TO:	GENERAL COMMITTEE
SUBJECT:	MERGER OF POWERSTREAM, ENERSOURCE AND HORIZON AND ACQUISITION OF HYDRO ONE BRAMPTON
PREPARED BY AND KEY CONTACT:	P. ELLIOTT-SPENCER, GENERAL MANAGER OF COMMUNITY AND CORPORATE SERVICES I. PETERS, DIRECTOR OF LEGAL SERVICES
SUBMITTED BY:	P. ELLIOTT-SPENCER, GENERAL MANAGER OF COMMUNITY AND CORPORATE SERVICES
GENERAL MANAGER APPROVAL:	P. ELLIOTT-SPENCER, GENERAL MANAGER OF COMMUNITY AND CORPORATE SERVICES
CHIEF ADMINISTRATIVE OFFICER APPROVAL:	C. LADD, CHIEF ADMINISTRATIVE OFFICER for CL

RECOMMENDED MOTION

1. That the Corporation of the City of Barrie approve the Barrie Hydro Holdings Inc. (BHHI) Board's recommendation that PowerStream Holdings Inc. (PowrStream) enter into a three way merger with Enersource Corporation (Enersource) and Horizon Holdings Inc. (Horizon) and then proceed to acquire Hydro One Brampton Networks Inc. (Hydro One Brampton) , subject to the identical conditions set out by BHHI as identified in Appendix "A" to Staff Report CCS002-15.

2. That an equity injection of up to $28.6 million, to be provided to MergeCo to finance BHHI's share of the purchase of Hydro One Brampton, be approved

3. That the equity injection of up to $28.6 million be financed in the following manner:

   a) Through the proceeds of a 10% sale of BHHI to a third party and the balance through available cash in BHHI, and by a partial redemption of the City's Promissory Note with BHHI for $20 million (and BHHI's promissory note with Powerstream); or

   b) In the event that a sale of 10% of BHHI does not transpire, financing be provided by the redemption of the City's Promissory Note with BHHI for $20 million (and BHHI's promissory note with Powerstream); available cash in the BHHI, and finally, by cash investment of up to $8.6 million, from the City's current cash and investment portfolio.

4. That the Mayor and City Clerk be authorized to execute all agreements, documents, notices, articles, certificates under or in connection with the proposed merger and acquisition in a form satisfactory to the City Solicitor and that City staff be authorized to take any action necessary in respect of the foregoing.

PURPOSE & BACKGROUND

5. In February, 1999, City Council directed that the City of Barrie retain ownership of the assets of the Barrie Public Utilities Commission and incorporate a Holding Company and other Affiliate corporations under the Ontario Business Corporations Act to operate Barrie's electrical distribution corporation (the Corporation) for the benefit of the citizens of Barrie.

6. In October, 2000, City Council directed, through Resolution 00-G-291, the establishment of a Holding Company and its related subsidiaries in accordance with the requirements of The Electricity Act, 1998. The Holding Company was named "Barrie Hydro Holdings Inc." and the subsidiaries were named "Barrie Hydro Distribution Inc." and "Barrie Hydro Energy Services Inc."

7. In September, 2008 City Council approved the merger of Barrie Hydro Holdings, with PowerStream. PowerStream is owned, through their holding Companies by the Cities of Vaughan, Markham and Barrie. The City of Barrie owns 20.5% of the shares of PowerStream, and Vaughan and Markham hold 45.3% and 34.2%, respectively.

8. PowerStream is the second largest municipally owned electrical distribution company in Ontario, with over 350,000 customers, in 15 communities located immediately north of Toronto and in Central Ontario.

9. PowerStream's Strategic Plan focuses on growth to the company through unregulated businesses and through the acquisition or merger with other LDC's. In 2009, PowerStream created the PowerStream Solar Business and in 2012 acquired 50% of Collus. Various other possible transactions have been investigated. The City of Barrie, through BHHI has supported this strategy through the reinvestment of dividends to support the Solar business and finance core business asset renewal.

10. The Province of Ontario has been encouraging the consolidation of the electrical distribution business – since 1999 local distribution utilities/companies have declined in number from 300 to 68.

11. In April of 2014, the Premier created an Advisory Council to provide recommendations to unlock the full value of provincial assets, including Hydro One Distribution networks. The panel was chaired by Ed Clark, and in November 2014 the Council recommended that the Province should retain Hydro One Transmission but should reduce its ownership in Hydro One Brampton and the rest of their distribution business. Hydro One Brampton was identified as a catalyst for consolidation, by possibly merging with one or more GTA-distribution companies. On December 12th, 2014 the Council issued a request For Information for ideas related to their initial recommendations.

12. In January, 2015 PowerStream received unanimous support from its shareholders to enter into a letter of intent for merger with Enersource and Hydro One Brampton, and to submit a response to the RFI. Subsequent to this Horizon Utilities expressed a desire to also pursue a merger.

13. On April 16, 2015: the Province announced that it intended 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.*"

14. 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).

15. 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.

16. 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.

17. Merger discussions have been undertaken throughout the spring and summer of 2015. A business case has been prepared, relative valuations of each party's ownership of the new "MergeCo" have been determined, and draft agreements have been prepared. Deloitte has prepared the detailed business analysis for the merged organization. The three shareholders of PowerStream retained industry experts, Navigant and BDR North America Inc., to provide independent analysis, advice and recommendations on 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.

18. PowerStream and Navigant have provided a number of updates and presentations to the Board of BHHI. The formal Business Case has been received from PowerStream, and a report has been received from Navigant setting out their analysis.

19. The Business Case and proposed agreements, in substantially final form are now being presented to the various holding Companies for approval. The Board of PowerStream unanimously approved the transaction on September 11, 2015. The merger of PowerStream into the new MergeCo requires the unanimous consent by all shareholders (Barrie, Vaughan, and Markham). VHI approved the transaction on September 16th, 2015, and the City of Vaughan on September 22, 2015. MEC Board will consider the transaction on September 30th, and the City of Markham on October 7th, 2015. The approval of the other parties to the MergeCo are anticipated through mid-September and early October. Following approval by the holding companies each municipal Council must consider the transaction for approval.

20. On September 14th, BHHI approved the Business case, conditional on a revised dividend policy acceptable to the City of Barrie. A revised dividend policy has been accepted by the CEOs of Powerstream, Horizon and Enersource which addresses the concerns raised by city staff. However, the policy is still being reviewed by tax experts.

