Ontario Energy Board | Commission de l'énergie de l'Ontario

BY EMAIL

April 15, 2019

Ms. Kirsten Walli
Board Secretary
Ontario Energy Board
2300 Yonge Street, 27th Floor
Toronto ON M4P 1E4

Dear Ms. Walli:

Re: North Bay (Espanola) Acquisition Inc.
Application for approval for North Bay (Espanola) Acquisition Inc. to purchase Espanola Regional Hydro Holdings Corporation and Espanola Regional Hydro Distribution Corporation, amalgamate them, and operate the amalgamated company under the name of Espanola Regional Hydro Distribution Corporation

OEB Staff Interrogatories
Ontario Energy Board File Number: EB-2019-0015

In accordance with Procedural Order No. 1, please find attached the OEB Staff Interrogatories for the above proceeding. This document has been sent to the applicant and to all other registered parties to this proceeding.

The applicant is to file with the OEB complete written responses to the interrogatories and serve them on all parties by April 29, 2019.

Yours truly,

Original Signed By

Andrew Pietrewicz
Project Advisor, Supply & Infrastructure

Encl.

OEB Staff Interrogatories

Application for approval for North Bay (Espanola) Acquisition Inc. to purchase Espanola Regional Hydro Holdings Corporation and Espanola Regional Hydro Distribution Corporation, amalgamate them, and operate the amalgamated company under the name of Espanola Regional Hydro Distribution Corporation

North Bay (Espanola) Acquisition Inc.

EB-2019-0015

April 15, 2019

<u>OEB Staff - 1</u>

Ref: Application, Cover Letter, Page 3

Ref: Application, Pages 8, 16, 25

Preamble:

Page 8 of the Application states “[…] ERHDC is party to a Services Agreement with PUC Services Inc. 1 (“PUC”)” and that “the term of the PUC Services Agreement continues until February 28, 2022”.

Cover letter page 3 of the Application states “No synergies are possible until the PUC Services Agreement expires”.

Page 8 of the Application states “this Application to the OEB is limited to the approvals required to affect the purchase by NBEAI of ERHHC and the subsequent amalgamation of NBEAI, ERHHC and ERHDC (the “Phase 1 Transaction”).”

Page 16 of the Application states “Although the consolidation will result in transaction and transition costs, these will be offset by the cost synergies and operational efficiencies that will be realized in the underlying OM&A costs once the Phase 2 Transaction is completed”.

Page 25 of the Application states “Following the completion of these two rebasing applications, and once the PUC Services Agreement ends, NBEAI will apply to the Board for approval of the Phase 2 Transaction” and that “the operational synergies associated with this transaction are not forecasted to arise until after approval of the Phase 2 Transaction”.

Table 7-1 on page 25 of the Application shows projected synergies between years 1 and years 8 of the proposed transaction. No cost savings are identified for Phase 1 of the proposed transaction, but a cost of $75,000 is identified for year three – 2021. As a result, Phase 1 of the proposed transaction is projected by the Applicant to result in a net cost.

Questions:

a) Please explain the $75,000 net cost projected for Phase 1.

b) Why does the $75,000 appear only in the “Synergies” section of Table 7-1 and not also in the “Status Quo” section: is it not common to both scenarios? Please explain.

c) How much of the $75,000 is related to Phase 1 of the proposed transaction and how much is related to Phase 2?

d) Please clarify who will pay for the cost and where the money will come from.

- For example: is it a cost to be recovered from ratepayers of Espanola and/or North Bay? If the cost will not be recovered from ratepayers, how will it be funded?

e) Is it necessary to incur the cost in Phase 1? Could the cost be deferred to Phase 2? Please explain.

OEB Staff - 2

Ref: Application, Pages 35-37

Preamble:

Page 35 of the Application states "Incremental one-time transaction and transition costs are expected to be approximately $600k. These costs will not be included in the revenue requirement of NBEAI, NBHDL or New NBHDL and thus will not be funded by ratepayers."

