Ontario Energy Board

Commission de l'Énergie de l'Ontario

EB-2005-0254

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S. O. 1998, c.15, Schedule B;

AND IN THE MATTER OF an application by PowerStream Inc. and Aurora Hydro Connections Limited under section 86 of the *Ontario Energy Board Act, 1998* seeking leave for PowerStream Inc. to acquire all outstanding shares in and subsequently to amalgamate with Aurora Hydro Connections Limited, and for related orders.

BEFORE

Bob Betts
Presiding Member

Pamela Nowina
Member

Paul Sommerville
Member

DECISION AND ORDER

September 19, 2005

The Application

On March 24, 2005, PowerStream Inc. (“PowerStream”) and Aurora Hydro Connections Limited (“AHCL”) (collectively, the “Applicants”) filed an application with the Ontario Energy Board (the “Board”) under section 86 of the *Ontario Energy Board Act, 1998* (the “Act”) seeking leave for PowerStream to acquire all outstanding shares in and subsequently to amalgamate with AHCL (the “Application”). The Application also seeks, as of a date to be notified by PowerStream, the cancellation of AHCL’s electricity distribution licence under section 77(5) of the Act, and an amendment to PowerStream’s electricity distribution licence under section 74 of the Act to include AHCL’s licensed service area in PowerStream’s licence.

Both PowerStream and AHCL are licensed electricity distributors.

PowerStream owns, operates and manages assets associated with the distribution of electricity within the geographic territory and municipal boundaries as outlined in Schedule 1 of its electricity distribution licence ED-2004-0420. PowerStream’s licensed service area covers the Town of Markham, the City of Vaughan and the Town of Richmond Hill. PowerStream’s ownership is currently divided as follows: 59% of the shares are owned by Vaughan Holdings Inc., which is wholly owned by the City of Vaughan; and 41% of the shares are owned by Markham Energy Corporation, which is wholly owned by the Town of Markham. Markham Energy Corporation’s ownership in PowerStream may increase by up to 2% prior to the closing of the transactions contemplated in the Application. This would be the result of the exercise by Markham Energy Corporation of an option contained in the share purchase agreement associated with the amalgamation of Markham Hydro Distribution Inc., Hydro Vaughan Distribution Inc. and Richmond Hill Hydro Inc. that resulted in the creation of PowerStream.

AHCL owns, operates and manages assets associated with the distribution of electricity within the geographic territory and municipal boundaries as outlined in Schedule 1 of its

electricity distribution licence ED-2002-0558. AHCL's licensed service area covers the Town of Aurora. AHCL is owned by Borealis Hydro Electric Holdings Inc., which is wholly owned by the Town of Aurora.

According to documentation filed with the Application, internal approvals necessary to enable the parties to enter into the agreement that underlies the proposed transactions have been obtained.

PowerStream is currently the fourth largest electricity distributor in Ontario in terms of customer numbers. Following the amalgamation, PowerStream would serve approximately 215,000 customers in the service areas currently served by PowerStream and AHCL.

PowerStream does not anticipate that it will be seeking to implement any immediate changes to the existing AHCL distribution rate orders. PowerStream has indicated that it will consider a rate harmonization plan, in accordance with the Board's Electricity Distribution Rate Handbook and any other Board requirements, following the completion of a cost allocation, cost of service and rate design study. The Share Purchase Agreement filed by the Applicants contains a covenant to the effect that, in the event that rates are harmonized, AHCL's current customers will benefit from the harmonization by a minimum of $10,000,000 over a ten-year period from what the rates would otherwise be were AHCL to remain a stand-alone company.

A Notice of Application and Written Hearing was published as directed by the Board. Mr. Michael Evans, of Aurora TrueValue, Hydro One Networks Inc. ("Hydro One"), Newmarket Hydro Ltd. ("NHL") and Mr. Benji Kestein, representing the "New Deal Ratepayers Group", (collectively, the "Intervenors") requested and were granted intervenor status in this proceeding. The Board also received two letters of comment, one of which raised certain issues for consideration by the Board and the other of which offered support for the transactions contemplated in the Application.

The full record of this proceeding is available for review at the Board's offices. While the Board has considered the full record, the Board has summarized and referred only to those portions of the record that it considers helpful to provide context to its findings.

The Interventions

The concerns raised by Mr. Evans can generally be described as falling within three categories of issues.