ANALYSIS

21. The proposed merger of PowerStream, Enersource and Horizon and the acquisition of Hydro One Brampton is a very large and complex transaction, with many issues and considerations. Considerable due diligence has been undertaken by all parties. Deloitte was mandated with developing the detailed financial model of the Business Case and determination of the relative value of each proposed shareholder. The CEOs of Enersource, Horizon and PowerStream were tasked with negotiating the terms of the Merger Agreement, Shareholder Agreement and Purchase Agreement for Hydro One Brampton. The Mayors of the six municipalities that own the three LDCs sat on the Advisory Committee to the negotiating team.

22. In order to receive independent advice and recommendations on the business case analysis with respect to the proposed Merger, the shareholders of the three LDCs all retained separate consulting firms. In the case of PowerStream, the Cities of Barrie, Vaughan and Markham, through their Holding companies, engaged Navigant Consulting and BDR North America Inc. to

provide consolidated and individual advice and analysis on the transaction. The analysis provided a comparison of various scenarios to the forecasts for PowerStream as a standalone business, referred to as the "status quo". Staff of the three municipalities have met numerous times collectively, and also individually, with Navigant and BDR North America Inc.

23. Updates have also been provided to the Boards of the respective holding companies. The decision to merge with Enersource and Horizon is a unanimous consent item under the PowerStream shareholder agreement and understanding the views of each municipality was an important aspect of the due diligence.

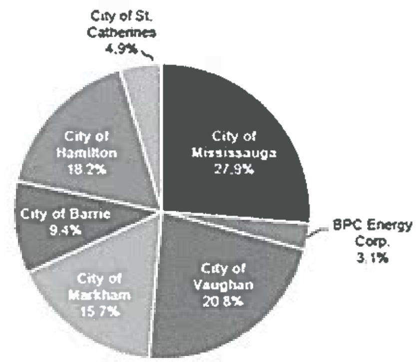
24. The Business Case recommended to the parties to the Merger consists of the following:

i) Relative ownership of MergeCo is:
   a. PowerStream - 46%
   b. Enersource – 31%
   c. Horizon 23%

The chart below shows the relative ownership of each municipality in the proposed MergeCo. The City of Barrie's ownership of the new MergeCo is 9.4%.

Pre-Merger Shareholding	
Enersource	
City of Mississauga	90.0%
BPC Energy Corp. (Borealis)	10.0%
	100.0%
PowerStream	
City of Vaughan	45.3%
City of Markham	34.2%
City of Barrie	20.5%
	100.0%
Horizon Utilities	
City of Hamilton	78.9%
City of St. Catharines	21.1%
	100.0%

Potential Merge Co Shareholding Contribution



ii) Brampton Hydro is proposed to be purchased for $607 million. PowerStream's share of the purchase is $186.3 million, of which $61.6 million is proposed to be funded by debt. The balance of $124.7 million requires an equity injection from PowerStream shareholders. Options to finance this equity injection include cash, conversion of existing promissory notes owed to the municipalities to equity, or a possible sale of 10% of PowerStream to a private investor. The option to sell 10% to a private investor is being investigated, but will not be known until a later date.

iii) The Solar assets of the PowerStream shareholders will be segregated as a special class of shares, "Class A Shares" to be held only by the PowerStream shareholders to ensure the return of equity investments made by the municipal shareholders and maintain forecast cash flows from dividends.

iv) The MergeCo is forecast to achieve operating synergy savings of $355 million, and Capital synergies of $168 million, over the next ten years. These are partially offset by transition costs of $95 million. In total, over the first ten years following the merger, MergeCo is forecast to achieve net cash savings of $427 million.

v) Dividend payments to the PowerStream shareholders are forecast to exceed the status quo by a net present value of $121.7 million over the period 2016 to 2039 (discounted at 9.3%), an increase of 45% over the status quo. Net present value discounts future cash flows to today's dollars – the average annual increase in dividends over the period is $12.8 million per year.

The specific financial impacts to the City of Barrie are discussed under the Financial section of this report.

25. In addition to the financial impacts of the proposed merger there are a number of considerations, related to Governance which are contained in the three main agreements required to undertake the Merger and the purchase of Hydro One Brampton – the Merger Agreement, the Share Purchase Agreement and the Shareholders Agreement. These considerations include shareholder rights, board representation, dividend policy, liquidity or ability to sell provisions and treatment of the Solar assets.

26. The proposed Merger will also have possible impacts on customers, facilities, and employees of PowerStream. Finally, the strategic direction of MergeCo will be set out in the Strategic Plan to be developed by the new Board. Without doubt, this strategic direction will focus on further consolidation of the LDC industry and growth in new business areas. The Shareholder's agreement discusses the role of the Shareholders in approving these transactions and the possible sources of new capital.

27. <u>Governance Issues</u>

i.) Shareholder Rights

A memorandum prepared by Gowling Lafleur Henderson LLP, who are representing Barrie and the other two shareholders, is attached to this report and details the main provisions of the proposed Unanimous Shareholders' Agreement (USA) that will govern the new merged entity (Merge Co).

Currently, as a shareholder of PowerStream, the City of Barrie, through BHHI, has a significant role in governance – the current shareholder agreement has numerous items which require unanimous shareholder approval. As a shareholder in Merge Co, Barrie becomes primarily an investor whose influence is exercised through its nominee on the Board of Directors. There are only a very limited number of matters that require unanimous shareholder approval. A new category of matters that require 66 2/3 % shareholder approval has been created under the proposed shareholders agreement – this creates the need for a supermajority but does not result in each shareholder having a veto.

ii.) Board Representation

Currently, the the City of Barrie, through BHHI, has three board members out of 13 on the PowerStream Board. In MergeCo, The City of Barrie, through BHHI, becomes one of six shareholders in the new merged entity and holds its interest directly (not through PowerStream Holdings). It has the right to appoint one director to a 13 person board of directors. That one director is not required to be independent as defined under Section 2.1.3 of the Affiliate Relationship Code. As BHHI is not required to appoint an independent director, it could appoint a director who is an officer or director of BHHI, a member of Council or an employee of the municipality or distributor.

The distribution of Board seats is as follows:

Shareholder	**Number of Director Nominees**
Enersource	4
Markham Enterprises Corporation	2
Barrie Hydro Holdings Inc.	1
Vaughan Holdings Inc.	3
Hamilton Utilities Corporation	2
St. Catharines Hydro Inc.	1

iii) Dividend Policy

The current dividend policy of PowerStream provides for dividends based on 50% of earnings. A change to the dividend policy is currently a unanimous shareholder decision item.

