Enersource Hydro Mississauga Inc., Horizon Utilities Corporation and PowerStream Inc.

EB-2016-0025

OEB Staff Compendium

B-STAFF-2

Reference(s): Exh B/T5/Sch 1, p.1-2

Preamble:

The proposed consolidation is expected to deliver material electricity ratepayer savings relative to the status quo, i.e., in the absence of a consolidation. Ratepayers of LDC Co are expected to enjoy lower rates through the ten year rebasing deferral period in comparison to the status quo for the reasons discussed below. Ratepayers are also expected to experience greater savings in comparison to the status quo from the time of the first anticipated rebasing, ten years following the completion of the consolidation, due to cost savings resulting from synergies.

a) Please identify the particular areas of business in which the applicants expect to derive synergies as a result of the proposed consolidation.

b) Please explain what assumptions have been made by the applicants with respect to the expected synergies and ratepayer savings.

c) Please identify any risks that may impact the anticipated synergies and savings.

Response:

a) The Applicants expect to derive synergies in the following areas of the business:

- More efficient delivery of corporate services such as Human Resources, Supply Chain, Information Technology, Facilities, Fleet and Finance;
- More effective delivery of core services such as customer service, engineering, asset management and operations; and
- More effective use of consultants, auditors and legal counsel.

b) Ratepayer savings are in two main areas:

- The price cap rate regime in effect during the rebasing deferral period results in rates that will be lower than if the applicants had remained standalone distributors; and
- The outcome of the first rebasing following the rebasing deferral period.

c) Please refer to Attachment 2, page 11 of the Application for a listing of risks that may impact the anticipated synergies and savings.

Opportunities & Risks

Opportunities:

- Interest costs for HOBNI share purchase during bridge period significantly lower than 4% assumed in model
- Greater synergies than planned are achieved

Risks:

- Synergies may not be achieved or are delayed
- Unidentified expenses/liabilities from HOBNI
- Rising interest rate environment
- Debt rating agencies lower Holdco’s credit rating below A

OVERALL IMPACT OF THE TRANSACTION

As discussed previously, the consolidation comprises the following:

a) Mergers of the regulated and non-regulated business activities of: PowerStream Holdings Inc. ("PSH"); Enersource Corporation ("EC"); and Horizon Holdings Inc. ("HHI");

b) An acquisition by the Applicants of the regulated electricity distribution business of HOBNI for gross proceeds of $607MM net of any purchase price adjustments as defined in the corresponding Share Purchase Agreement.

The Solar Generation business of PowerStream ("PS Solar") is included in the merged assets but the benefits thereof accrue solely to the benefit of the PS common shareholders.

Hydro One currently provides smart meter services to HOBNI pursuant to an agreement dated January 1, 2013, as amended August 31, 2015, and to be further amended as described in Section 4.1(1)(i)(ix) of the [SPA] (the "Smart Meter Agreement"). Hydro One will continue to provide services to HOBNI pursuant to the Smart Meter Agreement, as contemplated by Section 4.1(1)(i)(ix) of the [SPA].

The transaction provides that Hydro One will continue to provide services to HOBNI, pursuant to the existing Smart Meter agreement up until December 31, 2017.

The Financial Summary is provided as Attachment 2.

The impact of the proposed transaction on consumers with respect to the price, adequacy, reliability and quality of distribution service is addressed below.

- **Price**

The proposed consolidation is expected to deliver material electricity ratepayer savings relative to the *status quo,* i.e., in the absence of a consolidation. Ratepayers of LDC Co are expected to enjoy lower rates through the ten year rebasing deferral period in comparison to the *status quo* for the reasons discussed below. Ratepayers are also expected to experience greater savings in comparison to the *status quo* from the time of the first anticipated rebasing, ten years following the completion of the consolidation, due to cost savings resulting from synergies.

