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## Council Merger Question & Answers

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September 2008

These questions are from Guelph City Councillor Mike Salisbury. He submitted them to Guelph Hydro and requested a written reply.

Councillors Salisbury, Hofland and Wettstein meet with Guelph Hydro board and staff members on September 10/08 to discuss these answers in detail.

The numbers referenced in the questions are specific sections of the Business Case to which councillors and city hall senior staff have had access. Notes have been made to show where Guelph Hydro staff and councillors discussed issues that could not be made public for confidentially reasons. In some cases, the answers to these questions may seem out of context without the full background of the business case.

We are sharing this document with the public as part of our commitment to be as open and transparent around the merger as possible. This document will be posted at the Guelph Hydro merger site: [guelphhydro.com/merger](http://guelphhydro.com/merger)

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## HYDRO MERGER BUSINESS CASE QUESTIONS

### 2.1.5 Horizon Business Activities

*“Horizon holdings provides water billing services for the City of Hamilton” ... “economies of scope”*

Q1: Does GHESI currently engage in related service provision for Guelph? If not why not (what are the barriers to entry in this situation)

**Yes. We provide water billing services for the city of Guelph and this will continue after the merger. Customers will be able to take advantage of longer service hours and more efficient customer service through a new billing system. Guelph residents will be able to make payments and speak with a customer service person at the front desk at the Southgate office. It will still be a local call to ask a question about your water bill.**

Note: This is listed as a key strategy in meeting the financial targets of MergeCo section 5.1.2.1 Horizon Holdings has established / intends to establish Horizon Energy Solutions Inc. (HESI) which appears to be in direct competition with HUC (Hamilton Community Energy) and GHI (Ecotricity)

Q2: Has this potential conflict been addressed in our legal agreement?

**This merger will not change our efforts to grow the CEP and there is no conflict between HESI and GHI. We are free to compete in non-regulated activities. And while healthy C&DM competition is good for customers, we expect to partner rather than compete on future opportunities. For example, partnering with HESI might open doors for GHI to find more and less expensive capital to invest in our community.**

Q3: What are the predicted financial impacts for Horizon Utilities should HESI not be permitted to compete against GHI initiatives – conversely – what are the impacts to GHI and Ecotricity should HESI aggressively compete for market share in Guelph?

**The business case for HESI has not been developed so we cannot yet measure its impact.**

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Note: Both demand management and conservation business opportunities are noted in section 5.1.2.1 as a source of MergeCo revenue and growth required to achieve the forecasted financial targets.

Q4: There is no mention of HESI operations, strategy, or financial impact on MergeCo or the affiliate municipalities in the business case. What is the anticipated financial contribution of HESI to MergeCo?

**HESI's business was not a part of the MergeCo business case. When HESI's business case is developed it will not have any negative impact on the new utility. As part owner of the new utility and of HESI, we will be actively involved in developing this plan.**

#### 2.2.7.1 Operating practices GHESI

GHESI is considered "successful" due to a number of effective business practices:

- Contracting out highly specialized functions
- Outsourcing non-core functions
- Cooperation and partnerships to achieve cost savings
- Leader in specialized technology (GIS)

Q5: Do we currently, or have plans to, sell our competitive technical expertise to other LDCs  
**In the past, GHESI has sold mapping services to other LDC's. Current OEB regulations prevent us from doing so. This might be an opportunity for future revenue.**

#### 5.1.3 Operations

Key business processes required to achieve financial outcomes...*"historically, utilities have not..."*

Q6: What operational processes listed in section 5.1.3 does GHESI currently NOT already utilize and/or specifically what gaps in GHESI business operations are expected to be improved as a result of the merger?

**This merger will improve performance in all five areas listed in this section including activities based costing, continuous improvement methodology and Key Performance Indicators (KPI) (monitoring and tracking), reliability centered maintenance programs and asset management.**

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Q7: Please quantify the specific financial outcomes expected to be gained from these improvements in operations.