Questions:

a) Please explain the nature of the projected $600,000 one-time transaction and transition costs (for example: what are they for?)

b) Please clarify who will pay the costs and where the money will come from.

c) Please clarify how much of the costs are related to Phase 1 of the proposed transaction and how much are related to Phase 2. If any of the costs relate to both Phase 1 and Phase 2, please provide an estimated apportionment.

d) Why are any transaction and/or transition costs necessary during Phase 1?

e) If any of the costs in Phase 1 are related to Phase 2, please comment on whether it is necessary to incur those costs during Phase 1, given that the Applicant has not yet submitted an application seeking approvals for Phase 2.

f) Please comment on the linkage, if any, between the $600,000 one-time transaction and transition costs and the "[…] significant increases" in NBEAI's debt to equity ratios and reduction in ratios tied to liquidity anticipated during Phase 1.

g) Please comment on the linkage, if any, between the $600,000 one-time transaction and transition costs and the $75,000 net cost projected for Phase 1.

OEB Staff - 3

Ref: Application, Page 37, Section 8.5 "Details of the financing of the proposed transaction"

Preamble:

The Applicant states that "the proposed transaction will be 100% financed by new term debt from Toronto Dominion Bank" and that "NBEAI has negotiated financial terms with its lender that recognize the circumstances of ERHDC and the intention to amalgamate in 2022."

Questions:

a) Please confirm that the term debt will be issued to the NBEAI entity.

b) Please provide more detail on the arrangements of the loan, including but not limited to, the repayment term of the loan, interest rate (fixed/variable), collateralized assets, debt covenants imposed, etc.

c) Please provide any documented correspondence (memorandum of understanding, letter of intent, etc.) between the Applicants and the lending institution with respect to the new debt that outlines the terms and conditions of the loan.

d) Please comment on the nature of the debt covenants of the new loan, if any, and the ability of NBEAI or New NBHDL to meet those covenants, and the ramifications of violating these covenants with specific reference to the financial viability of NBEAI or New NBHDL.

e) Please explain whether the negotiated financial terms of the new loan are contingent on a future approval to amalgamate NBHDL and NBEAI in 2022. If so, please explain what the lending ramifications are if Phase 2 is not approved.

f) Please confirm that the new term debt and associated repayments are included in the pro forma financials included as Appendix J in this application.

g) If prior to the amalgamation and establishment of the New NBHDL, NBEAI experiences unforeseen difficulties in repaying the new loan, please comment on the nature of any cross-guarantees or financial support that NBHDL will provide to NBEAI to ensure it remains a going concern.

OEB Staff - 4

Ref: Application, Pages 36-37

Ref: Application (Appendix I, ERHDC 2017 Financial Statements)

Preamble:

The Applicant states "During this timeframe [Phase 1] NBEAI will see significant increases in its debt to equity ratios and ratios tied to liquidity will reduce, however, with the proposed amalgamation in 2022 the Applicant considers this to be temporary and have determined that the purchase price will not have an adverse effect on the financial viability of NBEAI or new NBHDL."

Questions:

a) Please provide additional detail on what quantitative analyses the Applicant has undertaken to conclude that the purchase price will not have an adverse effect on financial viability of NBEAI or new NBHDL.

b) Will the existing loans to ERHDC be eliminated (replaced) by the new loan from the Toronto Dominion Bank or is the new loan supplementary to the existing loans being held by ERHDC?

c) If NBEAI will keep ERHDC's existing debt arrangements, please indicate how the acquisition will affect the loan covenants imposed in the Infrastructure Ontario non-revolving term loans (as indicated in Note 11 of the 2017 Audited Financial Statements of ERHDC).

d) Please explain the consequences of breaching the debt service coverage ratio or debt to total assets ratio covenants under ERHDC's Infrastructure Ontario loans and provide an analysis to demonstrate whether NBEAI (and later new NBHDL) will or will not remain compliant with these covenants.

e) Will the existing loans to NBHDL be eliminated (replaced) by the new loan from the Toronto Dominion Bank or is the new loan supplementary to the existing loans being held by NBHDL?

f) If the newly amalgamated NBHDL intends to keep the current NBHDL's existing debt arrangements, please indicate how the 2022 merger will affect the various loan covenants it must maintain (the loan covenants associated with the Ontario Infrastructure Projects Corporation loan, as well as the debt service coverage ratio requirement on the other various term loans currently held by NBHDL).

g) Please explain the consequences of breaching any of the covenants identified in part f) above and provide an analysis to demonstrate whether new NBHDL will or will not remain compliant with these covenants.