The first category concerns the process surrounding the negotiation of the transactions contemplated in the Application, including whether the proper process was followed; whether the Mayor of the Town of Aurora, as a person who may have fiduciary responsibilities to the citizens of Aurora, ensured that a fair and transparent process was followed that obtained the maximum value for AHCL's distribution assets; and whether due diligence was exercised through the process, including whether appropriate legal and other advisors were retained.

The second category of issues raised by Mr. Evans relates to the purchase price and, more specifically, asserts that the price payable for the shares of AHCL is below market value.

The third category of concerns addresses issues relating to system reliability, expressed as general concerns regarding whether "supply from the south" is adequate to meet the power needs of existing customers and whether the "promise of power supply" is only for new residents and businesses in Aurora and not for existing customers. Mr. Evans also questioned the Applicants' assertion that rate benefits will arise as a result of the transactions contemplated in the Application.

The concerns raised by Mr. Kestein were much to the same effect. Mr. Kestein also indicated that the concerns of his group have to do with the contract, which he stated had not, at the date of his intervention, been made available to the general public. The

contractual provisions identified as being of interest included the length of the term, escape clauses, penalties and increases on review every three years.

As part of its intervention, NHL indicated a desire to obtain additional information that could expose issues relating to such matters as its, that is NHL's, continued access to transmission and distribution and the effects of the proposed transactions on the costs of borrowing and cash flow. However, the focus of NHL's intervention throughout this proceeding has been related to system reliability. Specifically, NHL was opposed to the inclusion of a particular provision in the Share Purchase Agreement filed by the Applicants under which PowerStream agreed to install, subject to regulatory approval, three 28 kV feeder lines "to provide sufficient capacity for load growth and enhanced reliability through redirecting of supply based upon customer requirements within Aurora". NHL argued that this provision may compromise the interests of electricity consumers in northern York region with respect to the adequacy, reliability and quality of electricity service, and suggested that the proposed approach would preclude other low cost supply options that are both more efficient and more reliable. NHL was also concerned that there may be a resulting increase in costs for NHL's customers, since NHL would expect to be required to make a capital investment in relation to the installation of the three feeder lines. This, in turn, would require NHL to incur added costs in the form of a capital investment in or contribution to other facilities identified as solutions to the supply issue in the region.

Hydro One did not take a position on the merits of the Application.

Mr. Evans requested that the Board proceed with this Application by way of oral hearing, a request that was supported by NHL.

The Combined Proceeding

On July 5, 2005, the Board issued a Procedural Order combining the subject Application with two others for the purpose of addressing common issues relating to the scope of

the issues that the Board will consider in determining applications under section 86 of the Act. The Procedural Order combined the Application with an application by Greater Sudbury Hydro Inc. for leave to acquire shares in West Nipissing Energy Services Ltd. (EB-2005-0234) and an application by Veridian Connections Inc. and Gravenhurst Hydro Electric Inc. for leave for Veridian Connections Inc. to acquire shares in and to subsequently amalgamate with Gravenhurst Hydro Electric Inc. (EB-2005-0257). The Board assigned file number RP-2005-0018/EB-2005-0234/EB-2005-0254/EB-2005-0257 to the combined proceeding.

The Procedural Order asked the parties to identify matters that they considered to be relevant to the Board's determination of applications under section 86 of the Act as well as matters they considered to be outside the scope of the Board's review. The Board also requested, without limiting the matters that the parties may wish to raise, submissions on the relevance of two specific issues:

(i) the adequacy of the purchase price payable in relation to the proposed transaction; and

(ii) the adequacy or integrity of, or the motivation underlying, the tendering, public consultation, public disclosure or decision-making processes associated with the proposed transaction.

The Board held an oral hearing on this matter on July 19, 2005. The Applicants made oral and written submissions in the combined proceeding. NHL also made oral and written submissions in the combined proceeding, focussing on the reliability issue previously raised by it. Mr. Evans and Mr. Kestein filed a letter reiterating their concerns regarding reliability.

The Board issued its Decision in the combined proceeding on August 31, 2005 (the "Combined Decision"). In the Combined Decision, the Board made two significant

determinations in relation to the manner in which the Board will review applications for leave to acquire shares or amalgamate under section 86 of the Act.

First, the Board determined that the factors to be considered in deciding such applications are those identified in the Board's objectives as set out in section 1 of the Act. Second, the Board determined that it will use a "no harm" test in deciding whether to approve a share acquisition or amalgamation transaction. In other words, the Board will approve a transaction if it is satisfied that the transaction will not have an adverse effect in terms of the factors identified in the Board's objectives.