**\$3.9 m in operating efficiencies will be found through consolidation of departments, processes and systems.**

*“MergeCo will develop and deliver continuous improvement methodology and principles”*

Q8: This statement implies that this scenario does not currently exist at GHI. Is this the case?  
Note: the 2007 Report to shareholders speaks to self-evaluation and continuous improvement with regards to governance and business ethics practices.

**Both GHI and GHESI are committed to continuous improvement. Asset management is an area of growth from which we feel our community will greatly benefit being part of a larger utility.**

**Being part of a larger utility will give us the opportunity to take advantage of sophisticated asset management systems. The cost of these systems is significant and more affordable within a larger utility.**

*“Identification, monitoring and tracking key performance indicators”*

Q9: The company overview in the business case lists “Key Service Quality Indicators” for comparison in sections 2.1.12 and 2.2.9. What additional key performance indicators are proposed as part of the merger and what specific financial outcomes are predicted as a result of this monitoring process?

Note: the Yearbook of Electricity Distributors (OEB) list additional financial, operational and performance indicators for all LDC’s in the province of Ontario. LDC’s are required to collect and report these performance indicators under OEB electricity reporting and record keeping rules.

**MergeCo will adhere to and report on all the Key Performance Indicators (KPI) that the OEB requests. Additionally KPI will be part of the strategy developed by the new management team for operational and finances. They include reliability, limiting the length and frequency of outages, and other delivery issues.**

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### 5.1.3 Asset Utilization - Reliability Centered Maintenance

*"Typically utilities..."*

Q10: Again, the business case uses non-specific examples and terminology to make the financial argument in support of a merger. Specifically:

- what deficiencies currently exist at GHESI with regards to asset utilization and reliability centered practices
- what demonstrated solutions to these deficiencies will be realized as a result of a merger with Horizon
- what are the quantifiable financial benefits which support the claims made in this section of the business case

**A best practice Asset Management program is current missing at GHESI. This merger will allow GHESI to benefit from MergeCo's investment in the staff and software needed to build a long term asset management program. With combined capital program of \$35-40 million annually, this investment could save MergeCo 5-10% of capital costs a year.**

**Note: these savings would be in addition to the estimated \$3.9m annual savings.**

### 5.1.3 Asset Investment

*"Utilities tend to..."*

Q11: This is more and more beginning to read like a general guide to LDC mergers rather than a comprehensive and financially defensible business case for THIS merger between Horizon and GHESI. Please provide the specific financial details with regards to the benefits of this specific merger proposal.

**The business case is built from the bottom up, that is from the joint work of our staff in each area of the business and their counterparts at Horizon. These numbers were built from internal GHESI team reports which are located in our offices.**

**NOTE: During the face to face meeting, councillors were walked through specific Integration Team reports and documents that outlined from where these savings would come.**

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#### 4.2 Strategic Drivers

*“Without contemplating innovative outsourcing arrangements, partnerships or increased scale through consolidation, shareholder return will be at risk”*

Q12: Section 2.2.7.1 GHESI operating practices describes the contracting out of highly specialized functions, the outsourcing of non-core functions, and strategic partnerships to achieve cost savings as the reasons why GHESI is considered a successful LDC. Are we successful or are we at risk?

**Both. Our success is a testament to the skills and professionalism of our staff. They have built a well respected utility.**

**However, the sector is rapidly changing and we need to stay on top of the change. If we don't find ways to be more efficient and reduce our costs, we will not be able to maintain the high level of reliability and safety that we are known for. GHESI has been successful in achieving cost savings in a number of key areas. However, there are core administrative functions that we cannot reduce or outsource such as customer service and billing, finance and accounting and IT. Outsourcing any of these functions could compromise our safety and reliability and customer service.**

*“MergeCo consolidation is the best defense to counter any erosion in shareholder value”*

Q13: Please provide documentation to quantify this statement.

