North Bay (Espanola) Acquisition Inc.
EB-2019-0015
Procedural Order No. 3
Donald D. Rennick Submissions
May 10, 2019

DDR-1 (a)

The interrogatory preamble makes note of the fact that there are no OM&A benefits accruing to NBHDL customers. This statement was based on the applicant's figures as shown in Table 7 – 1 which indicates that the OM&A cost per NBHDL customer will be unchanged in 2026 whether or not the amalgamation is finalized. It was also based on the fact that NBHDL customers will be required to service $8 million in debt following the amalgamation. This cost is not reflected in the OM&A figures presented in the application.

In spite of these facts, the applicant's response simply restates that <u>all</u> customers stand to benefit from the proposed transaction. Please explain the basis for this view based on the evidence presented in the application.

DDR-1 (b)

The interrogatory asks for some indication of the engineering an operational expertise that is lacking or not available to NBHDL that will be supplied by the amalgamation. The applicant's response merely restates the original claim without any additional support. Please indicate the specifics supporting the accuracy of this claim.

DDR-2 (b)

The interrogatory asked if the board members approved the transaction based on the "no harm" test. The interrogatory also asked what the approval was based on if it was not the "no harm test". The applicant provided a statement regarding the mandate of board members in general and suggested that board members followed their mandate in that regard. A direct response to the question was not provided.

Without the approval of NBHHL board members this transaction would not have proceeded. It is therefore important to know if management specifically asked board members to approve this amalgamation based solely on the reason that it would not negatively affect the customers of NBHDL or was additional information provided. Please present the narrative provided to board members in connection with their approval of this amalgamation process.

DDR-3

The response suggested referring to the responses given to Staff -7 (d) and SEC – 8.

The Staff - 7 (d) response includes the statement:

"ERHDC - OM&A growth rates of approx. 2.5% were applied where appropriate for ERHDC from 2018 through 2026 *with capital spending reflecting relatively flat expenditures* over the 2019-2026 horizon with the exception of a replacement bucket truck in 2019 and a substation rebuild in 2021."

And Page 28 – 16 of application includes the statement:

"However, *the substantial infrastructure requirements* of ERHDC over the next 10 years are primarily related to substation rebuilds and NBHDL has significant experience constructing substations."

The former statement indicates "flat capital spending" and the latter indicates "substantial infrastructure requirements". There is an apparent contradiction between these statements. How does this affect the calculations made?

The calculation of OM&A savings do not include amortization and depreciation. Please indicate the affect their inclusion would have on the calculations.

DDR-4

The response indicates that current funding will be sufficient to cover the additional principal and interest payments. The response was adequate concerning the cost associated with the PUC agreement but incorrectly suggested that current cost of capital currently included in rates would cover the increased financing costs resulting from the $8 million liability to purchase the shares of ERHHC.

The current cost of capital amounts being contributed by customers will not cover the additional principal and interest payments. The additional funds required to service the debt will necessarily divert those funds from the areas in which they are presently being used. Please suggest how this represents would not harm customers.

DDR-5

The response indicates that all customers will benefit from the estimated OM&A savings and suggests that IR Schedule A supports this view.

Table 7 -1 shown in Schedule A points out clearly that the OM&A cost per NBHDL customer in 2026 will be $358 if no amalgamation occurs ($8,624 divided by 24,117 customers). The additional calculation in Schedule A indicates that NBHDL customers portion of the forecast OM&A in 2026 will be virtually the same at $357 ($8,607 divide by 24,117 customers) if the amalgamation is approved.

Furthermore, dividing 100% of the forecast OM&A expense of $9,781 by the total customer base of 27,405 also calculates to a per customer OM&A of $357 which belies that applicant's response that the acquisition will result in a reduced OM&A cost per customer for both NBHDL and ERHDC customers. The additional principal and interest payments are not included in the OM&A forecasts and will certainly tip the balance to one that does harm current NBHDL customers.

Please provide specific reasoning to refute the facts shown in Schedule A

DDR-7

The response results from a misunderstanding of the effects of any savings forecast through consolidation of administrative practices since as indicated above in DDR-5. NBHDL customers will receive no benefits whether or not the amalgamation goes ahead.

DDR-8

The response suggests that the ERHDC rebuilds will be paid for within a 10 year period by current ERHDC customers. Please confirm that NBHDL customers will not be required to pay for these upgrades or the amounts they will be required to pay.

DDR-11

The response did not address the request for an explanation of how allocating NBHDL resources to ERHDC's needs regarding a financial rescue would not be harmful to NBHDL customers. It is evident that the operation of NBEAI will require additional resources and those resources will come from NBHDL at the expense of NBHDL customers.