Based on these two findings, the Board concluded that the price payable by a purchaser is only relevant if the price is too high and creates a financial burden on the acquiring company. In such a case, there could be an adverse effect on the economic viability of the purchaser. A price that is too low would not have an adverse effect in terms of the factors identified in the Board's objectives.

Similarly, the Board concluded that the conduct or motivation of a seller leading up to the transaction (including, for example, the amount of public consultation on, or public disclosure about, the transaction) are not in and of themselves grounds for denying the approval of a transaction. The "no harm" test looks at the effect of a transaction, not the reason for or the process preceding the transaction.

In the Combined Decision, the Board acknowledged that reliability of electricity service is a relevant consideration for the Board in determining applications for leave to acquire shares or amalgamate. However, the Board also determined that the proceeding associated with its consideration of the proposed transactions in the instant case is not the appropriate place to address this question. This is so because the Board has initiated a different, and more focussed, process to address the York Region supply issue. The Board concluded that the reliability concerns raised by NHL in these proceedings are more appropriately addressed in that process. The Board also noted that NHL would not be prejudiced by the deferral of the reliability issues to the Board's

broader York Region supply process, stating that “any leave [the Board] might give in relation to the share acquisition and amalgamation transaction would not constitute acceptance by the Board that the installation of the three feeder lines is a solution to the supply issue, nor would it pre-determine the outcome (in whole or in part) of the broader process”.

Based on the Combined Decision, all of the issues raised by the Intervenors with respect to the Application are no longer “in scope” for this proceeding, either because they have been deferred to the Board’s broader York Region supply process (reliability issues), because they are premised on the assumption that it is incumbent on the Applicants to demonstrate that the transactions proposed in the Application will result in a benefit (the question raised by Mr. Evans regarding the rate benefits associated with the transactions), or because they have been determined not to be factors relevant to the Board’s review of applications for leave to acquire shares or amalgamate under section 86 of the Act (issues respecting the process culminating in the proposed transactions and respecting the purchase price).

By letter dated September 7, 2005, the Board received notification from NHL indicating that it was satisfied that based on assurances contained in the Combined Decision, it would have an opportunity to address the issues of most concern in the more focused York Region supply process and accordingly was withdrawing its intervention.

On September 16, 2005, a conference call was held to allow the Board to hear the views of the remaining parties on the following questions:

1. Does any Intervenor contest the Application on the basis of issues that remain in scope in this proceeding, based on the Board’s August 31, 2005 Decision?

2. If so:

   (a) what are those issues?

   (b) what materials or evidence filed by the Applicants with respect to those issues does the Intervenor wish to test, and by what means? Is an oral hearing required for this purpose?

   (c) does the Intervenor wish to have the Applicants produce further materials or evidence?

   (d) does the Intervenor intend to produce evidence in support of its position in relation to the Application?

Participants in the conference call included: Ms. Long, representing the Applicants; Mr. Evans of Aurora TrueValue; Mr. Kestein, representing the New Deal Ratepayers Group; Ms. Band, Board Counsel; Mr. Baumhard, Board Staff; and Mr. Betts, Board Member, presiding over the session.

Also present were Mr. Nolan and Ms. Conboy, representing PowerStream; Mr. John Sanderson, representing AHCL; and Mr. Somerville, representing the Town of Aurora.

Ms. Long opened with submissions that all of the issues raised by the Intervenors to this time have been dealt with in the Combined Decision.

Mr. Evans' primary concern related to his apparent uncertainty regarding his eligibility for cost awards. He reiterated concerns about reliability of supply, and about generation solutions to supply problems, and indicated that he disagreed with the Combined Decision position on price, stating that the price should be based upon Market Value.

Mr. Evans requested a 30 day extension on behalf of himself and Mr. Kestein due to some delays in their receipt of documents and their lack of legal counsel to assist them in relation to this proceeding.

Mr. Kestein agreed with all points raised by Mr. Evans and reiterated his concern about the process followed by the Town of Aurora in relation to the sale of the shares of AHCL.

In her reply for the Applicants, Ms. Long stated that no new issues had been identified in the session, and further, the request for a 30 day extension was unacceptable.