Rebasing Deferral Period – Ten Years from the Completion of the Consolidation:

Each of the consolidating distributors would have filed Cost of Service or Custom IR applications during the proposed ten year rebasing deferral period in the absence of the proposed consolidation. The pre-existing rate plans for Horizon Utilities (2015-2019 Custom IR) and PowerStream (as proposed in its current Custom IR rate application, 2016-2020) will continue until their expiry, and rate adjustments will then take place under Price Cap IR through to the first rebasing of LDC Co. In the absence of the proposed consolidation and rebasing deferral, rebasing for Horizon Utilities and PowerStream would have taken place in 2020 and 2021, respectively, and projected rate increases would have been greater than under Price Cap IR. Enersource was scheduled to rebase in 2017 but has received OEB approval to defer the rebasing. HOBNI is scheduled to rebase in 2020. As with Horizon Utilities and PowerStream, rate impacts from rebasing are projected to have been greater than under Price Cap IR. Accordingly, the proposed transaction results in lower LDC Co rates than the *status quo* during the rebasing deferral period from the time each Party's rate plan expires.

Customer Value Creation

LDC Co will be focused on reducing operating expenditures. It will improve productivity through better utilization of existing assets. LDC Co will leverage best practices in Asset Management from the Parties. This includes the evaluation of long term capital plans, maintenance practices, design standards, and operating standards for alignment of best practices.

The net cost savings discussed above would not be possible without the proposed consolidation. LDC Co will provide distribution rates to customers that will be lower than they otherwise would have been, had the Parties remained standalone entities.

The Applicants expect that the consolidated customer base will create opportunities for LDC Co to provide additional services while adhering to applicable OEB Codes and related regulations. Currently, Horizon Utilities and PowerStream provide water billing services to their respective Shareholders (except for the City of Barrie for PowerStream) on the electricity bills. This approach may be investigated within other service areas of LDC Co. Further opportunities may present themselves in the area of CDM.

B-STAFF-4

Reference(s): Exh B/T5/ Sch 5, p.7

Preamble:

It is stated:

LDC Co will set the following IT objectives for business applications:

- **Establish a stable, consolidated, secure information technology infrastructure environment to sustain the operations of the new company and minimize operational risk during the transition period following the consolidation;**

IT related cost savings range from $1.1MM in year one post consolidation up to $10MM in year five and beyond.

a) Please explain what is meant by "establish a stable, consolidated, secure information technology infrastructure environment". Please explain whether this entails the establishment of a new IT system or whether this only involves the combination of the individual IT systems of the four distributors.

b) Please provide the assumptions that are being made for the projected savings.

Response:

a) "Establish[ing] a stable, consolidated, secure information technology infrastructure environment" refers to the consolidation of four production data centres and four disaster recovery data centres into one production data centre and one disaster recovery data. This requires the consolidation of the physical, network, and security infrastructures by consolidation, optimization, and standardization of infrastructure components utilizing existing Information Technology ("IT") assets as much as possible.

b) The assumptions for IT related cost savings that range from $1.1MM in year one post consolidation up to $10MM in year five are related to reductions in OM&A costs (salaries, maintenance, managed services, software licensing) associated with consolidation and decommissioning of redundant information technology infrastructure and enterprise applications systems, such as Enterprise Resource Planning ("ERP"), Customer Information

Systems ("CIS") and Geographic Information Systems ("GIS") systems as provided in Exhibit B, Tab 5, Schedule 5, page 6. These savings are based on the timing of infrastructure and application systems consolidations and decommissioning.

B-STAFF-5

Reference(s): Exh B/ T5/ Sch 5, p.8

Preamble:

It is stated:

Two call centres will be designated for LDC Co: one in St. Catharines; and the other in Vaughan. A possible future consolidation to one call centre will be evaluated for its feasibility. Two control rooms will be designated for LDC Co: one in Hamilton; and the other in Vaughan. A possible future consolidation to one control room will be evaluated for its feasibility.

a) Please advise of the present number of call centres and control rooms among the consolidating distributors.

b) Please explain what impact the proposed call centre/control room consolidation will have on service quality and reliability of service.

