Report to Strategic Priorities and Policy Committee

To: Chair and Members
Strategic Priorities and Policy Committee

From: Lynne Livingstone, City Manager

Subject: Proposed London Hydro and Newco Affiliate

Date: September 19, 2023

Recommendation

That, on the recommendation of the City Manager with the concurrence of the Deputy City Manager, Finance Supports and the Deputy City Manager, Legal Services:

a) the report dated September 19, 2023, titled “Proposed London Hydro and Newco Affiliate” **BE RECEIVED**; and,

b) no further steps be taken with respect to the incorporation of a retail affiliate for London Hydro Inc.

Executive Summary

As directed by Council, staff undertook further discussions with LHI concerning the incorporation of an entity ("Newco") that would assume unregulated business lines developed by LHI.

LHI has recently advised that “Every (Ontario) utility has developed its own respective platform and is now ready to be compliant with the Green Button regulations” and that the proposed “Newco” is no longer required.

Linkage to the Corporate Strategic Plan

Council’s 2023 to 2027 Strategic Plan for the City of London identifies “Well-Run City” as one of eight strategic areas of focus which supports the following:

“The City of London is trusted, open, and accountable in service of the community” which includes increasing transparency and accountability in decision making, financial expenditures, and the delivery of municipal programs and services.

“Londoners experience good stewardship, exceptional and valued service” which supports the expected result of London’s finances are maintained in a transparent, sustainable, and well-planned manner, incorporating intergenerational equity, affordability and environmental, social, and governance considerations.

Analysis

1.0 Background Information

1.1 Previous Reports Related to this Matter

Strategic Priorities and Policy Committee, meeting on January 26, 2021
https://pub-london.escribemeetings.com/filestream.ashx?DocumentId=76753

Strategic Priorities and Policy Committee, meeting on October 20, 2020, agenda item 4.1 - London Hydro Proposed Corporate Restructuring
https://pub-london.escribemeetings.com/filestream.ashx?DocumentId=75626

Strategic Priorities and Policy Committee, meeting on January 23, 2020, agenda item 4.1 — London Hydro Proposed Corporate Restructuring
https://pub-london.escribemeetings.com/filestream.ashx?DocumentId=70435

Strategic Priorities and Policy Committee, meeting on August 26, 2019, agenda item 4.2 – Delegation – V. Sharma, CEO, London Hydro Inc. – London Hydro Corporate Restructuring https://pub-london.escribemeetings.com/filestream.ashx?DocumentId=66558

2.0 Discussion and Considerations

2.1 Previous Municipal Council Direction

In August 2019, London Hydro Inc. appeared before Strategic Priorities and Policy committee to present a proposed new LHI corporate structure. The purpose of the proposed restructuring was intended to facilitate the development of LHI's non-regulated business activity – namely, at that time, the "Green Button" initiative. The core mandate of LHI, is the supply and delivery of electricity to London consumers. These activities are regulated by the Ontario Energy Board. The OEB is charged with a responsibility to set "just and reasonable rates" for electricity. The OEB "rate setting process establishes base rates for each distribution utility through a comprehensive review of the utility's costs as detailed in its rates application." The "Green Button" initiative was an industry-led effort that responded to a 2012 White House call-to-action to provide utility customers with easy and secure access to their energy usage information in a consumer-friendly and computer-friendly format for electricity, natural gas, and water usage. The restructuring proposed by LHI at the time was to establish a retail affiliate to address the regulator requirement to distinguish a utility's cost of providing the regulated service from other expenses. The expense associated with the development of Green Button products for use by other utilities must be transparent and must be excluded from the cost of providing electrical service to London consumers. This obligation would be aided by the operation of discrete corporate organizations.

In January 2020, Council directed staff to review and complete a detailed analysis of the proposed restructuring. That report was provided to Strategic Priorities and Policy committee in October 2020 and Council then directed staff to investigate the option of creating an unregulated company that would compare with the option proposed by LHI.

The report comparing the options was provided in January 2021 and at its meeting on February 2, 2021, the Council resolved that the following actions be taken with respect to the comparison of proposed London Hydro Inc. restructuring options:

a) the report dated January 26, 2021 entitled "Comparison of Proposed London Hydro Restructuring Options", BE RECEIVED;

b) the Civic Administration BE DIRECTED to report back to a future meeting of the Strategic Priorities and Policy Committee with the necessary by-laws and documentation to implement the proposed "Newco Option" with respect to London Hydro Inc. restructuring;

c) the Civic Administration BE DIRECTED to advise the Board of London Hydro Inc. that the Municipal Council will not be proceeding with the proposed "Holdco Option"; and,

d) the Board and staff of London Hydro Inc. and the Civic Administration of the City of London, BE THANKED for the work undertaken with respect to London Hydro Inc. restructuring.