MergeCo is developing a formal dividend policy that will be attached to the shareholders agreement. The policy is still under discussion, but appears to set out financial parameters. The Business Case is based on a dividend policy of 60% of earnings. However, post-merger Dividends are to be declared solely by the board of directors and certain conditions are defined as to when the Board could amend the policy. It will be difficult for any shareholder to "enforce" the dividend policy as contained in the Business Case. This creates a risk to future cash flows to BHHI and its Shareholder, the City of Barrie, if the policy is reduced to dividends below 60% of earnings. There are conditions which must be met to reduce the dividends.

Most are acceptable, however, in the draft available at the time of the consideration of the transaction by BHHI, one condition allowed the Board of MergeCo to reduce dividends when *"an impediment in the maintenance and **growth** of approved businesses, or logical extensions of existing or related businesses, in line with a Board approved business plan"*. All PowerStream shareholders have requested that this condition be removed, as dividends should not be reduced to fund growth of the Business. As such BHHI's approval was conditional on the development of a dividend Policy that was acceptable to the City of Barrie. Negotiations have taken place on this matter, and a revised draft has been prepared that is acceptable to the CEOs of PowerStream, Enersource and Horizon, therefore this condition was removed. However, it is still being reviewed by tax experts. Therefore, staff are recommending that Council approve the BHHI resolution, subject to a final dividend policy acceptable to the Chief Administrative Officer, General Manager of Community and Corporate Services and the Director of Legal Services. An update will be provided to Council at the General Committee meeting on September 28th, 2015.

iv) Liquidity / Ability to Sell

The ability to sell a share in PowerStream by existing shareholders is a unanimous shareholder item. Under the proposed shareholder agreement for MergeCo, any and all transfers of the shares of Merge Co by a shareholder are governed by the terms of the shareholder agreement. Overall, the shareholder agreement provides slightly more liquidity for the shareholders than is the case under the existing scenario with PowerStream. Specific examples of "Permitted Transfers" by municipalities are outlined in more detail in the attached Gowlings memo. Generally, a municipality is allowed to sell its shares if: (i) the shares are first offered to the other municipalities by a "right of first offer"; and (ii) the sale does not result in any adverse tax consequences to the other municipalities. (The tax consequences being referred to are those that would result from the transfer and departure tax regime under *Ontario's Electricity Act.*)

The shareholder agreement provides that should a Shareholder transfer or sell its Shares where the transaction triggers taxes payable, the selling Shareholder is responsible for all the taxes triggered. However, the remaining shareholders agree to repay these taxes to the first party triggering and paying taxes, at the time they sell or transfer their shares.

28. Merger Agreement

The Merger Participation Agreement sets out the terms and conditions by which PowerStream, Horizon and Enersource will amalgamate their businesses following and conditional upon receiving both OEB and Competition Act approval. The merger agreement provides for the segregation of the Solar Business to special Class A shares to be held only by PowerStream Shareholders and for the sale of 10% of the shares held by PowerStream, and Horizon shareholders. As Enersource already has 10% private equity investment, it is excluded from this clause.

The new MergeCo will be held by the Municipal Holding Companies, and as such PowerStream and Horizon cease to exist.

i.) Solar Business

In 2009, PowerStream management mobilized a team to assess the opportunities offered to Local Distribution Companies (LDCs) by the *Green Energy and Green Economy Act, 2009* in renewable generation and the Feed-in-Tariffs (FIT) program, and concluded that PowerStream should invest in a portfolio of solar generation projects concentrating in rooftop solar generation (the "Solar Business").

As described in CRP006-09 and 11-G-261, through Barrie Hydro Holdings Inc. (BHHI), the City participated in the PowerStream Solar Business, with a total funding commitment of $12.3 million. As a shareholder of PowerStream, Barrie Hydro Holdings Inc. (BHHI) invested in the PowerStream Solar Business and has received related dividends of $1.3 million in 2014 and $1.0 million in 2015 to-date.

In order to preserve the Solar cash flows and return of equity investments, the merger Business Case provides for the segregation of the Solar assets as a special class of shares, "Class A Shares" to be held only by the PowerStream shareholders. A detailed term sheet is being developed to enable the net income from PowerStream's solar business to be flowed exclusively to the three shareholders of PowerStream (Barrie, Vaughan and Markham). This schedule involves creation of a special class of shares having its own dividend policy and a management agreement providing that Merge Co will manage the solar business on essentially a pass through basis (including payments for the solar business' costs attributable to the specific business). There is a commitment to repay equity related to the solar business provided by the PowerStream shareholders within 20 years, subject to preconditions. The forecasted cash flows relating to the Solar Business are included in Appendix D.

ii.) Right to sell up to 10%

Barrie, Vaughan, Markham, Hamilton and St. Catharines will be permitted to sell up to 10% of their outstanding shares in MergeCo to any large Canadian third party pension plan or fund that is registered in Ontario, to any large Canadian bank, insurance company or investment fund, or to another direct or indirect shareholder of PowerStream, Horizon or Enersource, provided one or more municipalities continue to own at least 90% of the municipal holding company.

29. Share Purchase Agreement

The share purchase agreement sets out the terms for the purchase of Hydro One Brampton from the Province of Ontario. The agreement is between PowerStream, Horizon, Enersource and the Province. The purchase price is $607 million. The agreement includes an anti-flip clause where the purchasers of Hydro One Brampton cannot sell substantially all of the business carried on by Hydro One Brampton for five years after the closing date. As well, for three years after the closing date, no shareholder of the corporation shall sell shares which results in an organization or private corporation, other than the municipalities of Vaughan, Barrie, Markham, Mississauga, St. Catharines and Hamilton, BPC Energy Corporation and any third party institutional investor who has purchased up to 10% of the shares from any of the municipalities, owning more than 49% of MergeCo. Within the three year period, up to 49% of MergeCo could be sold to another organization or private corporation and substantially all of the Hydro One Brampton business could be sold.

30. Strategic Plan and Growth

The initial Strategic Plan will be approved by all the Shareholders as an attachment to the Shareholders Agreement. At the time of writing it was not clear that further changes would require the approval of the shareholders, or would be a Board decision. It is anticipated that the Plan will include a focus on continued growth through further mergers or acquisitions. This raises the issue of where additional capital can be obtained, as the municipal shareholders do not have the ability to continue with equity injections to finance growth. Due to the tax rules that govern LDCs, this puts a heavy reliance on debt to finance growth, as other options generate significant tax consequences. However, this situation exists in the status quo, as well.

