



Report to: General Committee

Date Report Authored: May 21, 2015

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**SUBJECT:** PowerStream Merger Update  
**PREPARED BY:** Graham Seaman, Senior Manager, Sustainability x.7523  
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**RECOMMENDATION:**

- 1) THAT the report dated May 21, 2015 entitled "PowerStream Merger Update" be received.
- 2) AND THAT staff be authorized and directed to do all things necessary to give effect to this resolution.

**EXECUTIVE SUMMARY:**

On April 16, 2015 the Premier of Ontario announced that Hydro One's transmission and rural distribution business would be privatized via an initial public offering and that the Province is in talks with PowerStream Holdings Inc., Enersource Corporation, and Horizon Holdings Inc. to merge with or acquire 100% of Hydro One Brampton Networks Inc. to create the second largest local distribution company in Ontario. The Province has targeted July 31, 2015 as the deadline for this transaction to gain shareholder approval.

PowerStream's three shareholders; the Cities of Vaughan, Barrie and Markham (through their holding companies) have partnered to evaluate the transaction. They have hired Navigant Inc, BDR North American and Gowlings to provide independent advice and analysis to assist in this important decision.

The City of Markham holds a 34.185% interest in PowerStream via its holding company Markham Enterprise Corporation ("MEC").

The City of Markham relies on the annual dividend and interest revenue earned from PowerStream, estimated to be approximately \$12 million in 2015.

The majority of these revenues are transferred to the City's Life Cycle Replacement and Capital Reserve to ensure the sufficient funding for repair and replacement of assets over the next 25 years.

The current Board of Director's composition of PowerStream, Enersource and Horizon varies from a mix of municipal representatives and independents to all independent directors. The composition of the merged entity Board is proposed to be comprised of 13 Directors, a majority of which are to be independent, with an independent Chair.

Markham's decision making process will be as follows:

1. MEC will receive and consider a recommendation from PowerStream's Board on the proposed merger with Enersource and Horizon and purchase option for Hydro

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- One Brampton. Independent advisors Navigant, BDR and Gowlings will offer their analysis and recommendations. MEC will make a decision.
2. MEC's recommendation will proceed to its shareholder, the City of Markham via General Committee for consideration and decision.
  3. General Committee's decision on the merger and purchase option will be considered again at Council. Council's decision will be final.

Unanimous shareholder approval is required from PowerStream, Enersource and Horizon. Once all shareholders of the three local distribution companies approve of the merger the Ontario Energy Board ("OEB") will review the proposed merger to ensure there is value for the electricity ratepayer via its "no harm test". Pending a favourable OEB review the merger can be completed.

Currently, the key milestone is the Provincial July 31<sup>st</sup> target for the shareholders of PowerStream, Enersource and Horizon to approve a merger of those companies and to exercise a Purchase Option to acquire Hydro One Brampton. This will require Markham's General Committee to receive a decision from MEC by mid-July and for Council to meet and make a decision by late July of this year. This is first of a number of reports to inform Markham Council of the merger process.

**PURPOSE:**

To provide an update to Markham Council on the proposed merger of PowerStream Holdings Inc. with Enersource Corporation, Horizon Holdings Inc., and Hydro One Brampton Networks Inc., (collectively the "LDC's") including the decision making process, key dates and current and proposed utility governance

Further updates will be provided to General Committee as negotiations progress.

**BACKGROUND:**

As described in the Province of Ontario's ("Province") announcement on April 16, 2015:

*In accepting the recommendation of the Premier's Advisory Council on Government Assets, the Province intends to proceed with a merger of Enersource Corporation, Horizon Utilities, Hydro One Brampton Networks Inc. and PowerStream Holdings Inc. to ensure value for the Province and to help catalyze Local Distribution Company ("LDC") consolidation for the benefit of ratepayers.*

*Together, the merger of these three strong performing utilities with Hydro One Brampton will create the second-largest electricity distributor in Ontario by number of customers. The merged entity would deliver efficiencies and economies of scale while continuing to provide safe, reliable and clean electricity. This represents a major step forward in promoting LDC consolidation in Ontario, in line with the recommendations made in the 2012 Ontario Distribution Sector Review Panel Report.*

**Enersource**

*Enersource Corporation serves over 200,000 residential and commercial customers across Mississauga. It is a diversified energy and technologies company that serves customers through the distribution of electricity and the delivery of services related to the*

*design, operation and maintenance of electrical systems. Ninety per cent of Enersource Corporation is owned by the City of Mississauga, and 10 percent is owned by BPC Energy Corporation (Borealis), which is part of the Ontario Municipal Employees Retirement System (OMERS).*