Attached as Appendix "A" is the January 26, 2021 report entitled "Comparison of Proposed London Hydro Restructuring Options" for ease of reference and which outlined the differences between establishing a Municipally owned "Newco" versus a Retail Affiliate with the proposed restructuring of London Hydro.

2.2 Purpose of the Proposed "Newco"

The Newco was to be an Ontario Business Corporation, owned by the City and created under the authority of section 142 of the Electricity Act: https://www.ontario.ca/laws/statute/98e15#BK360

For reasons discussed in the previous reports, Newco was to take ownership (at market value cost to the City) of LHI's unregulated assets, including solar generation equipment and Green Button technology services to third parties, when requested to do so by LHI. There has been no request and LHI has recently advised that due to changed conditions, there will not be a request.

LHI can continue to own the solar assets and despite the absence of an Ontario market for its Green Button services, can consider offering those services in other jurisdictions through such means as LHI considers appropriate.

2.3 Actions Taken and Current Status

Clause b) of the February 2, 2021 Council Resolution directs staff to report back with the documents needed to create a "Newco". Since that time, Civic Administration met on several occasions and exchanged correspondence with London Hydro representatives to discuss the requirements, timing, and next steps to proceed with the implementation of the proposed “Newco Option”. At each meeting, it was reported by LHI that there was no immediate need for the affiliate due to extensions that LHI had received from the OEB. It has now been reported that the Newco will not be required.

3.0 Financial Impact/Considerations

3.1 LHI Impact

LHI proposed the incorporation of a retail affiliate to facilitate the continued development of its Green Button technology and the sale of Green Button services to a broad range of customers. Given LHI’s recent advice concerning the lack of market opportunity, the absence of the proposed retail affiliate will have no impact.

3.2 London Hydro Dividend

In accordance with Article 5.4(a) of the Shareholder Declaration (2016), the City receives an annual dividend in the amount of $5.0 million, which is paid to the City on a quarterly basis. Article 5.4 is shown below:

> 5.4 Dividend Policy. The Board shall use its best efforts to declare and pay a regular dividend to the Shareholder. The payment of any dividend shall be subject to the following:
>
> > (a) As a target, annual dividend payment are expected to comprise 40% of annual net earnings of the Corporation;
> >
> > (b) Where annual net earnings of the Corporation exceed normal net earnings, the Board shall consider declaring a special payment in an amount equal to such excess net earnings; and
> >
> > (c) No dividend is to be declared where to do so would, in the Board’s reasonable opinion, impair the Corporation’s ability to carry out necessary or appropriate improvements and maintenance of existing infrastructure.

Civic Administration met with the Chief Financial Officer; Vice-President of Finance of London Hydro to discuss the future forecasted annual net earnings and if there was any potential opportunity for the declaration of a special dividend. Based on the projection that net earnings will remain consistent and estimated future cash outlays required to support capital infrastructure needs, it is not anticipated that any additional earnings will be available in the next few years to support the consideration of a special dividend payment.

Conclusion

London Hydro has now advised Civic Administration that there is no Green Button opportunity in Ontario. On this basis, staff recommend that no further action be taken with respect to the creation of a retail affiliate.

Prepared by: **Barry Card, Deputy City Manager, Legal Services**
Concurred by: **Anna Lisa Barbon, Deputy City Manager, Finance Supports**
Recommended by: **Lynne Livingstone, City Manager**

APPENDIX A

Report to Strategic Priorities and Policy Committee

To: **Chair and Members**
Strategic Priorities and Policy Committee

From: **Lynne Livingstone, City Manager**

Subject: **Comparison of Proposed London Hydro Restructuring Options**

Date: **January 26, 2021**

Recommendation

That, on the recommendation of the City Manager with the concurrence of the Managing Director, Corporate Services and City Treasurer, Chief Financial Officer and the Managing Director, Corporate Services and City Solicitor, the following actions be taken:

a) the report dated January 26, 2021 titled “Comparison of Proposed London Hydro Restructuring Options” Be Received;

b) Council consider the options for restructuring and if content to proceed, Civic Administration Be Directed to prepare a subsequent report with the content of the shareholder declaration, if required.

Executive Summary

Staff have, as directed, undertaken a comparison of the “Newco” and “Holdco” restructuring options.

The Newco option anticipates the incorporation of a new business corporation. The unregulated business of London Hydro would be transferred to and conducted by the Newco. Council would be the shareholder of each entity.

