alliance Metering Solutions which is owned by Waterloo Holdco and provides unit sub-metering services.

of the consolidation.³ Consolidating distributors are allowed to defer setting new base rates for up to 10 years from the closing of the transaction (Deferred Rebasing Period).⁴ Kitchener-Wilmot Hydro and Waterloo North Hydro selected to defer rate rebasing for 10 years following completion of the proposed amalgamation. The utilities also applied for OEB approval to maintain two separate distribution rate zones for each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas not only for the Deferred Rebasing Period but also for a further 10-year period referred to as the “Rate Harmonization Period” (i.e., years 11-20).

Learn more about this in the Rate Harmonization Period section below.

Decision

The OEB has applied the “no harm” test in assessing the Application and concluded that the proposed amalgamation meets this test. The OEB approved the amalgamation of Kitchener-Wilmot Hydro and Waterloo North Hydro into a single electricity distribution company, LDC MergeCo, subject to certain conditions.

In applying the “no harm” test, the OEB assessed the cumulative effect of the transaction in attaining the following objectives set out in the OEB Act: price, economic efficiency, cost effectiveness, reliability and quality of electricity service, and financial viability. The key aspects of the OEB’s findings are outlined in the table below.

Section / Issue	Application/Applicant Submissions	OEB Findings
4.1.1 Price, Economic Efficiency and Cost Effectiveness <i>(Decision, pp. 8-12)</i>	<ul style="list-style-type: none"> Total operating, maintenance and administrative (OM&A) savings of \$33 million over the 10-year Deferred Rebasing Period (years 1-10), as a result of merger-related efficiency gains. Expected lower distribution costs for customers of approximately 3.1% through the Deferred Rebasing Period, and by 4.5% following the transfer of the merger benefits to customers in year 11. 	<p>The OEB finds that the Applicants have demonstrated that the Transaction will achieve economic efficiencies and will likely deliver cost savings to customers in future rates.</p> <p>The OEB is of the view that, for the rebasing application for 2033 rates, requiring LDC MergeCo to demonstrate how savings have accrued to customers in the two rate zones will assist the OEB in determining that savings will in fact be delivered to customers in both rate zones and in assessing the rates harmonization plan that is expected to be part of that application.</p>
4.1.2 Reliability and Quality of Electricity Service <i>(Decision, pp. 12-13)</i>	<ul style="list-style-type: none"> A key objective of the transaction will be to ensure customer service, safety and reliability meets or exceeds existing levels in each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas. Customers will benefit from being served by a larger distributor that will 	<p>The OEB is satisfied that the amalgamated company can reasonably be expected to maintain the service quality and reliability standards currently provided by each of the amalgamating utilities.</p> <p>While the test is “no harm”, the OEB expects that the merged company will be able to adopt industry best practices around distribution automation with a positive impact on reliability through the</p>

³ EB-2014-0138, [Report of the Board on Rate-Making Associated with Distributor Consolidation](#), March 26, 2015 and OEB [Handbook to Electricity Distributor and Transmitter Consolidations](#)

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Section / Issue	Application/Applicant Submissions	OEB Findings
	have “expanded resources, including people and technology to improve system reliability and power quality, as well as monitoring and reporting of these performance metrics”.	consolidation of control rooms to form a centralized 24/7 control room.
4.1.3 Financial Viability <i>(Decision, pp. 13-14)</i>	<ul style="list-style-type: none"> Except for post-closing adjustments, the proposed transaction is predominantly a non-cash transaction and as such, there is no adverse effect on the financial viability of the Applicants. Post-closing adjustments are not expected to be material. Transaction and integration costs to implement the proposed transaction will be financed through the anticipated productivity savings expected from the merger during the Deferred Rebasing Period. 	<p>The OEB accepts the assurance of the Applicants that there will be no adverse effect on the financial viability of either the Applicants or the amalgamated company upon completion of the Transaction.</p> <p>The new company has forecast the debt to capital ratio for LDC MergeCo to be 39%, which is lower than the 60% debt level deemed by the OEB for rate-setting. This will provide the merged company flexibility to manage extraordinary events.</p>

Also of note were the OEB’s findings related to the following:

Rate Harmonization Period – Special Request *(Decision, Section 4.2, pp. 14-18)*

The Applicants requested approval to maintain two separate rate zones for each of the Kitchener-Wilmot Hydro and Waterloo North Hydro service areas not only for the Deferred Rebasing Period but also for the Rate Harmonization Period, i.e., for a total of 20 years.

The OEB found it premature to determine whether separate rate zones should be maintained beyond the Deferred Rebasing Period for an additional 10 years, noting that the Applicants have not provided sufficient evidence as to what adverse implications would arise if the OEB does not approve separate rate zones for the additional 10-year period at this time or why it would be in the best interests of ratepayers to decide this issue now.

The OEB noted that a consolidated entity is expected to make proposals for rates, including any proposed rate harmonization in its first rate rebasing application following consolidation.⁵ When LDC MergeCo files its rate harmonization plan, with a proposed timeline for the plan, including any proposal to continue separate rate zones

⁵ The OEB’s Handbook to Electricity Distributor and Transmitter Consolidations states that a rate harmonization plan can propose the approach and timeline for harmonizing rate classes or provide rationale for why certain rate classes should not be harmonized based on underlying differences in cost structures and drivers. For acquisitions, distributors can propose plans that place acquired customers into an existing rate class or into a new rate class. However, the OEB expects that whichever option is adopted, rates will reflect the cost to serve the acquired customers, including the anticipated productivity gains resulting from consolidation.

and for how long, the OEB will be in a position to understand all relevant aspects of the proposed rate harmonization plan. This is preferable to deciding one aspect now and other aspects later.

Earnings Sharing Mechanism (ESM) (*Decision, Section 4.3.1, pp. 18-22*)

Consolidating utilities that propose to defer rebasing beyond a five-year period are required to implement an ESM for the period beyond five years. Under the ESM proposed by the Applicants for years six through 10 of the Deferred Rebasing Period, excess earnings above 300 basis points of the consolidated entity's approved return on equity (ROE) are shared 50:50 with customers.

The OEB determined the following regarding the ESM:

- The ESM will be implemented for years six through 10 of the Deferred Rebasing Period following the amalgamation, starting on January 1, 2028 and ending December 31, 2032.
- While the results of the ESM will be reported on an annual basis, the detailed review and disposition of the account balance will be carried out as part of the next rebasing application.

The approved ROE on which to base the ESM is 8.43%.

About the OEB

The OEB is the independent regulator of Ontario's electricity and natural gas sectors. It protects the interests of consumers and supports the collective advancement of the people of Ontario. Its goal is to deliver public value through prudent regulation and independent adjudicative decision-making which contributes to Ontario's economic, social and environmental development.

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Ce document est aussi disponible en français.

This Backgrounder was prepared by OEB staff to inform Ontario's energy consumers about the OEB's decisions and is not for use in legal or regulatory proceedings. It is not part of the OEB's reasons for the decision; those may be found in the [Decision and Order](#), which is the official OEB document.