Following the acquisition of Hydro One Brampton, MergeCo will not have sufficient debt capacity to achieve its strategic growth objectives. Consequently, a structured approach is required to allow new capital to enter MergeCo, without triggering taxes. The parties to the merger are investigating alternative corporate structures such as the use of a Limited Partnership to allow for equity injections to be received from a private partner, without triggering the negative tax consequences that would occur if the equity was received through a merger or acquisition of 10% or greater of the business. The parties are seeking rulings and technical interpretations from the Ministry of Finance (Ontario) with respect to the partnership structure. Assuming that such rulings/interpretations are favourable, MergeCo should have considerable access to private equity capital to finance its strategic growth objectives

31. Impacts on Customers

The Business Case for MergeCo demonstrates that customers will benefit from lower distribution rates as compared to the rates that would exist if the merger transaction did not occur. On average, customers will benefit by approximately $40 per year in terms of the distribution portion of their electricity bills. According to Ontario Energy Board (OEB) policy, all of the savings resulting from LDC consolidations are transferred to customers at its first rate re-basing following a merger. The maximum length of time post-merger that a utility can wait to re-base is no later than 10 years. The period prior to such first re-basing is defined as the Re-basing Deferral Period.

However, customers will still benefit significantly through the period leading up to the first rate re-basing.

Overall, the Merger is expected to deliver lower distribution costs to MergeCo customers with average savings of:

- $48.6 million per year, or 5.9%, through the entire Forecast Period.
- $19.5 million per year, or 3.3%, through the Re-basing Deferral Period.
- $69.3 million per year, or 8.0%, following a transfer of merger benefits to customers in 2026.

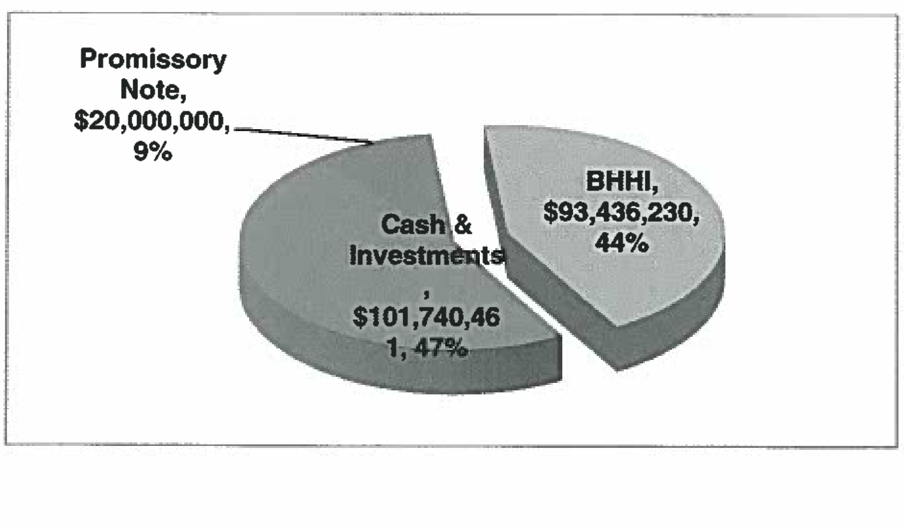
32. Facilities & Staff

The Business Case for MergeCo states that the six existing service centres that support asset related services such as construction and maintenance, trouble response, logistics, fleet services and metering will be generally maintained at existing levels. Based on the business case assumptions and the service territory to be covered, the operations centre in Barrie is proposed to remain. However, it should be noted that in the future, the closure of a facility is no longer a unanimous consent item.

The synergies that are estimated to be achieved through the merger do include considerable savings in personnel costs. These savings will be achieved through a sensitive and appropriate human resource plan. Workforce reductions will be managed in a manner to minimize disruption, be fair and transparent, and move towards the end state as quickly as possible. It is anticipated that organic growth and natural attrition will significantly assist in this process. The Business Case for MergeCo indicates that MergeCo will recognize the representative rights and collective agreements of each respective bargaining units and its members and intends that those rights and agreements will be maintained and respected.

FINANCIAL

33. This section deals with the specific financial impacts of the proposed merger on the City of Barrie. The investment in PowerStream, and possibly MergeCo, is the largest investment held by the City of Barrie. Based on the City of Barrie's 2014 Financial Statements, the investment in PowerStream, through the shares of BHHI, totalled $93.4 million, or 44% of the City's investments. The $20 million promissory note to BHHI comprised another 9% of total investments, for total investments related to BHHI/PowerStream of $113.4 million or 53% of all investments. The chart below shows the allocation of the City's total investments of $215.2 million, as at December 31, 2014.



34. The City's investment in PowerStream, through BHHI, generates annual returns from the Promissory Note of $1.1 million based on an interest rate of 5.58%. These funds are included in the City's operating Budget as a source of general revenue.

    The City also receives dividends from its investment in shares. Since the Merger of Barrie Hydro with PowerStream, the City has received dividends totalling $60.2 million; including special dividends of $37.4 million, related to amalgamation (see Appendix B). Excluding the special dividends, dividends have ranged between $2.2 million to $4.4 million. The increase in the last few years relates to Solar dividends.

35. Appendix C sets out the use of the these dividends - $27.6 million was used to fund special capital projects such as the grant to Royal Victoria Hospital, Barrie Molson Centre and Barrie Sports Complex; and $14.9 million was transferred to the tax capital reserve, for funding of various capital projects. The remaining $18.9 million has been reinvested in PowerStream to fund the solar business, suite metering and core business infrastructure renewal. None of the dividend revenue has been used to support the City's Operating Budget.

36. There are a number of aspects that must be considered in reviewing the financial impacts of the proposed Merger. First, the evaluation must consider if the transaction generates additional value to PowerStream shareholders, including BHHI and the City of Barrie, when compared to the existing investment, without undue risk. This is measured in terms of cash flow through dividend income and appreciation of the market value of the Business. This includes ensuring the price being paid to acquire Hydro One Brampton is consistent with market value, and that the PowerStream shareholders receive an appropriate share of the equity in the new MergeCo. Additionally, the investment must be considered with regard to the *Municipal Act* and supporting regulations, as well as the City's investment policies that require that investments ensure preservation of principal, liquidity, diversification, and then return on investment. Finally, as the transaction requires investment of additional equity, appropriate financing options of the injection must be identified.

37. The Business Case supporting the Merger has been received by the City of Barrie. The following is a summary of the main financial aspects as presented in Business Case:

    - PowerStream shareholders will hold 46% of the new MergeCo. The City of Barrie, through BHHI, owns 20.5% of PowerStream and will therefore hold 9.4% of MergeCo.