<u>OEB Staff - 5</u>

Ref: Dividend Policy

Questions:

a) Please outline the proposed dividend policy of the amalgamated entity (both NBEAI's policy and New NBHDL's policy).

b) Please provide an analysis that shows what the expected annual dividend payout of the amalgamated entity will be over the deferred rebasing period (for NBEAI during Phase 1 and New NBHDL during Phase 2).

c) Please provide an analysis on how the proposed dividend policy from 2019 to 2026 will not adversely affect the financial viability of NBEAI or New NBHDL.

<u>OEB Staff - 6</u>

Ref: Application, Page 38, Section 10: "Other Related Matters"

Preamble:

The Applicant states that both NBHDL and ERHDC have adopted IFRS and utilize MIFRS for regulatory reporting purposes. OEB staff is seeking additional information with respect to the impact of ERHDC's adoption of NBHDL's accounting policies within IFRS. Although both entities will report under the same accounting framework, whenever they are consolidated into one set of financial statements (either as separate entities or as an amalgamated single entity), ERHDC (the acquired company) will be required to adopt the accounting policies of NBHDL (the acquirer). This includes, but is not limited to, asset capitalization policies, depreciation policies, etc.

Questions:

a) Please provide the anticipated timeline of when ERHDC will revise its accounting policies to align with that of NBHDL, as required by *IFRS 10 – Consolidated Financial Statements*.

b) Has the Applicant undertaken any studies or reviews of the types of transactions that will be impacted as a result of ERHDC's adoption of NBHDL's accounting policies?

c) If so, please quantify the estimated impact on ERHDC's revenue requirement between the time that ERHDC revises its accounting policies and the time that ERHDC rebases using these updated policies. Specifically, please separate the components of revenue requirement (OM&A, depreciation, cost of capital, and PILs) that are expected to be impacted and show how these calculations are derived.

d) Please explain the Applicant's intentions with respect to how it plans to account for the differences calculated in part c) with respect to distribution rates.

e) If the Applicant's intention in part d) above is to request to have an Accounting Order established to track the revenue requirement differences between ERHDC's and NBHDL's accounting policies as part of this proceeding, please prepare a Draft Accounting Order as an appendix for approval.

<u>OEB Staff - 7</u>

Ref: Handbook to Electricity Distributor and Transmitter Consolidations

Ref: Application (Appendix J)

Preamble:

The OEB's *Handbook to Electricity Distributor and Transmitter Consolidations* includes a list of filing requirements. Under the filing requirements, Section 2.2.4, (page 6 of the filing requirements), applicants are asked to "provide pro forma financial statements for each of the parties (or if an amalgamation, the consolidated entity) for the first full year following the completion of the proposed transaction."

Questions:

a) Please provide pro forma financial statements for NBHDL for the fiscal year ended December 31, 2020.

b) Please provide pro forma financial statements for the proposed consolidated entity of New NBHDL, for the first full year following the completion of the amalgamation between NBHDL and NBEAI in 2022.

c) Please confirm that the pro forma statements in Appendix J reflect the incremental transition costs that are projected in this application and that the pro forma financial statements requested in part b) above will reflect the incremental transition costs and the savings.

d) Please explain how the projections in the pro forma statements in Appendix J are derived (or will be derived for parts a) and b) above).

<u>OEB Staff - 8</u>

Ref: Application, Pages 12, 27, 35

Preamble:

Page 27 of the Application states "[…] ERHDC has been outside of the rate setting structure for an extended period of time and needs to have rates re-set in order to continue investing in the operational and infrastructure needs of the communities it serves and to position itself in a more secure, financially viable position". Further, "Customers are not best served when the financial viability of an LDC is at risk".

Page 35 of the Application states "it is not financially viable, prudent or sustainable for ERHDC to continue to sit outside of the rate setting environment, operating under what could be considered an indefinite rate freeze" and that "ERHDC does not have the financial ability to continue executing its operational plans without a rate adjustment".

Page 12 of the Application states "if the Board approves the Phase 1 Transaction, NBEAI would also ensure ERHDC files a cost of service rebasing application for rates effective May 1, 2021 (the "Espanola Rebasing Application")."