Response:

a) There are currently four call centres and four control rooms among the consolidating distributors.

b) The proposed call centre/control room consolidation is expected to have no adverse impact on service quality and reliability of service. Customers are expected to benefit from being served by a larger utility that will have an expanded ability to monitor, report on and improve system reliability and power quality, given its greater resources (Exhibit B, Tab 5, Schedule 1, p.3).

Overall, it appears that the level of systems compatibility between the utilities will facilitate a transition to a common approach to delivering business applications while supporting continuing business operations and managing risk. IT related cost savings range from $1.1MM in year one post consolidation up to $10MM in year five and beyond.

Customer Service

Key elements of the consolidation will focus on customer service. Customers are the operational priority and will continue to receive excellent service. LDC Co will ensure a reliable, effective, and efficient electricity distribution system as well as innovative, value-added, energy services and solutions. Customers will have access to customer service in a timely, reliable and accurate manner. LDC Co will be operated on customer-centric values, and it will undertake a principled approach in the design of an effective organization plan such that customer service responsiveness levels target improvement but will certainly be no less than service levels prior to merging in each community. Adopting best practices and finding efficiencies while maintaining or improving customer service will be a key priority.

LDC Co will focus on five attributes within the customer perspective. Initiatives will be identified and organized to target improvement in the following five areas:

- Efficiency, i.e., distribution rates/price;
- Electricity reliability;
- Bill accuracy and quality;
- Responsiveness/ease of doing business; and
- Trust/corporate image.

The objectives and business principles contemplate enhanced customer service delivery as a result of the merger transaction. As such, customer service operational plans will be closely linked to the achievement of customer service satisfaction levels. In setting performance targets for customer service levels, LDC Co will consider:

- Present service levels of Enersource, Horizon Utilities, PowerStream and HOBNI and will reconcile to the highest levels among them;
- Service levels required by OEB regulation;

- Competitive benchmarks; and
- Results of customer surveys.

As part of its ongoing operation, LDC Co will regularly review the level of customer service support to ensure appropriate levels are maintained.

The Applicants have estimated that sustained operating, maintenance and administration ("OM&A") savings net of transition costs will be approximately $42.5MM in year five and beyond. The OM&A savings will be achieved through $270MM (net of transition costs) in savings over the first ten years post consolidation from payroll reductions and $42MM (net of transition costs) for non-payroll cost reductions. The OM&A budget for LDC Co is therefore anticipated to be approximately 15% lower than the sum of the OM&A budgets for the Parties, three to five years following completion of the consolidation.

Unredacted version filed Sept. 6, 2016 in response to Sept. 2, 2016 OEB Decision on Confidentiality Requests

B-STAFF-7

Reference(s): Exh B/T5/ Sch 5, p.8

Preamble:

The Applicants have estimated that sustained operating, maintenance and administration ("OM&A") savings net of transition costs will be approximately $42.5MM in year five and beyond. The OM&A savings will be achieved through $270MM (net of transition costs) in savings over the first ten years post consolidation from payroll reductions and $42MM (net of transition costs) for non-payroll cost reductions. The OM&A budget for LDC Co is therefore anticipated to be approximately 15% lower than the sum of the OM&A budgets for the Parties, three to five years following completion of the consolidation.

a) Please identify the specific operational areas/functions where the planned payroll and non-payroll reductions will occur.

b) Please explain what assumptions have been made by the applicants for the proposed payroll and non-payroll reductions.

c) Please identify risks that could negatively impact the applicants' projected OM&A savings, setting out the applicants' projected savings if those risks materialize.

Response:

a) Table 1 below identifies the specific operational areas/functions where the planned payroll and non-payroll reductions are anticipated to occur.