The suggestion that this amalgamation is a somehow a furtherance of NBHDL mission statement is a stretch. The mission statement (which is not mentioned anywhere on the web or on hydro bills) in no way encourages or mandates the acquisition of additional customers especially customers who are located over two hours away. NBHDL was incorporated solely to supply electricity to its owners who are the citizens of North Bay.

DDR-12

The applicant's should be aware that nothing is "funded through retained earnings" except dividends. If the applicant meant that the $600k in costs will be paid out of current or future liquid assets, they should be aware that those assets were supplied by ratepayers through delivery rates. Please provide a further explanation regarding the source of the funds to be used to pay one-time transaction and transition costs.

DDR-13

If the applicant suggests that the legal costs will be paid out of current or future liquid assets, they should be aware that those assets were supplied by ratepayers through delivery rates. Please provide a further explanation regarding the source of the funds to be used to pay one-time transaction and transition costs.

DDR-14

I am aware of the Board's stance on selling price. My query was an attempt to understand the reasoning behind combining two opposing valuation methods to arrive at a sale price since it appears to have overvalued the transaction which of course would be harmful to customers.

DDR-15

The response suggested referring to the responses given to Staff - 4(a).

Staff - 4(a) Table 1 shows the debt to equity ratio increasing from the 2018 ratio of 1 in the case of NBHDL to 1.26 in 2022 for the new NBHDL. This is not a more optimal debt to equity ratio. The IO calculation of debt service coverage ratio reduces from 1.75 to 1.34 post-phase 2 which is not an improvement. The IO calculation of debt to total asset ratio increases from 40% to 45%. This is not an improvement.

Please provide an explanation for the view that the liquidity and debt service ratios of new NBHDL will have "*more optimal debt to equity ratios*".

DDR-16 (a)

The response suggests, among other things, that paying off the new financing is not a requirement but merely a suggestion. The original loan or any financing that replaces it will require principal and interest payments until the liability is paid off.

The purpose of showing the calculation was to point out the funds required to cover the cost of the financing the purchase. The OEB's method of allowing LDC's to calculate a cost of capital component to rates is not an endorsement for one particular capital structure over another and has no bearing on the point being made.

The response suggests the "cash shortage" will be covered by the estimated OM&A savings. The purpose of the IR was not to suggest that cash would not be available but to illustrate that the cost of the investment, considered independently, does pay for itself nor provide a benefit to customers.

The response indicated that the term of the TD loan was 25 years as opposed to 20 years. The interest rate was not mentioned so I will assume that the 2.5% was correct. The error in the tax calculation was noted. In addition, a further error in the schedule was noted and an amended version has been included below.

The response suggests that OM&A savings will mean additional income. The purpose of the IR was to point out that while the application detailed the operational savings, it neglected to mention the debt servicing costs which will entail additional costs and be a drain on cash which is harmful to customers. The IR was also meant to point out that what NBHDL customers are essentially being asked to do is to take on additional customers with more responsibility, contribute a major portion of almost $12 million in rate base and PILS charges, all of which is harmful, and at the end of 25 years realize no actual savings in OM&A or other demonstrable benefits.

The response suggests the municipality will benefit from a larger/more valuable asset. The facts are that any increase in the rate base over the 25 years through increases in the actual ROE rate, additional capital purchases or increases in OM&A will require owners/customers to supply additional funds. Additionally, they will be required to fund the resulting increases in rates.

Schedule A (amended)

NBEAI Purchase Financing

Purchase Price (TD Loan)	$7,989,530
Total payments to retire loan in 25 years	$10,752,711
Interest	$2,763,181

Return On Equity

OEB - ROE rates for 2019	8.98%		
- LT Rate	4.13%		
- ST Rate	2.82%		
2016 Rate Base - ERHDC	$6,128,438		**Annual Return**
LT debt - 56%	$3,431,925	4.13%	$141,739
ST debt - 4%	$245,138	2.82%	$6,913
	$3,677,063		$148,651
Equity - 40%	$2,451,375	8.98%	$220,133
2016 Rate Base - ERHDC	$6,128,438		$368,785

	25 year Amortization
ROE for 25 years	$9,219,622
Less: Interest	$2,763,181
Income for tax purposes	$6,456,442
Plus	
PILS - 21.5% on taxable income	$1,768,325
PILS - Gross up	$484,318
	$2,252,643
Taxable income included in rates	$8,709,085
Less: PILS - 21.5%	$1,872,453
Net cash from ROE over 25 years	$6,836,631
Principal payments	$7,989,530
Add't revenue required	$1,152,899
Add:PILS on add'l revenue - 21.5%	$247,873
Add:PILS - Gross up	$67,889
Total cash shortage	$1,468,661

DDR-17 (a)

The response was adequate.

Respectfully submitted on this May 10, 2019

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