Entegrus Powerlines Inc.
320 Queen St (P.O Box 70)
Chatham, ON N7M 5K2
Phone: (519) 352-6300 / 1-866-804-7325
Entegrus.com

We're Your Local Power Distributor
135 Edward Street (P.O Box 460 Station Main)
St. Thomas, ON N5P 3V3
Phone: (519) 631-5550
Sttenergy.com

December 1, 2017

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

Re: Section 86 MAAD Application of Entegrus Powerlines Inc. and St. Thomas Energy Inc.
Board File No.: EB-2017-0212

Dear Ms. Walli,

Pursuant to Procedural Order No. 2, please find enclosed the Entegrus Powerlines Inc. ("EPI") and St. Thomas Energy Inc. ("STEI") reply submission in the above-noted matter.

If you have any questions, please do not hesitate to contact us.

Sincerely,

[Original Signed by]

____

David Ferguson
VP of Regulatory and Human Resources
Entegrus Powerlines Inc.
Phone: 519-352-6300 Ext 558
Email: david.ferguson@entegrus.com

[Original Signed by]

____

Rob Kent
Chief Operating Officer
St. Thomas Energy Inc.
Phone: 519-631-5550 Ext 5258
Email: rkent@sttenergy.com

cc: Jim Hogan, President & CEO – Entegrus Powerlines Inc.
Ian Mondrow, Partner, Gowling WLG

ENTEGRUS™
POWERLINES INC.

St. Thomas energy inc.
We're Your Local Power Distributor

MAAD Reply Submission

EB-2017-0212

Filed: December 1, 2017

Table of Contents

Table of Contents 1
Introduction 2
The No Harm Test 3
- Price, Cost Effectiveness and Economic Efficiency 3
- Reliability and Quality of Electricity Service 4
- Financial Viability 6

Rate-making Considerations 7
- Deferred Rate Rebasing 7
- Earnings Sharing Mechanism 7

Conclusion 8

INTRODUCTION

Entegrus Powerlines Inc. ("EPI") and St. Thomas Energy Inc. ("STEI") (collectively referred to as "the Applicants") are pleased to provide their reply submission in accordance with the Board's directions as set out in Procedural Order No. 2, dated November 21, 2017.

On July 21, 2017, the Applicants filed a Merger, Amalgamation, Acquisition and Divestitures ("MAAD") application (the "Application") with the Board. The Application proposed the amalgamation of EPI and STEI, to form New EPI. The Application is the result of a commercial process that commenced in the summer of 2016 and culminated with the shareholders of EPI and STEI entering into a Merger Agreement on July 21, 2017. New EPI will serve approximately 58,000 customers across 17 Southwestern Ontario communities.

Board Staff filed its submission on November 30, 2017. Board Staff submits that the Applicants' evidence reasonably demonstrates that the amalgamation of EPI and STEI meets the no harm test.[1] In particular, the evidence indicates that:

1. The proposed amalgamation can reasonably be expected to result in cost savings and operational efficiencies.[2]
2. The amalgamated entity can meet service quality and reliability standards currently provided for by each of the amalgamating distributors.[3]
3. No adverse impact on the Applicants' financial viability is anticipated.[4]
4. The 8 year deferred rebasing period chosen by the Applicants aligns with OEB policy.[4]
5. The Applicants' proposed earnings sharing mechanism (ESM) is consistent with OEB policy.[5]

---

[1] See Board Staff Submission, page 4

[2] ibid, page 5

[3] ibid, page 6

[4] ibid, page 7

[5] ibid, page 8

Board Staff accepts the Applicants' proposal to file a consolidated distribution system plan (DSP) in 2021[6], which is within 5 years of EPI's recently filed DSP in 2016, and within 6 years of STEI's most recent DSP filed in 2015. The Applicants will, by 2021, have had the opportunity to operate for a time and thereby identify and prioritize investments for a consolidated planning cycle.

Board Staff also support[7] the Applicants' requests to:

1. Transfer STEI's rate order to EPI.
2. Cancel STEI's electricity distribution licence and amend EPI's electricity distribution licence to enable EPI to serve the customers of STEI.
3. Continue to track costs to the existing deferral and variance accounts.

There were no intervenors in the proceeding. Accordingly, there are no other submissions.