Table 1 – Payroll and Non-Payroll Reductions by Operational Area/Function ($MM)

Functions	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total
Payroll	**6.7**	**17.5**	**28.0**	**34.5**	**36.7**	**36.7**	**36.7**	**36.7**	**36.7**	**36.7**	**306.9**
Asset Management & Engineering	0.9	2.3	2.1	2.3	2.3	2.3	2.3	2.3	2.3	2.3	21.4
Corporate	0.1	0.1	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	5.8
Customer Service	-	0.8	2.1	7.4	7.4	7.4	7.4	7.4	7.4	7.4	54.7
Finance	1.3	1.7	3.2	3.8	4.2	4.2	4.2	4.2	4.2	4.2	35.2
Human Resources	(1.1)	0.6	1.2	1.7	1.7	1.7	1.7	1.7	1.7	1.7	12.6
Information Technology	0.5	0.9	3.7	3.7	4.2	4.2	4.2	4.2	4.2	4.2	34.0
Metering	0.3	0.9	1.1	1.2	1.3	1.3	1.3	1.3	1.3	1.3	11.3
Procurement	0.4	0.6	1.2	1.4	1.4	1.4	1.4	1.4	1.4	1.4	12.0
Regulatory	(0.1)	0.5	1.5	1.5	2.4	2.4	2.4	2.4	2.4	2.4	17.8
Facilities, Logistics, Fleet	0.8	2.1	2.0	1.8	1.8	1.8	1.8	1.8	1.8	1.8	17.5
Construction, Control Room, Trouble Response	3.6	7.0	9.2	9.0	9.3	9.3	9.3	9.3	9.3	9.3	84.6
Non Payroll	**0.5**	**2.6**	**3.7**	**6.1**	**5.8**	**5.8**	**5.8**	**5.8**	**5.8**	**5.8**	**47.7**
Asset Management & Engineering	-	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.8
Corporate	-	-	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.8
Customer Service	-	-	(0.1)	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.7
Finance	0.1	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	3.6
Human Resources	0.3	0.8	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3	11.3

Information Technology	-	(0.4)	0.6	1.8	1.8	1.8	1.8	1.8	1.8	1.8	12.8
Metering	-	0.1	0.1	0.4	0.4	0.4	0.4	0.4	0.4	0.4	3.0
Regulatory	-	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.6
Facilities, Logistics, Fleet	-	0.8	1.1	1.4	1.4	1.4	1.4	1.4	1.4	1.4	11.7
Construction, Control Room, Trouble Response	0.1	0.7	0.1	0.1	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	0.4
Grand Total	**7.2**	**20.1**	**31.7**	**40.6**	**42.5**	**42.5**	**42.5**	**42.5**	**42.5**	**42.5**	**354.6**

b) Please see the Applicants' response to Interrogatory B-Staff-3b).

c) The primary risks that could negatively impact the Applicants' projected OM&A savings relate to projected synergies and transition costs in respect of the consolidation of the following core enterprise applications during the three years post consolidation: (i) legacy Customer Information Systems will be migrated to a single consolidated Oracle Customer Care and Billing system; (ii) legacy Enterprise Resource Planning systems will be migrated to a single consolidated system; and (iii) legacy Geographic Information Systems and Outage Management Systems will be consolidated to a single system.

The Applicants expect $270MM (net of transition costs) in savings over the first ten years from payroll reductions. The savings result from redundant positions largely in administration and back-office functions.

Additionally, the Applicants expect $42MM (net of transition costs) in savings in the first ten years from other non-payroll reductions. Savings are related to the elimination of costs due to the duplication of business processes across the four entities and adoption of best practices.

Delays in the completion of one or more of the aforementioned IT systems consolidation projects would likely result in a deferral of projected net OM&A savings; principally from projected savings from redundant administration and "back-office" functions. Additionally, such delays may potentially result in additional transition costs to complete IT system migration and integration.

- Competitive benchmarks; and
- Results of customer surveys.

As part of its ongoing operation, LDC Co will regularly review the level of customer service support to ensure appropriate levels are maintained.

The Applicants have estimated that sustained operating, maintenance and administration ("OM&A") savings net of transition costs will be approximately $42.5MM in year five and beyond. The OM&A savings will be achieved through $270MM (net of transition costs) in savings over the first ten years post consolidation from payroll reductions and $42MM (net of transition costs) for non-payroll cost reductions. The OM&A budget for LDC Co is therefore anticipated to be approximately 15% lower than the sum of the OM&A budgets for the Parties, three to five years following completion of the consolidation.

