WeirFoulds LLP

Consolidation of Ontario's Electricity Distribution Sector

March 8, 2013

Background

The Province's Distribution Sector Review Panel has issued a Report recommending major changes in the electricity distribution sector. If carried out, the recommendations will have significant impacts on municipalities and on the electricity utilities they own.

At present, there are 76 local distribution electricity utilities (LDCs). As a result of 1998 legislation, all of those LDCs are Ontario Business Corporations Act companies. Almost all are owned by municipalities, either wholly by one municipality or jointly by a number of municipalities.

The Report found that the present system adds materially to customer costs, as a result of a number of factors:

- Smaller LDCs have higher per capita costs for operations, maintenance, and administration, on average approximately 75% higher than for larger LDCs
- The duplication of equipment and facilities among neighbouring LDCs
- Smaller LDCs have to pay more to raise money
- There are significantly increased regulatory costs of having to oversee so many LDCs

The Report concludes that, if its recommendations were followed, electricity costs could be reduced by some $1.2 billion over ten years, for an annual savings of about $70 per customer.

Recommendations

The Report recommends consolidating the 76 LDCs into between 8 and 12 regional distributors. Two of those distributors would be in the north, with the remaining 6 to 10 distributors in the balance of the Province. Each of these would have a minimum of 400,000 customers.

The Report also proposes that a period of two years be granted for the voluntary merger of LDCs. If, at the end of that two-year period the recommendations in the Report have not been carried out, the Report recommends legislation requiring consolidation.

The Report proposes a number of incentives to encourage voluntary merger. These include allowing LDCs to recover their legitimate transition costs and avoiding an Ontario Energy Board review.

In order to protect their investments, municipalities owning the LDCs to be consolidated should receive equity in the new regional distribution utilities in proportion to the valuation of their assets used to create each of those new regional distributors. The objective is to ensure that LDCs' shareholders' fiscal positions are not adversely affected by the changes in the distribution sector.

The Report recommends that the government eliminate restrictions that prevent municipalities from making loans to distributors.

Two-thirds of the board of directors of the regional distributors should be composed of independent directors, although it would be preferable to have 100% independent board membership. It is also advised that the new regional distributors encourage their members to acquire proper training in the areas of governance and the roles of boards of directors.

Implications: Making the Decision to Merge

LDCs have been an important source of revenue for the municipalities that own them. As a result, many municipalities will be reluctant to surrender ownership, even with the Report's recommendation on the allocation of shares in the new regional distributors.

Municipalities and their LDCs will face difficult questions surrounding whether to merge, with whom to merge and how the assets of the LDCs should be valued. They will also have to address the impact of the merger on the assets, liabilities, rights and obligations of the merging entities and of the continuing entity formed by the merger. They will also face complex questions in the negotiation and finalization of the merger transaction and related documentation and concerning corporate governance, not just in the decisions related to the merger, but also in the post-merger governance arrangements. It will be essential that municipalities receive effective, independent advice about merger decisions.

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