#### ***Horizon Utilities***

*Horizon Utilities Corporation provides electricity and related utility services to over 240,000 customers in Hamilton and St. Catharines. Horizon Utilities is wholly owned by Horizon Holdings Inc., a company jointly owned by the cities of Hamilton and St. Catharines through their holding companies Hamilton Utilities Corporation and St. Catharines Hydro Inc.*

#### ***Hydro One Brampton***

*Hydro One Brampton Networks Inc. was acquired by Hydro One from the City of Brampton in 2001. It has more than 150,000 residential, commercial and industrial customers and serves an area of 300 square kilometers. In order to meet the growth of the community and needs of its customers, Hydro One Brampton continues to work with the City of Brampton and other organizations to improve Brampton's infrastructure and distribution system.*

#### ***PowerStream***

*PowerStream Holdings Inc. is a municipally owned energy company providing power and related services to more than 375,000 customers primarily residing or owning a business in communities located immediately north of Toronto and in Central Ontario. It is jointly owned by the Cities of Barrie, Markham and Vaughan through their respective holding companies, Barrie Hydro Holdings Inc., Markham Enterprises Corporation ("MEC") and Vaughan Holdings Inc." Markham, through MEC, owns 34.185% of PowerStream.*

#### ***Process for Merger***

*The three partners (PowerStream, Enersource, Horizon) will have until July 31, 2015, as targeted by the Province to determine whether to merge and whether to exercise an Option to acquire Hydro One Brampton. Or alternatively; approve a merger of PowerStream, Enersource, Horizon and Hydro One Brampton.*

#### **Regarding Hydro One's Broader Divestment by the Province**

**From the Office of the Preimer's announcement on April 16, 2015 entitled: Ontario Expanding Beer Sales to Grocery Stores; Ownership of Hydro One to be Broadened with \$4 Billion Raised to be Invested in Infrastructure Projects**

*...In order to strengthen long-term performance and generate value for Ontarians, the government intends to broaden ownership of Hydro One through an initial public offering. Following the IPO, the Ontario government would be the largest shareholder and, by law, no other shareholder or group of shareholders would be permitted to own more than 10 per cent. As a result the government would retain de facto control. The opportunity to buy into Hydro One would be made available in stages in order to maximize return to taxpayers.*

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*As is currently the case, Hydro One would have no role in setting rates. Rates would continue to be set by the independent Ontario Energy Board (OEB). The government also intends to strengthen the regulatory powers of the OEB to protect ratepayers and investigate complaints.*

*The province intends to proceed with a merger of Hydro One Brampton with Enersource, PowerStream and Horizon Utilities. The merger of these strong-performing utilities will create the second-largest electricity distributor in Ontario and allow for the new, larger company to use its collective resources to deliver a favourable impact on rates, more efficient services and innovative technologies for customers. The merger will also help catalyze Local Distribution Company consolidation for the benefit of ratepayers.*

*The government intends to introduce legislation this spring that would, if passed, guarantee that net proceeds from the ownership changes to Hydro One and any net proceeds from the merger will go to the Trillium Trust and be used to finance transit, transportation and other priority infrastructure projects across the province. Maximizing the value of these assets is part of the government's economic plan for Ontario. The four-part plan is building Ontario up by investing in people's talents and skills, building public infrastructure like roads and transit, creating a dynamic, innovative environment where business thrives and building a secure retirement savings plan.*

In essence there are two proposed modes the Province will divest Hydro One:

1. An initial public offering of Hydro One's electricity transmission and rural distribution business.
2. The merging or selling of Hydro One Brampton, a standalone local distribution company wholly owned by Hydro One, to the proposed merged company of PowerStream, Enersource and Horizon Utilities.

#### **OPTIONS/ DISCUSSION:**

The Province's proposal requires significant analysis and contains very aggressive timelines, specifically the Province has set July 31, 2015 as the date it needs notice of the preferred option to acquire or merge with Hydro One Brampton.

In order to determine if this merger and acquisition of Hydro One Brampton is in the best interests of Markham, a full range of options are under consideration, and related analyses are being undertaken, including merging, not merging, buying Hydro One Brampton or selling all (or a portion of) PowerStream.

To provide independent analysis, advice and recommendations, the three shareholders of PowerStream retained industry experts, *Navigant* and *BDR North America Inc.*, to spearhead the review of the business case analysis being undertaken by the parties to the proposed merger, as well as *Gowlings LLP* for independent legal advice. PowerStream has agreed to pay for the consulting costs incurred.