The Holdco option anticipates the incorporation of two new business corporations, a “Holdco” and a retail affiliate “LUSI”. Under the Holdco structure, the City would be the shareholder of the Holdco and the Holdco would be the shareholder of LHI and LUSI.

We conclude that both options are equally suited to the goal of separating the regulated and unregulated businesses carried on by London Hydro, when conditions warrant this separation. That point is reached, when and if, in the opinion of London Hydro, the developing retail technology business expands beyond a scale that can be justified as ancillary to the electrical distribution function of London Hydro.

The primary difference between the options is one of control. Under the Holdco structure, the Council will have no direct involvement with either of the regulated and unregulated entities. The Council will have direct involvement with the Holdco itself. Under the Newco option, the regulated and unregulated businesses currently carried on by LHI are split between LHI and the Newco. The City would continue to have direct involvement as the shareholder of each.

There is no expected difference between the options with respect to taxation and net revenue. There may be a difference in dividends and liability risk to the City, depending upon the contents of the shareholder declarations. For example, dividends are determined by the Board of an entity. If a subsidiary of the Holdco determines that it should reinvest earnings in its business and not pay a dividend to the Holdco, the City will be so informed. As to direct risk, the risk to a shareholder increases if management powers are withdrawn from the control of the Board of Directors by the shareholder. On the other hand, if no powers are withdrawn from the Board, there is no shareholder liability. That can be considered at the next step.

Linkage to the Corporate Strategic Plan

Council's 2019-2023 Strategic Plan includes the Strategic Area of Focus 'Leading in Public Service', which outlines the following:

- Expected Result: Maintain London's finances in a transparent and well-planned manner to balance equity and affordability over the long term.
- Strategy: Continue to ensure the strength and sustainability of London's finances.

Analysis

1.0 Background Information

1.1 Previous Reports Related to this Matter

Strategic Priorities and Policy Committee, meeting on October 20, 2020, agenda item 4.1 - London Hydro Proposed Corporate Restructuring
https://pub-london.escribemeetings.com/filestream.ashx?DocumentId=75626

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1.2 Previous Municipal Council Actions

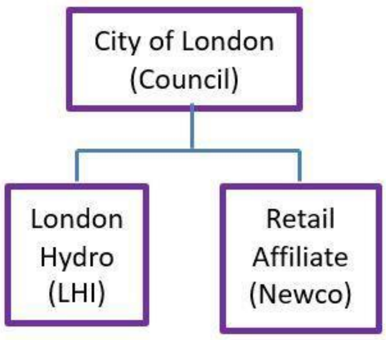
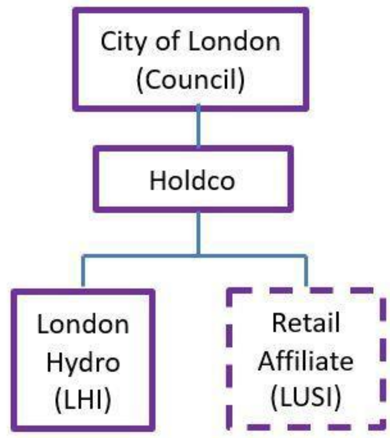
At its meeting of October 20, Municipal Council received a report that outlined, as recommended by KPMG in the January 23, 2020 Strategic Priorities and Policy Committee report, a detailed legal review and risk assessment of the draft Shareholder Declaration documents to ensure that key terms are aligned with City's objectives and interests, and do not create additional risk and exposure. Municipal Council requested further information with respect to options for the proposed London Hydro Restructuring and passed the following motion:

"That the following actions be taken with respect to proposed Corporate restructuring to London Hydro:

a) the staff report dated October 20, 2020 with respect to the restructuring proposal by London Hydro Inc. (LHI) BE RECEIVED for information; and
b) the Civic Administration BE DIRECTED to investigate the option of creating an unregulated company and bring forward a report that would compare this option with the options outlined in the above-noted report;"

In response to the direction above, Civic Administration and London Hydro have exchanged information with respect to the option of creating an unregulated retail affiliate entity. An evaluation framework was created to compare the option of a municipally owned LHI and retail subsidiary with the option proposed for the restructuring of London Hydro by the Board for a municipally owned Holdco Subsidiary with Holdco owned LHI and retail affiliate. Table 1 below depicts in graphical form the two options for an unregulated entity that will be compared later in the report.

