SUBJECT: Merger – Horizon Utilities Corporation (HUC) and Guelph Hydro Electric System Inc. (GHESI) (FCS08091) (City Wide)

RECOMMENDATION:

a) That the amalgamation of Horizon Utilities Corporation (“Horizon”) and Guelph Hydro Electric Systems Inc. (“GHESI”) be approved and authorized based on the material terms and conditions as set out in the documents (including the business case summary) submitted to Council on September 18, 2008;

b) That the Mayor and City Clerk are hereby authorized to execute and deliver all agreements, documents and instruments, required to implement the merger, in a form and content satisfactory to the Acting City Manager and the City Solicitor;

c) That the presentation by Horizon Utilities Corporation of the business case summary be received for information;

d) That the Municipal Merger Co-operation Agreement , as approved by the Board of Directors of Hamilton Utilities Corporation, (attached as Appendix “A” to report FCS08091) be approved;

e) That the Amended and Restated Shareholder Declaration, included the attached Dividend Policy, as approved by the Board of Directors of Hamilton Utilities Corporation, (attached as Appendix “B” to report FCS08091) be approved;

f) That any dividends received, as a result of the recapitalization adjustment relating to the merger, be earmarked for Capital purposes;

g) That Hamilton Utilities Corporation inform Council and the General Manager of Finance and Corporate Services of any future mergers, at the earliest possible occasion, in order to ensure that the City can conduct its’ due diligence inquiries and other required background work in the most efficient and effective manner; and
EXECUTIVE SUMMARY:

The proposed merger of Horizon Utilities Corporation (HUC) and Guelph Hydro Electric System Inc. (GHESI) is forecast to deliver benefits to customers and municipal shareholders. The merged company will continue to be publicly owned by the Cities of Guelph, St. Catharines and Hamilton. It is forecast that the merger will assist in mitigating future distribution rate increases, which account for approximately twenty percent (20%) of a residential customer’s total bill. Future distribution rate increases may be mitigated, over time, by achieving cost savings through economies of scale. The merger will result in an annual savings in operating costs of $3.9 million and a projected increase in dividend income to the City. In addition, the City will receive a special dividend related to the re-capitalization of approximately $3 million subject to the closing financial position of HUC and GHESI.

The merger is expected to result in a more valuable financial asset for the ratepayers due to its increased financial strength.

BACKGROUND:

In the Summer of 2008, Horizon Utilities Corporation advised Council that HUC was evaluating the feasibility and developing a business case on the merits of merging Horizon Utilities Corporation (HUC) and Guelph Hydro Electric System Inc. (GHESI).

As a result, staff initiated a peer review of the business case, including all legal aspects, in order to ensure that interest of the City, as the shareholder of HUC, is considered. The firms of PricewaterhouseCoopers and Gowling Lafleur Henderson (Gary D. Graham) were hired to undertake this review. The primary focus of the financial review was to look at the financial expectations of the City as the controlling shareholder and, more specifically, to review the equity allocation methodology used by the Merger Steering Committee to arrive at respective equity holdings. With respect to the legal review, the peer reviewer was expected to comment on the strategic issues and, more specifically, to comment on the Shareholder’s Agreement and Dividend Policy, once again to ensure the interests of the City.

Horizon Utilities Corporation (HUC) and Guelph Hydro Electric System Inc. (GHESI) are wholly-owned by Horizon Holding Inc. (Horizon Holdings), an investment holding company. Horizon Holdings is owned 78.9% by Hamilton Utilities Corporation (HUC)
and 21.1% by St. Catharines Hydro Inc. (SCHI). HUC and SCHI are wholly-owned by the municipalities of Hamilton and St. Catharines, respectively.

GHESI and Horizon Holdings intend to merge, by way of a triangular amalgamation, such that HUC, SCHI and GHI own shares in Horizon Holdings which, in turn, wholly-owns Horizon Utilities and HESI. The assets, liabilities and other undertakings of GHESI will become part of Horizon Utilities as result of the merger.
The newly formed Horizon Utilities would have approximately $500 million in assets and serve approximately 280,000 customers in Guelph Hamilton and St. Catharines.

<table>
<thead>
<tr>
<th>Customer Class</th>
<th>Guelph</th>
<th>Horizon</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential</td>
<td>43,296</td>
<td>210,358</td>
<td>253,654</td>
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<tr>
<td>General Service &lt; 50 kW</td>
<td>3,514</td>
<td>21,238</td>
<td>24,752</td>
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<td>General Service &gt; 50 kW</td>
<td>564</td>
<td>2,514</td>
<td>2,718</td>
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<tr>
<td>Large Users</td>
<td>4</td>
<td>12</td>
<td>16</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>47,382</strong></td>
<td><strong>233,766</strong></td>
<td><strong>281,148</strong></td>
</tr>
</tbody>
</table>

**ANALYSIS/RATIONALE:**

N/A.

**ALTERNATIVES FOR CONSIDERATION:**

HUC’s business case suggests that it is anticipated that the Ontario Energy Board (OEB), as regulator, will adopt performance based regulation (IRM) that reward actions of those LDC’s that merge to find cost-efficiencies.

**FINANCIAL/STAFFING/LEGAL IMPLICATIONS:**

As set out in the business case, and subject to comments above, the City will realize a one-time dividend payment of approximately $3 million and increase its’ potential for higher dividend payments, over the next five (5) year period, as a result of this merger. The savings that will contribute to higher dividends in the first five (5) years will ultimately accrue to customers through mitigation of the requirement for future rate increases.

It is recommended that any dividend received as a result of the recapitalization adjustment, relating to the merger, be earmarked for Capital purposes.

**POLICIES AFFECTING PROPOSAL:**

N/A.

**RELEVANT CONSULTATION:**

Corporate Services Department – Legal Services Division
PriceWaterhouseCoopers
Gary D. Graham, Gowling Lafleur Henderson
CITY STRATEGIC COMMITMENT:

By evaluating the “Triple Bottom Line”, (community, environment, economic implications) we can make choices that create value across all three bottom lines, moving us closer to our vision for a sustainable community, and Provincial interests.

Community Well-Being is enhanced. ☑ Yes □ No

Environmental Well-Being is enhanced. ☑ Yes □ No

Economic Well-Being is enhanced. ☑ Yes □ No

Does the option you are recommending create value across all three bottom lines? ☑ Yes □ No

Do the options you are recommending make Hamilton a City of choice for high performance public servants? ☑ Yes □ No