THE NO HARM TEST

In January 2016, the Board issued a *Handbook to Electricity Distributor and Transmitter Consolidation* (the "Handbook"). The Handbook describes the no harm test, which the Board uses to assess MAAD transactions. The no harm test primarily focuses on the impacts of the proposed transaction on price and quality of service to customers, and the cost effectiveness, economic efficiency and financial viability of the consolidating utilities.

The proposed transaction must have a positive or neutral effect to meet the no harm test.

Price, Cost Effectiveness and Economic Efficiency[8]

The Handbook states that applicants must show that there is a reasonable expectation that the costs to serve customers following a consolidation will be no higher than they would otherwise have been under

---

[6] See Board Staff Submission, pages 5-6

[7] ibid, page 8

[8] See Application pages 23-24 and pages 29-30. See Interrogatory Responses 1-Staff-5, 1-Staff 6, 1-Staff-8 and 1-Staff-9.

the status quo. The impact of the proposed transaction on economic efficiency and cost effectiveness is assessed based on expected sustained operational efficiencies within the utility operation.

The Applicants submit that the effect of the amalgamation on underlying cost structures will be positive. Customers will benefit from cost synergies that will arise from the transaction, including reductions in: management fees, information technology costs, corporate governance costs and combined fleet purchasing, inventory/stock and line deployment efficiencies. Projected OM&A cost savings are expected to reach $1.2M-$1.4M and projected capital cost savings are expected to reach $0.2M-$0.3M. The aforementioned savings translate into an approximate decrease of 3%-4% of revenue requirement, which will accrue to ratepayers beyond the proposed deferred rebasing period.

The Applicants have proposed an 8 year deferred rebasing period, during which transaction and integration costs will be financed through productivity gains and will not be funded by ratepayers. Under the status quo, EPI and STEI would have filed multiple rebasing applications during the deferred rebasing period. The Applicants expect that these status quo rebasing applications would have resulted in distribution rate increases. The Applicants submit that the ratepayer will enjoy a period of distribution rate stability, including lower distribution rates throughout the 8 year rebasing deferral period than otherwise would have occurred.

Board Staff submits that the evidence provided supports the claim that the proposed amalgamation can reasonably be expected to result in cost savings and operational efficiencies.

Reliability and Quality of Electricity Service[9]

The Handbook indicates that distributors should deliver improved reliability performance without an increase in costs, or maintain the same level of performance at a reduced cost.

The Applicants note that a key objective of the amalgamation is to ensure that levels of service post-merger meet or exceed existing service levels of both organizations. Operational centres will be maintained in Chatham, Strathroy and St. Thomas, in order to preserve local focus and continue to provide community and relationship-based customer service, while maintaining or enhancing response

[9] See Application pages 24-25 and pages 28-29. See Interrogatory Responses 1-Staff-7, 1-Staff-18, 1-Staff-19 and 1-Staff-20.

times (through additional backup resources) to address system needs and emergencies. The Applicants further noted that there are no plans to reduce staff or to eliminate functions, rather the intention is to redeploy existing positions through attrition, particularly in billing and certain IT functions to enhance customer service capabilities.

The Applicants submit that customers will benefit from a larger combined pool of resources to monitor, report on and improve system reliability and power quality. Greater resources will also allow for more employee specialization and focus on emerging technologies and innovation. The amalgamation will also provide the opportunity to review and select operational best practices from both organizations, giving consideration to reliability, cost and risk impacts.

In addition, legacy STEI customers will benefit through the implementation of various EPI technologies not currently employed by STEI. These technologies include: SCADA, visibility into Hydro One's grid control system, an enhanced Geographic Information System, an Outage Management System and social media channels.

The Applicants proposed that a consolidated DSP be completed and filed with the OEB in 2021, once management of the consolidated entity have an opportunity to operate for a time and thereby identify and prioritize investments for a consolidated planning cycle. It was noted that a key objective of the DSP will be to ensure that New EPI maintains or improves upon its key reliability indices, specifically the System Average Interruption Duration Index ("SAIDI") and the System Average Interruption Frequency Index ("SAIFI").

Board Staff submitted that the amalgamated entity can meet service quality and reliability standards currently provided by EPI and STEI. Board Staff also noted its acceptance of the proposal to file the consolidated DSP in 2021.

Board Staff further submitted that New EPI should monitor customer issues with legacy rate zone Conditions of Service and rates differences and be required to report on this at least once through the deferred rebasing period.

