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Ohio | Public Utilities Commission

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August 16, 2019

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PUCO

RECEIVED-DOCKETING DIV

Docketing Division
Public Utilities Commission of Ohio
180 East Broad Street
Columbus OH 43215

RE: *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Issue Long-Term Debt, to Issue and Sell Common Stock, Receive Equity Infusions, and Enter into Interest Rate Risk Management Transactions Pursuant to the Previously Approved Financial Services Agreement.*

Dear Docketing Division:

Enclosed please find Staff's Review and Recommendation on the application of Vectren Energy Delivery of Ohio, Inc. for authority to Issue Long-Term Debt, Common Stock, Receive Equity Infusions and to Enter into Interest Rate Management Agreements in Case No. 19-0970-GA-AIS.

Doris McCarter
Division Chief, Capital Recovery and Financial Analysis
Rates and Analysis Department
Public Utilities Commission of Ohio

Enclosure
Cc: Parties of Record

BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Issue Long-Term Debt, to Issue and Sell Common Stock, Receive Equity Infusions, and Enter into Interest Rate Risk Management Transactions Pursuant to the Previously Approved Financial Services Agreement.	)))))))	Case No. 19-0970-GA-AIS

Staff Review and Recommendation

APPLICATION DESCRIPTION

Pursuant to the Ohio Revised Code, Sections 4905.40 and 4905.41, Vectren Energy Delivery of Ohio, Inc. ("VEDO") filed an application with exhibits on April 23, 2019 ("Application"). In its Application, VEDO is seeking Public Utilities Commission of Ohio ("Commission" or "PUCO") authorization to issue and sell both long-term debt ("Long-Term Debt") and additional common stock ("Common Stock"), as well as receive equity infusions ("Equity Infusions"). The Application also seeks authority to enter into interest rate risk management transactions ("Interest Risk Management Transactions"). Taken together, the Application seeks approval for a Proposed Financing Program ("Financing Program"). If approved, the Financing Program is to occur during a period that ends June 30, 2020 ("Authorization Period").

The Long-Term Debt would: a) not exceed $120 million in aggregate principal amount; b) have a maturity not to exceed 40 years; c) have a fixed or variable annual interest rate not to exceed 7 percent; d) be issued and sold for cash at not less than 95 percent of the face amount; and e) consist of security types described in the Application.

VEDO is a wholly-owned subsidiary of Vectren Utility Holdings , Inc. ("VUHI"). VEDO may choose to increase its equity capitalization by the issuance and sale of Common Stock, or by an Equity Infusion from VUHI, or a combination of thereof (collectively, "Equity Transactions"). The Application specifies an aggregate amount of Equity Transactions of $75 million.

VEDO also seeks authority to enter into Interest Risk Management Transactions to better manage interest rate risks associated with debt issued under the Application. The Application identifies financing instruments commonly used in capital markets including interest rate swaps, caps, and collars. The Interest Risk Management Transactions specified in the Application have been included in previous applications.[1]

The purposes of the Financing Program are: a) the acquisition of property, materials, or working capital; b) construction, completion, extension or improvement of facilities, plant or distribution system; c) the improvement of service; and d) the discharge or lawful refunding of VEDO's obligations.

REVIEW AND ANALYSIS

On February 1, 2019, CenterPoint Energy, Inc. ("CenterPoint") completed its acquisition of Vectren Corporation ("Vectren"). As a result, Vectren became a wholly-owned subsidiary of CenterPoint. VUHI is a wholly-owned indirect subsidiary of CenterPoint, and it serves as an intermediate holding company for Vectren's three regulated utilities. The three regulated utilities are Indiana Gas Company, Southern Indiana Gas & Electric Company, and VEDO. VUHI provides shared services to its regulated utilities, including the pooling of debt arrangements. A Financial Services Agreement ("FSA") has been in place for some time; it sets forth the terms and methods that enable VEDO to secure short and long-term financing through VUHI.

The FSA allows VEDO and the regulated utilities to combine their financing requirements in an attempt to acquire favorable interest rates and lower debt issuance costs. Under the terms specified in the FSA, VUHI issues debt on behalf of its subsidiaries based upon the individual funding needs of each regulated utility. The terms of financing and the allocation of expenses are described in the FSA, which has been previously acknowledged by the Commission.[2]

According to the FSA, VEDO and the regulated utilities may guarantee VUHI's debt to third parties in order to obtain favorable terms. However, the FSA also provides a level of protection to VEDO in that VUHI is prohibited from pledging or mortgaging VEDO's assets in connection with any guarantee. VUHI's long-term credit ratings are investment grade: *A2* from Moody's with a Negative outlook and *BBB+* by Standard and Poor's with a Stable outlook. The outlook from Moody's reflects weakening credit metrics owing to a multi-year capital investment program in a period of expected lessened cash flow related to federal tax reform. The bulk of the capital investment program stems from a generation transition plan at VUHI's Indiana subsidiaries. Moody's Negative outlook is a concern but VUHI would need to be dropped by five ratings grades for it to lose its status as an investment grade issuer.