#### ***Navigant (NYSE: NCI)***

*Navigant is a specialized, global professional services firm dedicated to assisting clients in creating and protecting value in the face of critical business risks and opportunities.*

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*Navigant Consulting services include a wide range of financial management services, investigation services, litigation support services, and business management consulting services, as well as software programs for use in database management, analysis and benchmarking.*

*Through senior level engagement with clients, Navigant professionals deliver expert and advisory work through implementation and business process management services. The firm combines deep technical expertise in Disputes and Investigations, Economics, Financial Advisory and Management Consulting, with business pragmatism to address clients' needs in highly regulated industries, including Construction, Energy, Financial Services and Healthcare.*

### **Gowlings**

*Gowlings is a leading Canadian and international law firm, with over 700 legal professionals serving clients in 10 offices across Canada and around the world.*

Gowlings has advised the City on all of the mergers and acquisition transactions undertaken by PowerStream, including the first merger of Markham Hydro Distribution Inc. with Vaughan's hydro company.

### **BDR North America Inc.**

*BDR is a Toronto-based consulting firm of seasoned professionals specializing in the energy sector in terms of mergers and acquisitions, business and strategic planning and regulatory.*

*BDR has for many years managed and advised regarding the process of merger, acquisition and divestment of both generation and "wires" facilities in the electricity industry and related affiliates. Key to these assignments is the development of appropriate valuations for the businesses in the context of the relative risks.*

The consultants were hired to review the merger business case and provide an analysis that includes, but is not limited to:

1. Valuations of the merged company that would result from the completion of the transaction and PowerStream's relative share in the new merged company, taking into account items such as relative condition of assets, potential growth in customer bases, and equity in unregulated businesses
2. Current and potential future value of PowerStream and the cash flow to shareholders (dividends and interest) compared to the expected value of the shareholders' interest in the merged company, as well as the expected payouts to shareholders
3. A review of the proposed dividend policy and its impact on cashflows and the potential impacts either for future equity calls from shareholders or the need to source private equity
4. An analysis on how the transaction(s) would impact the shareholder's ability to divest their holdings (in whole or in part) taking into account tax implications and the political landscape
5. Valuation of potential purchase option of the new partner and the impact to cash flows (taking into account the premium and synergies) and long term value

6. An analysis of merger & acquisition benefits & risks, industry trends, and any other relevant information, including impact to ratepayers

**Objectives**

Markham is utilizing the City's Investment Policy objectives as a framework to evaluate the different options. The Policy's four investment objectives, in order are:

1. Legality of Investments
2. Preservation of Principal
3. Maintenance of Liquidity
4. Competitive Rate of Return

Since the City's investment in PowerStream is different than a traditional municipal investment (T-Bill, bond, etc.), there are other factors, such as impact on future hydro rates of Markham residents/businesses, that will also need to be taken into consideration.

**Governance**

Governance of the three companies proposing to merge is currently:

PowerStream's board has 13 members with six, four and three appointed by Vaughan, Markham and Barrie respectively. Vaughan's appointments are current Council members including Mayor Maurizio Bevilacqua (current Board Chair), Barrie's appointments include Mayor Jeff Lehman and two independent Directors. Markham has recently appointed Mayor Frank Scarpitti (past Board Chair and current Vice-Chair), Regional Councillors Jim Jones and Joe Li and Mr. Dan Horchik sits as an independent Director.

Enersource's board has 10 members with Mayor Bonnie Crombie, two Councillors and a representative from Borealis Infrastructure sitting for the shareholders with the remainder made up of independent Directors.

Horizon's board has 11 members all of whom are independent Directors.

Markham Enterprises Corporation ("MEC") owns all of Markham's shares in PowerStream Holdings Inc. All 13 City of Markham Council members are Directors of MEC. Select City Staff act as Officers of MEC.

The proposed structure for Board of Directors for the merged LDC organization is 13 Directors, a majority of which are to be independent, and an independent Chair. In the case of the 3-way merger and Purchase Option it is proposed that, PowerStream would have 6 Directors, Enersource 4 Directors, and Horizon 3 Directors.

**Decision Making Process**

Management of each LDC will negotiate the terms of a transaction comprised of the three way merger and acquisition of Hydro One. If endorsed by the Boards of Directors of Enersource, Horizon and PowerStream, the recommendations will move to the holding companies of each municipal partner for consideration. Once a decision by a holding company is made, its recommendation will be made to the municipal shareholder for consideration at a Council meeting.

For each of the LDCs, unanimous consent is required from all shareholders, i.e., Markham, Vaughan, Barrie, Mississauga, Hamilton, St. Catharines and Borealis Infrastructure all need to agree to the merger.