In response to interrogatory 1-Staff-18 relating to the maintenance of separate rate zones and Conditions of Service documents, the Applicants note that EPI has significant experience in maintaining multiple rate zones and communicating different rates and charges to its customers. New EPI will provide separate rate brochures for each rate zone and its interactive website will also provide rate-zone specific rates, charges and Conditions of Service based on the customer profile. The Applicants acknowledged material differences in the EPI and STEI Conditions of Service documents and noted that soon after amalgamation approval, a project team would be formed to study best practices, culminating in a combined Conditions of Service document.

The Applicants note that the maintenance of separate rate zones (and resulting differences in rates and charges) for a period of time are an established result of distributor consolidation transactions. Under Board policy, rate harmonization is undertaken at the time of rebasing. The Applicants are confident from past experience that it can communicate and administer multiple rate zones in such a way as to minimize customer confusion. Accordingly, the Applicants' feel that the additional reporting advocated by Board Staff is not necessary, though if so directed by the Board the Applicants can provide such reports.

Financial Viability[10]

The Handbook states that the primary considerations in assessing the impact of a proposed transaction on the financial viability are: (i) the effect of the purchase price (including any premium paid), and (ii) the financing of incremental costs to implement the consolidation transaction.

The proposed amalgamation is a non-cash and based on an exchange of shares. The share exchange is based on fair market value of the distributors, which establishes a premium of 60% of rate base (approximately $54M for EPI and $18M for STEI). As the shares being allotted are those of Entegrus Inc. (the parent company of the merged distributors), the purchase premium will be recorded by Entegrus Inc., and not New EPI. The Applicants submit that the premium will thus in no way impact the financial viability of New EPI.

[10] See Application pages 32-33. See Interrogatory Responses 1-Staff-10, 1-Staff-11, 1-Staff-12, 1-Staff-13 and 1-Staff-14.

The Applicants note that transition costs, which include approximately $1.0M-$1.2M of OM&A costs and approximately $0.9M-$1.1M of capital costs, will be financed through existing working capital until expected productivity gains materialize in 2018.

Board Staff submits that the evidence demonstrates that no adverse impact on the applicants' financial viability is anticipated.

RATE-MAKING CONSIDERATIONS

Deferred Rate Rebasing[11]

Board policies on rate-making associated with consolidation are established in a report entitled *Rate-making Associated with Distributors Consolidation*, issued July 23, 2007 (the "2007 Report") and a further report issued under the same name on March 26, 2015 (the "2015 Report").

The 2015 Report permits consolidating distributors to defer rebasing for up to ten years from the closing of the transaction. 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.

As noted above, the Applicants have proposed an 8 year rebasing deferral period. Board Staff submits that the deferred rebasing period chosen by the Applicants aligns with the OEB's policy regarding consolidations.

Earnings Sharing Mechanism[12]

The 2015 Report requires that consolidating entities that propose to defer rebasing beyond five years implement an earning sharing mechanism ("ESM") for the period beyond five years, whereby excess earnings are shared with consumers on a 50:50 basis for all earnings that are more than 300 basis points above the consolidated entity's annual Regulated Return on Equity ("Regulatory ROE").

---

[11] See Application page 34.

[12] See Application pages 35-37. See Interrogatory Responses 1-Staff-6 and 1-Staff-15.

The Applicants have proposed that earnings in excess of 300 basis points above the Board's established Regulatory ROE for the consolidated entity post year 5 (after merger closing) be divided on a 50:50 sharing basis between New EPI and its ratepayers. As detailed in the Application on page 36, the Applicants explained that the computation of Adjusted Regulatory Net Income for the purposes of calculating Regulatory ROE would continue to exclude revenue and expenses that are not otherwise included for regulatory purposes. On page 37 of the Application, the Applicants noted that in order to equitably split the ESM benefit amongst ratepayers of both rate zones, the ESM deferral account would be allocated by rate zone based on revenue requirement and then by rate class, based on most recent billing determinants.

Board Staff submits that the proposed ESM is consistent with the OEB's policy. As acknowledged in response to interrogatory 1-Staff-15, the Applicants are not seeking approval for the new proposed ESM deferral account in the current application and intend to request approval for this account in a later rate application.

CONCLUSION

In conclusion, the Applicants submit that the evidence provided reasonably demonstrates that the proposed transaction to effect the amalgamation of EPI and STEI meets the no harm test. This is supported by the Board Staff submission.