**Simply put, consolidation works. We only need to look at the savings that St. Catharines and Hamilton achieved when they first merged into Horizon and the savings that will be realized with this merger. At the same time, the organization grows its Human Resources skill set while delivering better customer service.**

**NOTE: during the meeting we distributed copies of various presentations comparing OEB utility data outlining the benefits of consolidation. These reports will be posted on the merger web site.**

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Q14: Please provide the supporting cost benefit analysis performed which compared the “best defense” strategy against the alternatives (innovative outsourcing arrangements and partnerships) as compared with the status quo.

**NOTE: Councillors were directed to the confidential Recommendation To Merge document given to City Council on May 28/08. This document contained a sample of this cost analysis. This analysis outlines the creation of a business model where LDC’s share administrative functions.**

#### 4.4 Target Market

*“the highest density at the lowest cost”* NOTE – this is a compelling vision / strategy

Q15: Mississauga recently announced its willingness to sell its LDC. Is it within the scope of the existing MOU for Horizon to enter into discussions with Mississauga during this merger process?

**No other merger discussions are being considered within this agreement.**

Q16: Is Horizon considering or has Horizon entered into discussions with Mississauga?

**Horizon has not spoken with Mississauga about merging opportunities.**

Q17: What is the anticipated impact of the Places to Grow legislation with regards to Horizon’s long term growth strategy based upon a target market area having “*significant amount of land to expand*” given that the business case suggests that load growth within an existing service area has a negative impact on revenue.

**The Places To Grow document was one of many references for forecasting future customer bases. Load growth will drive revenue growth for the new utility regardless of intensification.**

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*“negotiations with Hydro One regarding the adjacent service areas between Hamilton and Guelph” is “paramount” for MergeCo.*

Q18: Is it reasonable that Hydro One would be interested in parting with this prime service area given the basic foundation / justification for mergers has been the economies of scale achieved through growth and acquisition?

Q19: Has Horizon discussed this acquisition with Hydro One? And if so what is the status of this merger?

**We believe that greater economies can be achieved through consolidation in contiguous areas. Both Horizon and GHESI have had preliminary talks with Hydro One and we anticipate that those conversations would continue with the new utility.**

#### **4.6 Implementation Plan**

*“in preparing the assumptions used in this business case...”*

Q20: What were the “assumptions” used. Please provide the list of assumptions developed by the management teams.

**The detailed Integration Team reports prepared by GHESI and Horizon included literally hundreds of assumptions on very specific operational practices.**

**NOTE: Specific sections of the Integration Team reports were reviewed with councillors.**

#### **5.2.2 Centralized vs. decentralized functions**

*basic premise – “while both utilities are leaders in efficiency and have favourable cost structures, opportunities for further cost efficiencies still exist”*

*“centralising job functions are how companies create scale and lower overheads”*

*“Opportunities exist for reduction and rationalization of asset related service with the adoption of best practices”*

Q21: What is the rationalization of services? What does this mean?

**Rationalization here refers to the consolidation of business practices, process and team members. This refers to the efficiencies and best practices that will be found in the merger.**

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Q22: Are we not currently utilising best practices with regards to asset related services in Guelph. If not – why not. And if not what would be involved in instituting such best practices what would be the in-house cost benefit analysis of implementing best practices compared to the utilising the expertise of Horizon to do this for us as part of a merger?

**We have strong asset and operational practices in place. That said, we do not have the people or resources to be truly ‘best practice’ (few LDC’s do). One of the benefits of this merger is the development of a long term Asset Management program that is currently underway at Horizon.**

Q23: Does Horizon currently employ best practices in the provision of asset related services in BOTH Hamilton and St-Catharines

**Horizon is in the process of implementing a comprehensive Asset Management program and expects it roll it out within the next 12 months.**

Q24: What have been the measurable benefits in this aspect for St-Catharines with regards to this issue post merger?

**We understand that Horizon’s programs for maintenance and operations have improved service in St. Catharines. For example, since the merger, St Catharines has improved documentation around their capital and asset planning needs. This of course then translates into better asset management.**

### **section (ii) – Centralized Functions**

This section contains one paragraph describing the difference between de-centralized vs. centralized job functions, and a short paragraph defining the “technology focused” aspect of leverage for productivity and a chart detailing the proposed location of functional operating departments within each community.