Markham's decision making process will be as follows:

1. MEC will receive and consider a recommendation from PowerStream's Board on the proposed merger with Enersource and Horizon and purchase option for Hydro One Brampton. Independent advisors Navigant, BDR and Gowlings will offer their analysis and recommendations. MEC will make a decision.
2. MEC's recommendation will proceed to its shareholder, the City of Markham via General Committee for consideration and decision.
3. General Committee's decision on the merger and purchase option will be considered again at Council. Council's decision will be final.

If all parties approve the merger and acquisition, Mergers Acquisitions Amalgamations and Divestitures application will be made to the Ontario Energy Board (the "OEB"). The OEB, in its role as the electricity regulator, will examine the proposed synergies, rate structures and long term rate plan for the new company to ensure consumer protection.

Specifically and as summarized by BDR North America staff, the OEB will:

*...in approving a transaction, the standard of the OEB is the "no harm test". The OEB seeks to be assured that customers will not be negatively impacted as to: "prices and the adequacy, reliability and quality of electricity service". Specifically, the OEB asks for information as to:*

- *Details of plans to ensure operational safety and system integrity;*
- *Service centre locations and expected response times;*
- *Capital expenditure plans;*
- *Whether the owners propose to harmonize rates, and if so, when; and*
- *Since a merger or acquisition allows the LDC to extend the time between rebasing, when a rebasing is proposed to take place.*

*While detailed corporate information is required to be filed, OEB processes allow some of it to be treated as confidential, in order to protect the business interests of the parties.*

*The OEB can proceed by way of written, rather than oral hearing, if the applicant(s) show by their evidence that there are no material adverse impacts of the transaction. MAAD applications are not typically contested; however, as with any application to the OEB there can be interventions. There were a number of interventions in the application to permit Hydro One to acquire Norfolk Power. In that case, despite the interventions and the filing of evidence against the transaction, there was no oral hearing.*

### **Approval Process/Timelines**

City staff and the City's consultants have been meeting regularly to work through the options and potential impacts to rates of return, cash flows, consumer rates, and risk profiles. While MEC can recommend that PowerStream proceed with a merger, the ultimate approval authority will reside with Markham Council.

The estimated timelines are as follows:

<b>May 31, 2015:</b>	Final Business Case completed.
<b>Mid-July</b>	General Committee (GC) receives recommendation from MEC Board on PowerStream merger with Enersource and Horizon including whether to acquire Hydro One Brampton. GC discusses and makes recommendation to Council.
<b>Late-July</b>	Council meeting regarding merger and acquisition decision following recommendation from GC.
<b>July 31, 2015</b>	<b>Provincial Target date</b> for approval of merger/purchase option including the Merger or Purchase Agreement.
<b>August, 2015:</b>	Mergers Acquisitions Amalgamations and Divestitures (MAADs) Application to the Ontario Energy Board.
<b>Dec. 31, 2015:</b>	<b>Target date</b> for closing pending favourable MAAD response. <b>Closing may move into 2016 (by March 31, 2016).</b> Final report to City Council to follow closing of the transaction.

**FINANCIAL CONSIDERATIONS:**

One significant financial consideration will be a balance between enterprise value growth and managing cash flows.

The City of Markham relies on the annual dividend and interest revenue earned from PowerStream, estimated to be approximately \$12 million in 2015.

The majority of these revenues are transferred to the City's Life Cycle Replacement and Capital Reserve to ensure the sufficient funding for repair and replacement of assets over the next 25 years.

**HUMAN RESOURCES CONSIDERATIONS**

Not applicable.

**ALIGNMENT WITH STRATEGIC PRIORITIES:**

Not applicable.

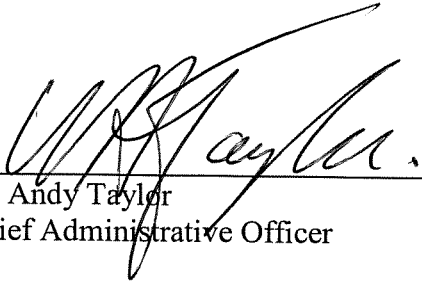
**BUSINESS UNITS CONSULTED AND AFFECTED:**

Not applicable.



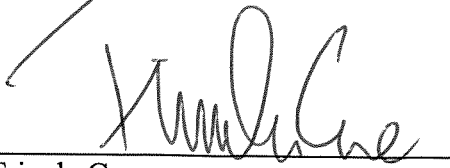
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**RECOMMENDED BY:**



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W. Andy Taylor  
Chief Administrative Officer



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Trinela Cane  
Commissioner of Corporate Services

**ATTACHMENTS:**

None