    - Brampton Hydro is proposed to be purchased for $607 million, subject to closing adjustments. PowerStream's share of the purchase is $186.3 million, prior to closing costs, of which $61.6 million is proposed to be funded by debt. The balance of $124.7 million requires an equity injection from PowerStream shareholders. The City of Barrie's share of the equity injection, through BHHI, is $26 million, prior to closing costs. PowerStream has suggested a contingency of 10% be provided for closing costs increasing the City's requirement up to $28.6 million.

    - The Solar assets of the PowerStream shareholders will be segregated as a special class of shares, "Class A Shares" to be held only by the PowerStream shareholders to ensure the return of equity investments made by the municipal shareholders and maintain forecast cashflows from dividends. However, dividends will be slightly reduced as a result of the necessity to replace Infrastructure Ontario debt with private sources, as MergeCo will not be 100% publicly owned. The reduction to the City will be approximately $1.2 million over the next ten years.

    - The MergeCo is forecast to achieve operating synergy savings of $355M, and Capital synergies of $168 million, over the next ten years. These are partially offset by transition costs of $95 million. In total, over the first ten years following the merger, MergeCo is forecast to achieve net cash savings of $427 milliion.

- Dividend payments to the PowerStream shareholders are forecast to exceed the status quo by a net present value of $121.7 million over the period 2016 to 2039, an increase of 45% over the status quo. Net present value discounts future cash flows to today's dollars – the average annual increase in dividends over the period is $12.8 million per year. The City of Barrie's share of increased dividends has a net present value of $25 million. The average annual increase in dividends to the City, through BHHI, is forecast at $2.6 million.

38. Navigant's Findings

As noted earlier, in order to receive independent advice the PowerStream shareholders retained industry experts, Navigant and BDR North America Inc., to provide independent analysis, advice and recommendations, on the business case analysis supporting the merger. Navigant's independent analysis addressed the aspects for evaluation, noted earlier, of additional value and risk, including cash flow and future market value compared to status quo; acquisition price of Hydro One Brampton; and the Power Stream shareholders relative value of MergeCo. Additionally they considered the liquidity of the investment and the impact of various financing options for the required equity injections on forecast returns.

Their high level findings show the transaction creates value for the City of Barrie, but does come with some additional risks. Navigant's findings are based on a review, testing and sensitivity analysis of the Business Case assumptions. A summary of their conclusions follows:

- The purchase price for Hydro One Brampton is within market value but is in the high end of recent transactions;

- The relative value of ownership in MergeCo given to PowerStream Shareholders is reasonable;

- Navigant supports the segregation of Solar assets as a separate class of shares owned by the existing PowerStream shareholders, as their analysis suggested the Solar assets were undervalued within the whole of MergeCo;

- The operating and capital expenditure synergies identified to be achieved by the transaction are reasonable and achievable. Navigant evaluated returns to the shareholders under a scenarios where the synergies were only partially achieved and the returns to shareholders still exceed the status quo;

- Navigant's analysis forecasts that the investment of $26 million in equity is expected to create $43 million in shareholder value, over the analysis period of 25 years, an increase of $17 million. This conclusion represents the average of a number of sensitivity scenarios:

- Over 25 years, customers will benefit on average $40 per year for all customers and $25 per year for residential customers, on the distribution portion of their electricity bill;

- While the investment in MergeCo has more risk and will provide a lower return than investments made to date in PowerStream, the rate of return is projected to exceed what would be realized if the transaction was not completed;

- The existing investment in PowerStream is illiquid because of unanimous shareholder consent requirements and transfer and departure taxes and the transaction will not have a major impact on liquidity. The alternative corporate structures being investigated (Partnership structure) could improve liquidity but there is a high degree of uncertainty attached to them;

- The transaction requires an additional equity investment of approximately $26 million, to finance the purchase of Hydro One Brampton, excluding a contingency of up to 10% for closing costs. Navigant estimates the return on this investment is approximately 7.7%;

- The equity investment is expected to be recovered through increased dividends over 10 years, on a net present value basis (NPV), however, returns compared to status quo vary depending on the method of financing the equity injection (shown excluding contingency for closing costs):

  - If the transaction is financed by cash, NPV of cash flows over the first ten years are lower than the status quo by $3 million;

  - Financing the transaction by converting the existing promissory note held by the City to equity improves NPV cash flows over the next 10 years so they exceed status quo by $9 million.

  - Financing the equity injection through the sale of 10% of PowerStream, estimated to generate approximately $18.4 million further improves NPV cash flows over the next 10 years so they exceed status quo by $11 million, although long term returns will be reduced as the City will have a lower ownership share in MergeCo.

  - Appendix D summarizes Navigant's analysis of ten year cash flows, under the various financing options for the equity injection.

<u>Staff Comments and Conclusions</u>

39. Staff have reviewed Navigant's analysis of the Business Case, through numerous meetings and presentations. The conclusions reached by Navigant support the Business Case for the Merger.

Staff considered the merger transaction in terms of the requirements of the *Municipal Act* and the City's investment policy. The *Municipal Act* and its related regulations define what securities a municipality can invest in. The requirements limit investments to only the highest quality securities. It is important to note that Municipalities are restricted from owning shares in a corporation, with the exception of Electrical Utilities, or through the CHUMS One Fund. The *Act* states that preservation of principle, or low risk securities is the highest criteria, followed by liquidity and then return on investment. The *Act* also restricts the amount that can be invested in different securities, to reduce risk by ensuring diversification.

40. The investment in the MergeCo is very similar to the City of Barrie's investment in BHHI and PowerStream. The investment is an eligible investment under the *Municipal Act* and the quality and credit rating of the investment is anticipated to be very similar. The liquidity of the investment is no more illiquid than the existing PowerStream investment, with a possible slight improvement as suggested by Navigant. Forecast returns on investment increase in terms of dividend income, repaying the equity injection after 10 years. Finally, the return on equity invested to purchase Hydro One Brampton is estimated at 7.7% by Navigant.

