

## CLIENT UPDATE

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### Managing the Challenges Facing Municipalities and their Utilities

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Electricity distribution utilities are facing an unprecedented number of challenges. They are under significant cost pressures due to the need to repair and replace aging infrastructure, and to respond to provincial requirements to integrate renewable energy sources into their systems. At the same time, they face declines in their revenue due to, among other things, the effect of conservation programs and the availability of alternative sources of supply. Technological advances hold the promise of allowing consumers, residential and commercial, to reduce their demand in the short term and, in the long term, perhaps leave the grid altogether. *The ultimate risk for utilities is that the traditional business model may no longer be viable, with the attendant risk of stranding valuable assets.*

The options available to the utilities to respond to these challenges include broadening the range of services they offer (for example, to become energy service companies) and to merge with or acquire other utilities, in the hope that the economics of scale will increase their ability to successfully respond to the challenges. Some of the options available to the utilities require changes to the existing regulatory structure and perhaps changes in the governing legislation. That means that, to a considerable degree, the ability of the utilities to respond successfully may be out of their control.

All of these issues create dilemmas for the municipal owners of utilities. The profit from the utilities' operations are a reliable, predictable source of revenue for those municipalities. In addition, the ownership of the utility provides a measure of local control which has, historically, been important to the municipalities' service to their residents. *As the pressures on utilities become more pronounced, their ability to attract financing at favourable rates may become more difficult.*

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The sale or merger of a utility would mean partial or complete loss of local control. A sale would mean the loss of a predictable revenue stream.

The pressure to sell or merge arises not just from the challenges utilities face but from the Ontario government. In response to the task force recommendations on utility consolidation, the government opted for a voluntary approach. However, elements of the Clark report suggested that the government may be rethinking that voluntary approach, allowing Hydro One Networks Inc. to be the driver for consolidation.

In all of these developments it is essential that utilities and their municipal owners have the best advice available to them on the challenges and on the options for responding to those challenges. *They need advice on the options available them to finance the repair and replacement of aging infrastructure, including the use of public/private partnerships to do so.* They need advice on the range of options available to them for changes in the utilities' business model. They need advice on the necessary regulatory options, including the required changes in the existing regulatory model. They need *legal, accounting, and financial advice* on the options for sale or merger. In the event that the utility decides to sell or to merge, they need advice on how to integrate the proceeds of the sale into their ongoing financing arrangements.

The advice required by the utilities and their municipal owners must be tailored to their individual circumstances. Advice cannot be based on a one-size-fits-all model.

## ENERGY

We provide transactional, litigation and regulatory advice to both public and private sector clients in the energy sector. Our lawyers have advised public and private companies active in oil and gas exploration in North America and Africa. We also have extensive experience in the regulation of the transmission and distribution of electricity.

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