ERHDC last filed a rebasing application in February 2012 for 2012 rates. It has been operating under interim rates since May 2016. ERHDC was scheduled to rebase in 2017 but received OEB approval to defer to 2018. As of mid-April 2019, ERHDC has not yet submitted its 2018 cost of service filing, nor has it indicated to OEB staff that it intends to seek OEB permission to defer the application. As of May 1, 2019 ERHDC would be required to convert its rate year to 2019.

Questions:

a) Does ERHDC intend to submit its 2018 cost of service filing to the OEB by the end of April 2019? If not, why not? If not, has it requested or does it intend to request OEB approval to defer its 2018 filing? Please explain.

b) Under Phase 1 as proposed, please confirm the year in which the ERHDC would file its cost of service rebasing application for rates effectives May 1, 2021?

c) If ERHDC's need to rebase is so pressing, why does the Applicant propose to wait until 2021, or thereabouts, to rebase ERHDC's rates (i.e. rather than rebase Espanola now)?

d) What is the soonest that ERHDC could file a complete cost of service application? Please explain.

e) Please comment on when ERHDC would next rebase if the OEB did not approve the proposed Phase 1 transaction? Is the date of Espanola's next rebasing tied to whether or not the current consolidation proposal is approved?

f) Please comment on whether and how ERHDC's rebasing in Phase 1 will account for the savings projected in Phase 2?

OEB Staff - 9

Ref: Application, Pages 11, 24

Preamble:

Page 11 of the Application states "[…] NBHDL is due to file its cost of service rebasing application for rates effective May 1, 2020".

Page 24 of the Application states "[…] NBHDL intends to file the NBHDL Rebasing Application for rates effective May 1, 2020, as currently required."

Questions:

a) Please confirm that NBHDL is due to file its cost of service rebasing application for rates effective May 1, 2020 and that it intends to file its application for rates effective May 1, 2020 as currently required, irrespective of whether or not NBEAI's proposed consolidation application is approved.

b) Please confirm the year in which NBHDL would file its cost of service rebasing application for rates effectives May 1, 2020.

c) Please comment on whether and how NBHDL's rebasing in Phase 1 will account for the savings projected in Phase 2.

<u>OEB Staff - 10</u>

Ref: Application, Cover Letter

Ref: Application, Pages 1-44

Preamble:

The Applicant seeks approval to purchase Espanola Hydro, merge with it, but operate Espanola Hydro and North Bay Hydro as separate companies with independent rebasings before 2022. This is referred to in the application as “Phase 1”.

The Applicant proposes to return at a later date with a second application for approval to merge the Espanola company created in Phase 1 with the North Bay distributor, effective 2022. This is referred to in the application as “Phase 2”.

The Applicant anticipates Phase 1 will result in a net cost. The Applicant also anticipates that Phase 1 will strain it financially (e.g. “significant increases in its debt to equity ratios” during the period to 2022 and reduced “ratios tied to liquidity”). The Applicant states all of this will be more than corrected in Phase 2 (i.e. net savings and financial relief will come).

Approvals sought by the Applicant at this time relate only to Phase 1; the Applicant has not yet submitted an application to the OEB for approvals related to Phase 2.

The Applicant identifies a pressing need to rebase Espanola Hydro’s rates.

Espanola Hydro was scheduled to rebase in 2017 but received OEB approval to defer to 2018. Espanola Hydro has not yet submitted its 2018 cost of service filing, nor has it requested OEB permission to defer the application. As of May 1, 2019 Espanola Hydro would be required to convert its rate year to 2019.

Despite the pressing picture it paints, the Applicant proposes that Espanola Hydro should apply to rebase for rates effective 2021 (i.e. not now or next year).

Questions:

a) If Phase 1 contains only net cost and financial stress, while Phase 2 contains the benefit and relief (and the Phase 2 application is to be submitted in the future and is therefore not a sure thing), why not file Phase 1 and Phase 2 approval requests in a single application and at the same time rather than in two separate applications filed years apart?

b) Please comment on the pros and cons of the following indicative scenarios, and on whether such scenarios were considered by the Applicant and why they were not pursued:

- **"1": As proposed, but with earlier Espanola rebasing**
  - Espanola rebases sooner (i.e. rather than for rates effective 2021 as originally proposed by the Applicant),
  - The consolidation involves two separate applications filed years apart (i.e. as originally proposed by the Applicant).