The intent of the Financing Program is to fund capital expenditures, repay outstanding long-term and short-term debt, and fund working capital needs. VEDO's capital expenditure budget is estimated to be $140 million during the Authorization Period. There are no outstanding issues of long-term debt that will come due during the Authorization Period. However, it may be advantageous for VEDO to redeem outstanding debt prior to its maturity during the Authorization Period.

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[1] See *In the Matter of the Application of Vectren Energy Delivery of Ohio, Inc. for Authority to Issue Long-Term Debt, to Issue and Sell Common Stock, Receive Equity Infusions, and Enter into Interest Rate Risk Management Transactions*, Case No. 18-0737-GA-AIS, Finding and Order (June 28, 2018) (VEDO 2018 AIS)

[2] *Id*

Equity Infusions are investments received from VUHI that are recognized as additions to VEDO's capital. As VEDO is wholly owned by VUHI, new shares are not typically issued. There was a $10 million common equity transaction funded by VUHI in December 2018.[3]

VEDO is seeking authority to enter into Interest Risk Management Transactions including interest rate swaps, caps, floors, and collars, among others. The purpose of these transactions is to better manage interest rate risks associated with debt issues. They allow, for example, converting variable rate debt to fixed rate debt. Interest Risk Management Transactions do not create additional claims on VEDO's cash flow nor influence the level of debt outstanding. The Commission has authorized these activities in prior applications.[4]

Long-term capitalization includes long-term debt, including current maturities, as well as common shareholder's equity. For rate making purposes, Vectren has targeted consolidated equity capitalization of 45-55 percent of long-term capitalization. VEDO relies upon Vectren's capital structure in this regard and has sought to maintain a capital structure within this same range. The following table summarizes the recent, actual and estimated capital structure as of June 30, 2020, assuming full utilization of the requested authority to issue $120 million in Long-Term Debt and $75 million in Equity Transactions*:

	Actual 03/31/2019 ($ 000s)	**(%)**	**Estimated 06/30/2020 ($ 000s)**	**(%)**
Long Term Debt	$ 413,164	55%	$ 533,164	55%
Common Equity	$ 339,946	45%	$ 432,073	45%
Total Capitalization	$ 753,110	100%	$ 965,237	100%

*Estimates include a contribution to common equity from internally generated funds but do not include entity-level accounting impacts (goodwill, intangible asset allocation) from the merger with CenterPoint.

As shown in the table, the proposed financing will maintain VEDO's equity percentage at the lower end of the targeted range. Currently, there are no changes being contemplated to the targeted capitalization percentages.

RECOMMENDATION

Upon review of the Application and supporting documentation, Staff believes VEDO's request appears reasonable and recommends approval with the following conditions:

1. In the event that the credit rating of VUHI is downgraded or goes on credit watch with negative implications, beginning after August 16, 2019, VEDO will file such notice in this docket within 10 days of such change and apprise the Commission of VEDO's projected course of action to insulate VEDO from any negative consequences of such downgrade. Based upon the filing of

[3] See *Third Report of Applicant Vectren Energy Delivery of Ohio, Inc. on Exercise of Financing Authority*, VEDO 2018 AIS (January 22, 2019).
[4] See VEDO 2018 AIS

VEDO, the Commission will then determine whether any additional Commission action is warranted.

2. The authorization to consummate the financing transaction(s) to issue the Long-Term Debt within the parameters set forth in the Application in no way relieves VEDO of its responsibility to negotiate and obtain the best competitive market terms available.

3. In the event that VEDO enters into interest rate management agreements, it will report the terms and full particulars to the Commission within 30 days of executing the transaction(s).

4. VEDO shall file a summary report, in this case docket, within 60 days of issuing any Long-Term Debt under the authority granted in this case. The report shall summarize the principal amount, interest rate and type of security issued; the other terms and full particulars of the Long-Term Debt including a description of any collateral required, issuance expenses, any discounts or premiums, any credit enhancements, and any other pertinent repayment terms; and the use of proceeds from the Long-Term Debt in broad categories.

5. To the extent that VEDO's Board of Directors has not yet authorized the type, number, or value of shares of Common Stock, the Commission's approval is limited to an aggregate amount of Common Stock for the purposes stated in the Application and should not be construed as an endorsement of the Common Stock issuance; and

6. VEDO should notify the Commission by docketing a report in a timely manner as soon as VEDO's Board of Directors approves the issuance of the Common Stock.

7. As referenced in the Application, CenterPoint is assessing the appropriateness of alternative financing models to the current FSA. If CenterPoint's assessment analysis identifies a more advantageous financing model, then VEDO should notify the Commission and thoroughly review the details of the new potential financing model with PUCO Staff prior to binding itself to any new alternative financing arrangements.