Table 1: Alternatives for Municipally-Owned Retail Subsidiary

Option 1	Option 2
Municipality Owned LHI and Retail Subsidiary	**Municipally Owned Holdco Subsidiary with Holdco-owned LHI and Retail Affiliates**
	

2.0 Discussion and Considerations

2.1 Evaluation Framework for Comparison of Restructuring Options

The purpose of restructuring is to facilitate the continued development of the unregulated ("Green Button") component of London Hydro's business. The Green Button business has been developed ("incubated") by London Hydro without restructuring. In its July 2018 submission to the OEB regarding rates, LHI said:

"*London Hydro would re-iterate, as we have in our application and response to the Board staff questions, that the business line we are promoting leverages existing open source technology emulated by London Hydro for our own customers and that our intent is only to expand the customer base to which capital and operational costs can be spread over therefore benefitting both London Hydro and external customers.* ***Section 71(4) provides us that ability without the complications of creating an affiliate. The genesis of Section 71(4) implementation was the result of Bill 112, Strengthening Consumer Protection and Electricity System Oversight Act, 2015. Obviously the government realized the limitations placed on electricity distributors in expanding its line of business outside of its franchise by requiring affiliates.*** *London Hydro would emphasize that the Green Button platform is an open source platform designed for the metered utility industry as a whole (i.e. natural gas, electricity and water and other) for the basic purpose of promoting energy conservation, consumer education, and increasing utility efficiency. London Hydro would suggest that this proposal is not intended to compete against private enterprise. In fact opening up the Green Button market should allow third parties to take advantage of the technology to create standard based applications for new market opportunities*. (Emphasis added).

There is no immediate need to restructure and as London Hydro notes, the creation of affiliates does cause "complications". The comparison framework set out below is intended to facilitate the comparison exercise and identify the complications.

Civic Administration and London Hydro staff have developed a table for comparison of the two options for restructuring.

The two options for an unregulated entity comparison are as follows:

1. Municipally Owned Retail Subsidiary – "Newco"
2. Proposed Restructuring with a Holding Company – "Holdco"

The various items for consideration and contrast between the two options are shown in the table that follows:

Item	Newco	Holdco	Comments
OEB Regulatory Oversight	No oversight by the OEB.	No oversight by the OEB.	
Affiliate Relationships Code (ARC)	OEB Affiliate Relationships Code applies.	OEB Affiliate Relationships Code applies.	
Investment	Investment decisions made by Board of Newco guided by the shareholder declaration.	Investment decisions made by Board of Holdco guided by the shareholder declaration.	Under the Holdco structure, investment decisions affecting the subsidiaries, London Hydro and the new retail corporation, would be guided by the shareholder declaration for each, established by the Holdco as owner.
Liabilities	Liabilities can flow through to the owner (the City), when the shareholder declaration removes discretion concerning a matter from the Board of Directors.	Liabilities can flow through to the owner (the City), when the shareholder declaration removes discretion concerning a matter from the Board of Directors.	Under the Holdco structure, the City would not be the owner of the subsidiaries and would not be liable with respect to powers withdrawn by the shareholder declarations from the Boards of the subsidiaries.
Insurance	Insurance would be the responsibility of the Newco with the assistance of the City.	Insurance for all three entities would be arranged by the Holdco.	
Degree of Control by Council	Shareholder Declaration sets limits on Newco Board powers.	Shareholder Declaration sets limits on Holdco Board powers.	Under the Holdco structure, no direct Council control over shareholder declarations for the subsidiaries.
Appointment of Directors	Appointed by Council.	Appointed by Council.	Under the Holdco structure, no Council power to appoint Directors to Boards of the subsidiaries.
Business Focus	Council approved shareholder declaration for each of LHI and Newco.	Council approved Shareholder Declaration for Holdco: Holdco approved shareholder declaration for each of LHI and the new retail entity.	
Tax Implications	No material difference (to be confirmed*).	No material difference (to be confirmed).	*Expert tax advice will be required for Newco in particular as LHI did not examine this possibility.

Item	Newco	Holdco	Comments
Liability Risk to City	City assumes risk of decisions withdrawn from Boards of Newco and LHI.	Holdco assumes risk of decisions withdrawn from Boards of LHI and new retail entity.	
Dividend Considerations	Newco Board decision.	Holdco Board decision.	
Independence	Independent subsidiaries of the City.	Holdco affiliates can be less independent of each other, if desired.	
Impact on London Hydro	No impacts (status quo).	No immediate impacts expected as a result of the change of ownership.	
Confidentiality	More of a challenge with direct City ownership, due to transparency requirements of legislation.	Can conduct business as confidentially as the Board considers appropriate.	
LHI Management "Flexibility" to develop unregulated business	Constrained due to the potential for external scrutiny.	Such flexibility and discretion as the owner (Holdco) considers advisable.	
Timeline Implications	Newco can be incorporated immediately to own the generation assets and could be used in future as the retail subsidiary or as a holding company.	Much legwork has been done.	OEB approval required for any generation asset transfer from LHI. LHI can continue to develop its retail product in either case, on an interim basis. The establishment of a retail entity under the Holdco structure would require additional steps.