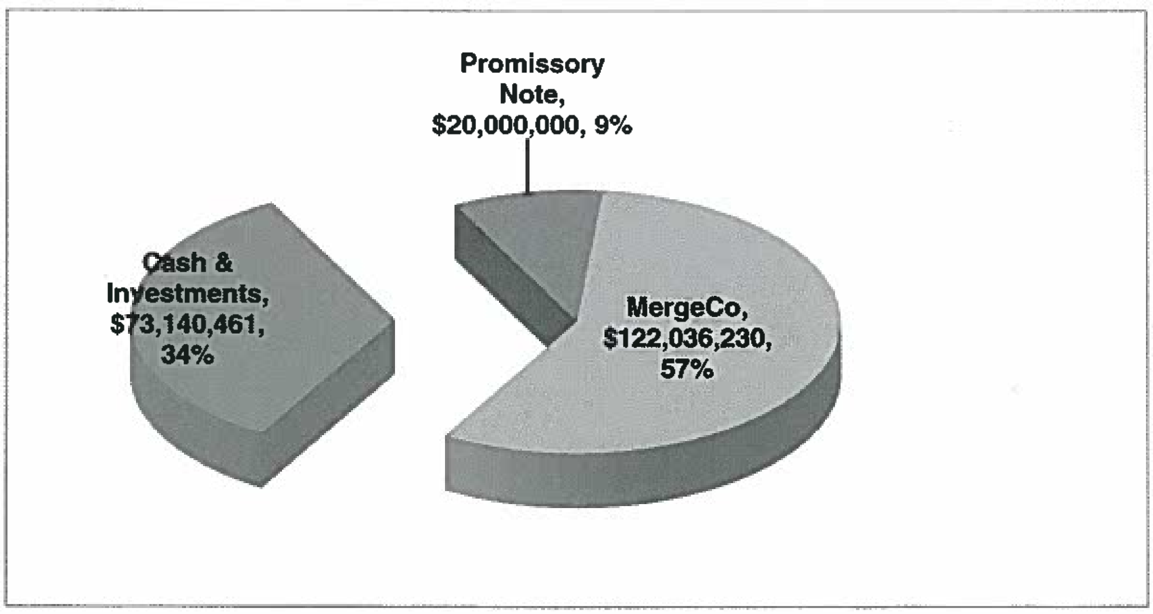
41. Staff had a significant concern with wording contained within the draft dividend policy for Merge Co. The proposed dividend policy had a condition which would allow the Board to reduce dividends below 60%. The condition stated that the Board can reduce dividends if they are *"an impediment in the maintenance and growth of approved businesses, or logical extensions of existing or related businesses, in line with a Board approved business plan"*. The cash flow from

this transaction provides a significant revenue stream to the City of Barrie which can be used to finance many pressures the City is faced with. As such, BHHI approved the transaction, conditional on the development of a dividend policy acceptable to the City of Barrie. . Negotiations have taken place on this matter, and a revised draft has been prepared that is acceptable to the CEO's of PowerStream, Enersource and Horizon, that has this condition removed. However, it is still being reviewed by tax experts. Therefore, staff are recommending that Council approve the transaction, subject to a final dividend policy acceptable to the CAO, General Manager of Community and Corporate Services and the Director of Legal Services.

42. Staff also has concerns regarding diversification of the City of Barrie's investments, if the transaction's required equity injection is funded by cash. The equity injection is estimated at up to $28.6 million including closing costs – to raise this amount of cash, the City would have to liquidate other investments. While the anticipated return on the investment of funds in MergeCo is much higher than returns earned on the City's existing investments, moving more of the City's investment portfolio into MergeCo raises concerns over diversification and liquidity.

43. As noted earlier in the report, as of December 31, 2014, the total investment in PowerStream, including the promissory note was $113.4 million or 53% of total City investments of $215.2 million. If an additional $28.6 million is moved to the investment in PowerStream/MergeCo, the total invested rises to $142 million, or 66% of total City investments. This significantly reduces the diversification of the City's investments.

44. The City's other investments are very liquid. They can be accessed easily and quickly, to meet cash requirements, avoiding the need to borrow short term funds. The investment in MergeCo is illiquid, and cannot be sold. Moving additional cash into PowerStream/MergeCo will result in a significant proportion of the City's investment portfolio being illiquid. The chart below shows the allocation of the City's investments post-merger based on December 31, 2014 values if cash is used to finance the transaction.



45. Therefore, Staff representatives recommend financing the equity injection by the following, in order of priority:

i) Through the sale of 10% of the BHHI shares in PowerStream, excluding the Solar assets. This option provides new private sector equity, without triggering tax consequences, reducing the investment required from the City of Barrie. It alleviates the concerns regarding diversity and liquidity regarding the City of Barrie's investment portfolio. Returns will be reduced in the long term from those identified in the Business case, as ownership in MergeCo is reduced from 9.4% to 8.4%. However, Navigant's analysis showed this option had the most positive impact on NPV ten year cash flows. Additional reasons for favouring a sale of 10% include:

- Receive higher dividend cash flow over status quo with minimal equity investment
- Allows the investment in the promissory note to remain, with a return of 4.41%, significantly above the return the City receives on its other investments
- Locks in the current market value of the investment, which is higher than historical market values
- Minimizes risk on liquidity and preservation of capital with no tax consequence
- City's cash reserves are maintained for to meet working capital needs and possible future investment opportunities
- May attract a strategic private partner that could influence tax rule change and increase internal competition on future divesture
- Selling 10% effectively transfers a portion of the risk
- 10% sale aligns with the Provincial mandate for consolidation of LDC's
- Allows the merger to move forward which will ultimately benefit utility users

The estimated value of a 10% sale of PowerStream to BHHI and the City of Barrie is $18.4 million. The amount of remaining injection of equity will depend on an actual and acceptable offer to purchase.

ii) The next recommended source of financing any remaining balance of the equity injection is available cash in BHHI, estimated at $3 million, at December 31, 2015. If a sale does not materialize this would become the first source of financing.

iii) Any remaining balance would be financed by the partial conversion of the BHHI promissory notes. In the event a sale of 10% of PowerStream is not realized, the remaining balance of the equity injection after utilizing the available cash in BHHI would be financed through the conversion of the promissory note and a cash injection from the City of Barrie. While this this would reduce or eliminate the interest income from the promissory notes, this is factored into the Navigant analysis. While it converts the notes to a less liquid form of investment, these funds are already invested in PowerStream. As well, while the note is somewhat liquid it is not as liquid as other City investments – to access the cash in the note, the provisions for calling the note must be followed.

iv) A cash injection from the City of Barrie would be required to fund any remaining balance.

Appendix E provides a summary of anticipated dividends under the various financing scenarios and Appendix F presents a summary of the discounted cash flows anticipated over the life of the investment.

ENVIRONMENTAL MATTERS

46. There are no environmental matters related to the recommendation.

ALTERNATIVES

47. The following alternative is available for consideration by General Committee:

Alternative #1 Council could choose to not support the Merger between PowerStream, Enersource and Horizon and the purchase of Hydro One Brampton.

This alternative is not recommended as the Merger transaction increases the City's returns on its investment over and above the status quo. Approval of the transaction is a unanimous shareholder item for PowerStream shareholders. If the City of Barrie does not approve the transaction, the merger will not proceed, even if the Cities of Vaughan and Markham are in favour of the merger.