Upon considering the points raised by all parties, the Board ruled as follows:

1) Mr. Evans, of Aurora TrueValue was advised that the Board's *Practice Direction on Cost Awards* specifically includes parties representing consumer interests as being eligible for cost awards, and confirmed that he therefore is eligible for cost awards. Mr. Evans was reminded that eligibility was not a guarantee that costs would be awarded, and further that all of this was clearly stated in the Board's *Practice Direction on Cost Awards* in his possession.

2) The Board rejected a request from the two Intervenors for a 30 day extension to allow them additional time to prepare for the questions put to them. Adequate time has been permitted to understand the Application, the Combined Decision and the questions put to them for discussion during the conference call, as well as to prepare their answers to those questions.

3) The Board ruled that Mr Evans and Mr. Kestein had reiterated past issues and failed to identify any that were not already considered in the Board's Combined Decision of August 31, 2005, or that could not be dealt with in other Board processes, such as the Board's review of the York Region

supply situation. This led to a ruling that the Board would now proceed with its deliberations on the Application based upon the evidence it had at this point in the proceeding.

As a result of a question from Mr. Betts to Mr. Evans, the Board clarified a procedural point that Mr. Evans was the Intervenor of record in this matter, not Aurora TrueValue.

Board Findings

Section 86 of the Act provides, among other things, that leave of the Board is required before an electricity distributor can amalgamate with any other corporation. In addition, under that section no person may acquire voting shares in an electricity distributor without leave of the Board if, as a result of the acquisition, the person would hold more than 20 percent of the voting securities of the distributor.

The Combined Decision has made it clear that, in deciding whether or not to grant leave in relation to the Application, the Board must determine whether the transactions contemplated in the Application will have an adverse effect on:

(i) the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service; or

(ii) economic efficiency and cost effectiveness in the generation, transmission, distribution, sale and demand management of electricity or the maintenance of a financially viable electricity industry.

The Applicants have submitted that the transactions contemplated in the Application will:

- provide opportunities for efficiencies and economies of scale, which could mitigate the impact of increased upward pressure on distribution rates for electricity consumers currently served by AHCL;

- provide benefits to Aurora ratepayers due to the synergies of integrating within a larger, lower cost utility (based on figures from the years 2002 and 2003, PowerStream's operation, maintenance and administration costs per customer were approximately 25% lower than those of AHCL);

- enable better inventory management and ensure sufficient spare equipment for high reliability through the harmonization of engineering standards;

- provide electricity consumers currently served by AHCL with benefits associated with being served by a larger utility which, given its larger resources, will have an increased ability to monitor, report on and improve system reliability and power quality;

- allow PowerStream to configure its distribution network using best practices given that the service territories of the parties are geographically contiguous;

- based on an analysis of current rates, result in lower rates for electricity consumers currently served by AHCL than would be the case were AHCL to remain a stand-alone company; and

- be financed through debt financing, with interest coverage and cash flow-to-debt ratios being in accordance with all requirements of banking and Electricity Distributors Finance Corporation bond financing arrangements so as to be sufficient to satisfy the credit rating agencies.

The Board also notes that the following commitments have been made by PowerStream in the context of the transactions contemplated in the Application:

- to maintain or improve customer service levels and service offerings, including meeting or exceeding the minimum service level requirements established by the Board (including expected response times) and which are comparable to the service and reliability levels currently enjoyed by customers served by PowerStream (including on call services 24 hours a day 7 days a week);

- to establish a customer advisory committee comprised of representatives resident in Aurora that will meet quarterly with respect to rates, reliability and customer issues on a consultative basis in order to receive local input and feedback, and to maintain a local presence in the Town of Aurora; and

- to provide AHCL's current customers with a benefit from the harmonization of rates of at least $10,000,000 over a ten-year period relative to what they would otherwise be as compared to AHCL remaining a stand-alone company.

Based on the above, the Board is satisfied that the transactions contemplated in the Application will not have an adverse effect in relation to the factors identified in its objectives as set out in section 1 of the Act. In other words, the Board is satisfied that the Application meets the "no harm" test.

The Board does, however, wish to further comment on the issue of the installation of the three feeder lines proposed to be constructed by PowerStream. As noted earlier, the Share Purchase Agreement filed by the Applicants contains a section under which PowerStream has agreed to install, within three years but subject to regulatory approval, three 28 kV feeder lines "to provide sufficient capacity for load growth and

enhanced reliability through redirecting of supply based upon customer requirements within Aurora". As noted in the Combined Decision, any leave given by the Board in relation to the transactions contemplated in the Application would not constitute acceptance by the Board that the installation of the three feeder lines is a long term solution to the supply issue, nor should it be regarded in any degree as a determination of any aspect of the broader York Region process.