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Q25: As part of the development of the business case and underlying financial, benefits of the merger proposal, what are the existing costs associated with the status quo (the current location of the various operations in Guelph) and the cost benefit analysis of the proposed reorganization of centralized operations.

**A detailed implementation plan has not yet been developed. When completed, it will outline the full breakdown of operational savings. The business case conservatively identifies a cost of \$4m for the entire integration process.**

**This merger will result in annual saving of approximately \$3.9m. The first 12 months after the merger, the operational savings will be insignificant. Within 24 months there will be savings of \$2m and within 36 months the new utility will be enjoying the full annual savings of \$3.9m.**

#### 6.1.2.1 Key Financial Risks

*“uncertainty in provincial energy policy and OEB regulations and potential for significant impacts to the MergeCo financial prospects”*

Q26 The fundamental foundation of the business case is that anticipated changes in the provincial energy policy and OEB regulations will create favourable environment supporting mergers in the sector. Does this uncertainty represent an opportunity or a liability and to what degree of certainty can we predict which it will be?

**The financial merits of this transaction stand on their own, and do not rely on any future policy or government directions.**

Q27: what contingencies for unfavourable regulations have been developed as part of the merger business case?

**Our best contingency for future regulation changes is to merge. As a larger utility, we will be in a better position to deal with any regulatory changes that take place.**

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### 5.3 – Asset Management Plan

*“given the size of the asset base and investment required, it is necessary that MergeCo put in place dedicated staff resources whose function it is to ... ensure maximum value is derived at all times.”*

Q28: Does Guelph currently employ dedicated asset management staff resources? If yes – what is the cost savings or increased ROI realised under the merger proposal as compared to the status quo? If no – why Horizon require additional staff resources to manage additional assets coming into MergeCo where the contributing partner did not require dedicated staff in a pre-merger situation.

**We currently do not have any dedicated Asset Management staff. This responsibility is shared between a number of different positions at Guelph Hydro. The combined assets of the two utilities will be integrated into Horizon’s current Asset Management Program and likely be managed by dedicated personnel responsible for this function.**

**It is anticipated that the Asset Management Program will redirect and better utilize about \$2 million per year, with this amount having the potential to increase and contribute significantly to offsetting the capital requirement for asset renewal programs.**

Q29: This appears to fly in the face of the basic assumption that economies of scale will be realised by bringing the two organisations together. In this case it appears that an additional level of bureaucracy is required to ensure the equitable implementation of the Merger Participation Agreement. (in other words we need a separation between asset management and service to prevent squabbling between the merger partners)- please comment on this case.

**The Asset Management Program focuses on the justification for investment decisions related to the long term stewardship of the assets. The benefits will be a combination of annual spending reductions for identified capital and maintenance programs, and improved risk management through justifiable increases in spending to meet increasing asset renewal requirements.**

**The Program also will allow for improved documentation and justification of asset management decision, which is important to preparation for and success in future rate cases before the OEB.**

**It is anticipated that the Asset Management Program will redirect and better utilize about \$2 million per year, with this amount having the potential to increase and contribute significantly to offsetting the capital requirement for asset renewal programs.**

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### 5.5 Information systems technology

Q30: What is project “FUSION a Horizon Utilities project” – what are the benefits, the costs, and purpose?

**FUSION is a new Enterprise Resource Planning (ERP) software application that integrates Horizon’s operations and financial reporting. This new Information Technology system is integral to the entire enterprise and will be used for purchasing, HR, work orders and all financial reporting. This technology and application will be operated from the Southgate facility in Guelph.**

**Horizon built a detailed business case for the implementation of FUSION and it was reviewed and approved by senior staff and their board. FUSION was started in 06 and went ‘live’ earlier this month. The benefits and efficiencies of FUSION will extend to GHESI after the merger.**

### 5.6 Opportunities

*“sufficient opportunities exist for the management group, such that except in a few cases most individuals will be offered a position in MergeCo.*

Q31:

**NOTE: This question dealt with staffing and HR issues. Answers were provided in confidence to council members.**