LINKAGE TO COUNCIL STRATEGIC PLAN

48. The recommendations included in this Staff Report support the following goals identified in the 2014-2018 Strategic Plan:

- Responsible Spending

49. Responsible spending includes the prudent investment of City funds, to generate a return on investment which can be used as a source of financing for City services and infrastructure.

Appendix A
Resolution from the Board of Barrie Hydro Holdings
Passed September 14th, 2015

RESOLVED THAT the Board of Directors of Barrie Hydro Holdings Inc. ("BHHI") approve and recommend to its Shareholder, the City of Barrie, the merger of PowerStream, Horizon Holdings Inc. and a new Enersource holding corporation, as well as the merger of PowerStream Inc., Enersource Hydro Mississauga Inc. ("Enersource") and Horizon Utilities Corporation ("Horizon"), substantially in accordance with the Merger Participation Agreement, as presented to the Board of Directors of BHHI, subject to any non-material modifications or amendments as approved by the President & CEO of BHHI, and authorize BHHI to enter into and deliver the Merger Participation Agreement and Unanimous Shareholders Agreement, in a form satisfactory to the President & CEO of BHHI, and to perform, observe and comply with its obligations under such Agreement;

AND IT IS FURTHER RESOLVED THAT BHHI approve and recommend to its Shareholder, the purchase of Hydro One Brampton Networks Inc. ("Brampton"), substantially in accordance with the Share Purchase Agreement as presented to the BHHI Board of Directors, as between Her Majesty the Queen in Right of Ontario as Represented by the Minister of Energy (the "Province"), and Brampton Distribution Holdco Inc., as Vendor and PowerStream Inc., Enersource and Horizon as Purchaser, subject to any non-material modifications or amendments as approved by the President & CEO and in the accordance with the Financing Plan endorsed by the Board of PowerStream, as agreed between PowerStream Management and the Shareholder Representatives;

AND IT IS FURTHER RESOLVED THAT the above approvals and recommendations are conditional upon the completion of both the Merger Participation Agreement and the Share Purchase Agreement in accordance with the conditions to closing set out in such agreements and a dividend policy with provisions acceptable to the City of Barrie.

AND IT IS FURTHER RESOLVED THAT BHHI's share of the equity required to finance the purchase of Brampton be provided by, firstly, the proceeds from a potential sale of up to 10% of the outstanding shares in BHHI, secondly, by way of equity injection from available cash in BHHI, thirdly, by way of a partial or full conversion of existing shareholder notes up to twenty million, and lastly, if required, by cash equity injection provided by the City of Barrie;

AND IT IS FURTHER RESOLVED THAT the Chairman and President and CEO of BHHI are hereby authorized and directed to sign the Merger Participation Agreement, Unanimous Shareholders Agreement and Share Purchase Agreement in accordance with the following resolutions, and in doing so approve and execute any amendments to the Merger Participation Agreement, Unanimous Shareholders Agreement or Share Purchase Agreement subsequent to the date of these resolutions;

AND IT IS FURTHER RESOLVED THAT the Chairman and President and CEO of BHHI are hereby authorized and directed to sign and/or dispatch and deliver all other documents, notices, articles, certificates to be signed and/or dispatched or delivered under or in connection with the Merger Participation Agreement, the Unanimous Shareholders Agreement or Share Purchase Agreement or to take any action deemed necessary in respect of any of the foregoing.

AND IT IS FURTHER RESOLVED THAT the Resolution of any material matters remaining to be negotiated, including final, Liquidity Rights, Dividend Policy and Solar Term Sheet, be delegated to PowerStream's members of the Board Advisory Committee, based upon the recommendation(s) of the President & CEO of PowerStream.

APPENDIX "B"

Historical Dividends Received by Barrie Hydro Holdings Inc. (in $millions)

Year	Dividends Paid to BHHI to-date
2008	25.7 (Note 1)
2009	14.0 (Note 2)
2010	2.2
2011	2.8
2012	3.3
2013	3.1
2014	4.7
2015	4.5
Total	**60.2**

Note 1: Includes $25.7 million in Special Dividends upon amalgamation with PowerStream.
Note 2: Includes $11.7 million in Special Dividends related to amalgamation.

APPENDIX "C"

Uses of Dividends Received from PowerStream - Including Special Dividends (in $millions)

Amount	Uses of Dividends to-date
4.6	Barrie Molson Centre capital project
3.1	Barrie Community Sports Complex capital project
3.6	Priority Capital Projects for 2009
14.9	Tax Capital Reserve
16.3	Royal Victoria Hospital Expansion
12.3	PowerStream Solar Business
4.1	PowerStream Core Business
2.5	PowerStream Suite Metering Business
61.4	**Total**

APPENDIX “D”

Navigant Analysis of Equity Injection Funding Options

$M	Status Quo	100% Cash	Convertible Note	10% Sale
Equity (Cash) Investment Required in 2016	$3	$26	$6	$5
Average Increase in Annual Cash Flow (10-Years)	--	$2.4	$1.6	$1.7
Net Present Value of Total 10-Year Cash Flow[2]	$38	$35	$47	$49
Increase / (Decrease)	--	($3)	$9	$11
Average Increase in Annual Cash Flow (25-Years)	--	$1.3	$0.5	$0.4

APPENDIX "E"

Undiscounted Forecasted Cash Flows in $millions
(adapted from information provided by Navigant Consulting)