The Board recognizes that PowerStream entered into this commitment prior to July 25, 2005, the date on which the Board initiated the broader York Region supply process, and accepts PowerStream's statement that the feeder line proposal does not constitute a permanent supply solution for York Region. It should not, therefore, be implemented in a manner that frustrates any aspect of the broader York Region process.

Finally, the Board notes the statement made in a letter dated June 6, 2005 filed with the Board by the Mayor of the Town of Aurora to the effect that the purchase price payable in respect of the transactions contemplated in the Application "represents a premium of some 30% over the base value of the utility as it currently stands". The Board takes this opportunity to remind the Applicants that, as noted in the Combined Decision, any premium paid in excess of the book value of acquired assets is not normally recoverable through rates.

Cost Awards

The Board received submissions and a claim for cost awards, including a suggestion for an advance toward cost awards, from Mr. Evans.

The Applicants replied with arguments that in making its determination regarding whether Mr. Evans is eligible for a cost award, the Board should consider that the issues raised by Mr. Evans with respect to price and supply are outside the scope of the Board's review, and therefore that Mr. Evans should not be granted an award of costs in order to pursue those issues. The Applicants also argued that, should the Board

determine that Mr. Evans is eligible for costs, the Board should only consider the amount of the cost award at the end of the proceeding in accordance with the Board's normal practice. The submissions of the Applicants on this issue were made prior to the Board's July 5, 2005 Procedural Order.

The Board acknowledges that, prior to its Combined Decision, there was some uncertainty regarding the scope of the issues to be considered in determining whether to grant leave in applications to acquire shares or amalgamate under section 86 of the Act. The Board finds that it would not be appropriate to deny costs to an intervenor for having raised issues that were, at the time, of potential relevance but that have subsequently been determined to be out of scope. The Board also notes that Mr. Evans did raise issues relating to reliability which, but for the York Region supply process, would have been relevant considerations for the Board in its determination of the Application.

The Board confirmed in its September 16, 2005 conference call that Mr. Evans is eligible for costs.

In this Decision, the Board has determined that Mr. Evans shall be awarded 100% of his reasonably incurred costs in connection with his participation in this proceeding. In the Combined Decision, it was noted that the Board would issue a separate decision on cost awards in relation to the combined hearing at a later date. Accordingly, Mr. Evans' entitlement to costs for his participation in the combined hearing will be determined by the Panel that presided over the combined hearing. To facilitate the processing of cost awards to Mr. Evans, he should await that Panel's determination of cost awards for the combined hearing before filing his detailed cost claim. Mr. Evans must then submit his detailed cost claim, in the form required by the Board's *Practice Direction on Cost Awards,* within 21 days of the date on which a decision on cost awards is issued by the combined hearing Panel.

The Board anticipates that the Board's costs of, and incidental to, this proceeding, which relate almost exclusively to the combined proceeding, will be addressed by the combined hearing Panel in its decision on cost awards.

THE BOARD THEREFORE ORDERS THAT:

1. PowerStream Inc. is granted leave to acquire all outstanding shares in, and subsequently to amalgamate with, Aurora Hydro Connections Limited.

2. Notice of completion of each of the share acquisition and the amalgamation shall be promptly given to the Board.

3. The Board's leave to acquire shares and amalgamate shall expire 18 months from the date of this Decision and Order. If either the share acquisition or the amalgamation has not been completed by that date, a new application for leave will be required in order for the non-completed transaction to proceed.

4. The eligible costs of Mr. Evans in relation to this Application, other than in relation to the combined proceeding, as assessed by the Board's Cost Assessment Officer, shall be paid by the Applicants upon receipt of the Board's Cost Order.

Pursuant to section 6(1) of the Act, the Management Committee of the Board has delegated to Mark Garner, an employee of the Board, the powers and duties of the Board with respect to the determination of applications under section 74 and section 77(5) of the Act. Accordingly, the Board refers to Mark Garner the application to cancel Aurora Hydro Connections Limited's electricity distribution licence and the application to amend PowerStream Inc.'s electricity distribution licence.

ISSUED at Toronto, September 19, 2005

ONTARIO ENERGY BOARD

Original signed by

Peter H. O'Dell
Assistant Board Secretary