- **"2": Earlier Espanola rebasing, all consolidation requests made in a single application**
  - Espanola rebases sooner rather than later,
  - The consolidation involves one application.

- **"3": Espanola rebasing as proposed, but all consolidation requests made in a single application**
  - Espanola rebases for rates effective 2021 as originally proposed,
  - The consolidation involves one application.

- **"4": Merge first, rebase later**
  - Espanola and North Bay Hydro merge (i.e. to form "the new NBHDL")
  - Espanola defers rebasing
  - The consolidation involves one application.

c) Please comment on why ERHDC and NBHDL did not elect to file an acquisition and amalgamation application effective 2022 (i.e. for the period after the expiry of the existing arrangement between PUC and ERHDC) instead of the phased approach contemplated in the current Application? Please further comment on why this is the case given that Espanola and North Bay would have pursued independent rebasings prior to 2022 anyhow (i.e. in absence of the consolidation).

OEB Staff - 11

Ref: Application, Pages 19-32

Ref: Application, Pages 1-44

Preamble:

Table 7-3 on page 30 of the Application provides SAIFI and SAIDI metrics for the North Bay and Espanola distributors. The table states "Please note due to ERHDC being fully embedded with HONI, the majority of weather-related events cause upstream outages which are classified as Loss of Supply and therefore are not included in the above SAIDI/SAIFI calculations, resulting in very favourable statistics for ERHDC when excluded. As such, the statistics do not provide an equal comparison between the two utilities."

Page 32 of the Application states “As NBEAI is acquiring ERHDC the proposed transaction will result in a change of control. All transmission and distribution assets in the ERHDC service territory will fall under the control of NBEAI in Phase 1 […].”

Page 32 of the Application states “Due to the distance between the two utilities and the importance of maintaining and/or enhancing current customer service levels, it is proposed that the current operation centres will be maintained in both service territories throughout the duration of this process.”

Page 19 of the Application states “Front line operations staff that currently respond to outages and power quality issues are expected to continue to serve the same communities. The Applicant anticipates that response times will not decline. Throughout both phases of this transaction, it is the intention of the Applicant to maintain the service levels of both LDCs through the merging of technologies, system control, adoption of best work practices, etc.”

Page 31 of the Application states in the context of Phase 2, “Of note, the ERHDC electrical system will be displayed, managed, and operated from the NBHDL Control Room, an element of operation that is currently lacking at ERHDC.”

Page 29 of the Application states “[…] it is proposed the existing service center will continue to operate in Espanola.”

Questions:

a) For clarity, will the Espanola distribution system be operated from the Espanola operations centre during Phase 1? If so, who will it be operated by? If not, please explain.

b) Please clarify the significance of the term “control” versus “operate” on page 32 in the context of distribution system operations and reliability for the Espanola service territory.

c) Will there be a reduction to the number of Espanola system operators during Phase 1? If yes, please explain and comment on implications for Espanola reliability.

d) Will there be a reduction to the number of Espanola front line operations staff that currently respond to outages and power quality issues during Phase 1? If yes, please explain and comment on implications for Espanola service levels and quality standards (e.g. such as response times).

e) With respect to distribution system operations, service levels and quality standards, will there be any merging of technologies, system control, adoption of best work practices, etc. during Phase 1?

f) Are Loss of Supply events excluded only from ERHDC's SAIDI and SAIFI statistics in Table 7-3? If yes, please explain why they are not also excluded from NBHDL's statistics for greater comparability?

g) Please clarify what is meant by "[…] an element of operation that is currently lacking at ERHDC" in the quote from Application page 31 above.

h) Is the Espanola service centre referenced on page 19 the same as the operations centre referenced on page 32? Please clarify.

OEB Staff - 12

Ref: Application, Page 9

Preamble:

Page 9 of the Application states "The closing of the acquisition of the Purchased Securities is conditional upon the receipt of all required approvals and third-party consents, including the OEB's approval of this Application."

Questions:

a) Please clarify which required approvals and third-party consents are referenced in the quote above. Please also summarize the status of each and provide an outlook for expected completion as applicable.

b) Please clarify when the transaction will close following receipt of the approvals and consents noted above.