Scenario	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	10 yr Total
Status Quo (No Merger)											
Dividends	2.9	3.0	3.3	3.6	3.9	4.8	5.1	5.4	5.6	6.0	43.6
Interest on shareholder loans	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	1.1	0.8	10.7
Cash flows from Solar Business	2.1	2.2	2.1	1.9	1.7	1.4	1.2	1.2	0.9	0.7	15.4
Forecasted Cash Inflows	**6.1**	**6.3**	**6.5**	**6.6**	**6.7**	**7.3**	**7.4**	**7.7**	**7.6**	**7.5**	**69.7**
Merger (Cash Purchase with Base Assumptions)											
Dividends	3.8	5.3	6.3	7.3	7.5	7.6	7.7	7.7	8.3	9.0	70.5
Interest on shareholder loans	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8	8.0
Cash flows from Solar Business	2.1	2.1	2.0	1.8	1.5	1.3	1.1	1.1	0.8	0.7	14.5
Forecasted Cash Inflows	**6.7**	**8.2**	**9.1**	**9.9**	**9.8**	**9.7**	**9.6**	**9.6**	**9.9**	**10.5**	**93.0**
Difference from Status Quo	**0.6**	**1.9**	**2.6**	**3.3**	**3.1**	**2.4**	**2.2**	**1.9**	**2.3**	**3.0**	**23.3**
Merger (Conversion of Promissory Note)											
Dividends	3.8	5.3	6.3	7.3	7.5	7.6	7.7	7.7	8.3	9.0	70.5
Interest on shareholder loans	-	-	-	-	-	-	-	-	-	-	-
Cash flows from Solar Business	2.1	2.1	2.0	1.8	1.5	1.3	1.1	1.1	0.8	0.7	14.5
Forecasted Cash Inflows	**5.9**	**7.4**	**8.3**	**9.1**	**9.0**	**8.9**	**8.8**	**8.8**	**9.1**	**9.7**	**85.0**
Difference from Status Quo	**(0.2)**	**1.1**	**1.8**	**2.5**	**2.3**	**1.6**	**1.4**	**1.1**	**1.5**	**2.2**	**15.3**
Merger (Sale of 10% and $4.59M from Conversion of Promissory Note)											
Dividends	3.5	4.8	5.7	6.5	6.7	6.8	7.0	6.9	7.5	8.1	63.5
Interest on shareholder loans	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7	7.0
Cash flows from Solar Business	2.1	2.1	2.0	1.8	1.5	1.3	1.1	1.1	0.8	0.7	14.5
Forecasted Cash Inflows	**6.3**	**7.6**	**8.4**	**9.0**	**8.9**	**8.8**	**8.8**	**8.7**	**9.0**	**9.5**	**85.0**
Difference from Status Quo	**0.2**	**1.3**	**1.9**	**2.4**	**2.2**	**1.5**	**1.4**	**1.0**	**1.4**	**2.0**	**15.3**

APPENDIX "F"
Net Present Value of Total Estimated Cash Flows in $millions (adapted from information provided by Navigant Consulting)

Scenario	Net Investment Required	Present Value of Dividends (@5%) Years 1 to 10	Years 11 to 25	NPV of Equity (25+ yrs)	Sub-total	Present Value of Interest Payments (@5%) Years 1 to 10	Years 11 to 25	NPV of Principal	Sub-total	Total (Shaded Areas)
Status Quo (No Merger)	(3,075)	32,539	64,522	108,751	205,811	8,427	4,898	6,201	19,526	222,263
Merger (Cash Purchase with Base Assumptions)	(28,600)	53,002	67,839	116,790	237,630	6,224	4,898	6,201	17,323	226,353
Merger (Conversion of Shareholder Loans)	(8,600)	53,002	67,839	116,790	237,630	-	-	-	-	229,030
Merger (Sale of 10%) Note 1	(3,000)	47,702	61,055	105,111	213,867	4,795	3,774	4,778	13,347	224,215

Note 1: Includes promissory note conversion of $4.59 million.
Note 2: Excludes cash flows relating to Solar dividends and returns of capital. Net present value of estimated Solar Dividends for years 1 to 10 discounted at 5% is $12.3M for Status Quo and $11.7M under all of the Merger scenarios.

Appendix "G"

Memorandum from Gowlings LLP

gowlings

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Paul H. Harricks
Direct 416-369-7296
paul.harricks@gowlings.com

Memorandum

To: Mayor and Members of Council for the City of Barrie

Date: September 24, 2015

Re: Project Aura Interim Report

File Number: T1003698

A. Introduction

I have been retained by the shareholders of PowerStream Holdings Inc. ("**PHI**") to provide independent legal advice on:

1. The legal risks and considerations related to the merger of PHI, Enersource Holdings Inc. and Horizon Holdings Inc. (the "**Merger**");

2. The corporate structure and governance arrangements of the new corporation resulting from the Merger ("**MergeCo**"); and

3. The legal risks and considerations related to MergeCo's purchase of Hydro One Brampton Networks Inc. ("**HOBNI**").

In connection with my engagement I have provided ongoing legal advice to the three PHI shareholders, including Barrie Hydro Holdings Inc. ("**BHHI**").and their respective municipal shareholders (in the case of PHI, the City of Barrie). I have met on several occasions with the board of directors of each PHI shareholder, including PHI, and have been involved in providing instructions to PHI and its legal advisors on issues that were of concern to the PHI shareholders.

B. Scope of Review

In the course of my engagement I have reviewed successive drafts of each of the following:

1. The Merger Participation Agreement ("**MPA**") pursuant to which the Merger will be completed;

2. The Unanimous Shareholders Agreement ("**Shareholders Agreement**") which, as of the effective date of the Merger, will govern the relationship between the shareholders of MergeCo and its subsidiaries;

3. The Share Purchase Agreement pursuant to which MergeCo will acquire all of the issued and outstanding shares of HOBNI;

4. The proposed Dividend Policy for MergeCo (the "Dividend Policy"); and

5. The Term Sheet for the operation and management by MergeCo and its subsidiaries of the current solar power business of PHI which will, pursuant to the Shareholders Agreement, be owned by a subsidiary of MergeCo but operated for the exclusive benefit of the PHI shareholders (the "Solar Term Sheet").

Each of the foregoing documents is, as of the date of this report, still under negotiation between the relevant parties although, as I have been advised by PHI and its advisors, almost all of the major commercial issues have been settled as between PHI, Enersource Holdings Inc. and Horizon Holdings Inc. Consequently, I will be preparing and providing to the PHI shareholders a subsequent report once all of the foregoing documents have been negotiated and settled to the satisfaction of the negotiating parties.

C. Summary of Conclusions

Consistent with the mandate that I was given by the PHI shareholders, and based upon my review of the current versions of the foregoing documents that have been provided to me, my conclusions are as follows:

1. All of the Documents are in a form that are typical for transactions of Project Aura.

2. The legal risks to BHHI and the City of Barrie associated with the transactions are within the range of what is typical in transactions of the nature of Project Aura.

3. The Documents are drafted in a way that adequately protects the interests of BHHI and the City of Barrie.

4. While the Dividend Policy is still under discussion if it is adopted by all the parties and substantially the form being proposed, and while the payment of dividends can never be guaranteed, it will provide considerable assurances to Shareholders of MergeCo will receive the level of cash flows (as a percentage of net income) that they are expecting. In this regard, we understand that the resolution approving the Transaction passed by the Board of Directors of BHHI provides that its approval is conditional on the Dividend Policy being in a form acceptable to the City of Barrie council.

5. Similarly, if the Solar Management Term Sheet is finalized in the form currently being proposed, it will provide the PHI shareholders, including BHHI with satisfactory legal protections. **[In this regard we similarly understand that the PHI board resolution includes a condition to the effect that the definitive management agreement will be executed and substantially a form contemplated by the Solar Management Term Sheet.]**