B-STAFF-8

Reference(s): Exh B/T6/ Sch 1, p.1

Preamble:

It is stated:

The total anticipated savings net of transaction costs over a ten year rebasing deferral period resulting from the merger of Enersource, Horizon Utilities and PowerStream, and the acquisition of HOBNI total approximately $312MM in operating costs and approximately $114MM in avoided capital costs, which represent $426MM in total cash savings.

These operating and capital savings will benefit customers through lower rates than the status quo, and will benefit shareholders through increased and more stable dividends.

The approximately $114MM in capital savings, net of any transition costs (Figure 25, below), over the ten year rebasing deferral period arise mainly due to moving to single, common Information Systems (a single customer billing system, for example) and Operating Systems (a single Control Room, for example), harmonizing engineering standards and adopting best work practices.

a) Please identify the areas of the distributors' businesses where the applicants anticipate these savings to be generated.

b) Please identify risks that could negatively impact the projected savings, setting out what the applicants' projected savings would be if those risks materialize.

Response:

a) The Applicants anticipate capital savings to be generated in the following business areas in the first five years:

- Information Technology $89.4MM
- Procurement and Strategic Sourcing $13.4MM
- Operations / Control Room $10.5MM
- Other $14.3MM

For years six to ten, an $8.0MM in annual capital savings is forecast.

The Applicants anticipate operating savings to be generated in the following business areas in the first five years:

• Operations / Control Room	$36.8MM
• Finance	$26.2MM
• Procurement and Strategic Sourcing	$24.4MM
• Customer Service / Billing / Call Centres	$21.3MM
• Human Resources	$18.6MM
• Other	$37.6MM

For years six to ten, a $42.5MM in annual OM&A Savings is forecast.

b) The Applicants have identified the following risks that could negatively impact the projected savings by either increasing transitional costs or decreasing energy savings:

- Information Technology
  - scope or timeline changes related to CIS Integration, ERP Integration, or other key system integrations – risk to synergy savings
  - actual RFP costs vs forecasts – risk to transitional costs

- Union Agreements
  - ability to negotiate a satisfactory Collective Agreement – risk to synergy savings

- OEB Decision Timing
  - a delay would increase purchase price of HOBNI – as additional capital will be spent in the normal course of business

The Applicants cannot estimate the impact on projected savings should these risks materialize.

IMPACT OF THE TRANSACTION ON ECONOMIC EFFICIENCY AND COST EFFECTIVE DISTRIBUTION OF ELECTRICITY

The Applicants have determined the cost structure of LDC Co as a result of the consolidation based on the best information available and certain assumptions, as provided in Exhibit B, Tab 5, Schedule 1. Realization of synergy savings will depend on a number of factors including the complexity of the precedent-setting integration of four large LDCs.

Synergy Forecast

The total anticipated savings net of transaction costs over a ten year rebasing deferral period resulting from the merger of Enersource, Horizon Utilities and PowerStream, and the acquisition of HOBNI total approximately $312MM in operating costs and approximately $114MM in avoided capital costs, which represent $426MM in total cash savings. These operating and capital savings will benefit customers through lower rates than the *status quo*, and will benefit shareholders through increased and more stable dividends.

The approximately $114MM in capital savings, net of any transition costs (Figure 25, below), over the ten year rebasing deferral period arise mainly due to moving to single, common Information Systems (a single customer billing system, for example) and Operating Systems (a single Control Room, for example), harmonizing engineering standards and adopting best work practices.

Reductions in the capital budget are anticipated as shown in Figure 25 below. However, in each of the service areas, the electricity distribution system will need to be expanded and refurbished as specified in capital plans. Lines crews will need to be in reasonably close proximity to customers in order to respond to power outages, make repairs and restore service. Accordingly, there are likely only limited opportunities for other reductions in capital expenditures during the rebasing deferral period.

It is anticipated that LDC Co will have sustained net annual operating savings, relative to the *status quo*, of approximately $43MM in 2020 and beyond (Figure 25), driven primarily by the integration of back-office functions.