3.0 Key Issues and Considerations

3.1 Comparison of Restructuring Options

Civic Administration and LHI staff discussed and reviewed the various items contrasted between the two options for creating an unregulated business entity as shown in the table above. Both parties reached the conclusion that there is no material difference between the options, from a functional perspective.

The solar generation assets and retail business can readily, with OEB approval, be transferred to a new unregulated business entity owned by the City or the Holdco.

It is also believed that from a taxation perspective there is also no material difference between the two options, however, this would need to be confirmed with expert tax advice for Newco in particular as LHI did not examine this possibility in its restructuring work.

The Holdco approach clearly diminishes the Council's involvement in both London Hydro and the proposed retail entity, LUSI. The question is whether or not this change can be justified by the intangible benefit of the potential "business focus" brought to the Boardroom of each corporation by Directors that are not members of the Council.

Differences between the two options for an unregulated business entity are mainly related to the subtle consequences of direct municipal ownership (i.e, priorities, confidentiality and "business distance").

London Hydro has prepared a summary of what it describes as the advantages of the Holdco approach which are not apparent from the comparison table. This summary is attached as Appendix "A" to this report and cites the following:

1. The Holdco option will achieve stronger synergies and strategic coordination,

2. The Holdco option has relatively lower downside risk, and

3. The Holdco option is the norm among municipal electrical utilities.

As to the first "difference", Affiliates are subject to Rules under the OEB "Affiliate Relationships Code". These rules require that:

2.2.1 Where a utility provides a service, resource, product or use of asset to an affiliate or receives a service, resource, product or use of asset from an affiliate, it shall do so in accordance with a Services Agreement, the terms of which may be reviewed by the Board to ensure compliance with this Code. The Services Agreement shall include:

(a) the type, quantity and quality of service;

(b) pricing mechanisms;

(c) cost allocation mechanisms;

(d) confidentiality arrangements;

(e) the apportionment of risks (including risks related to under or over provision of service); and

(f) a dispute resolution process for any disagreement arising over the terms or implementation of the Services Agreement.

A services agreement is required in either case and consequently, the looked for "Synergies" should be possible under both scenarios.

Is there a difference in the level of risk to the City as a result of the Newco structure? As mentioned previously, there is no inherent legal risk to the shareholders of a business corporation. Subsection: 92(1) of the Business Corporations Act provides that "The shareholders of a corporation are not, as shareholders, liable for any act, default, obligation or liability of the corporation". There are a few exceptions. The exception which could apply (to each of the proposed entities and presently applies to LHI) is subsection 108(5) of the Act, which pertains to restrictions imposed by a shareholder agreement or declaration.

Section 108(5) says that: "A shareholder who is a party to a unanimous shareholder agreement has all the rights, powers, duties and liabilities of a director of a corporation... to the extent that the agreement restricts the discretion or powers of the directors to manage or supervise the management of the business and affairs of the corporation and the directors are relieved of their duties and liabilities, including any liabilities under section 131, to the same extent". Consequently, while shareholders are not generally liable for the actions of the corporation they own, they are responsible for actions they have directed by means of a shareholder agreement or declaration.

Under the Newco structure, the City would be responsible for the consequences of restrictions on the discretion or powers of the directors of the Newco, if these restrictions in a particular case interfere with the ability of the directors to supervise the management of the business of the Newco. The same is true under the Holdco structure: the City is responsible for the consequences of restrictions on the discretion or powers of the directors of the Holdco, if these restrictions interfere with the ability of the directors to supervise the management of the business of the Holdco.

The difference in risk is that under the Holdco structure, any shareholder declaration respecting LHI and LUSI will be imposed by the shareholder of those entities, which is the Holdco. If the Holdco restricts the powers of the directors of LUSI, the Holdco is answerable, not the City. If the City restricts the powers of the directors of Newco, the City is answerable. Needless to say, if there is no restriction of powers, there is no difference to the risk.

While the Holdco structure is a common form of municipal ownership, the statistic does not reveal an operational advantage of any type. The Holdco approach does offer flexibility for joint ownership and mergers, but that is not being considered in this case. The purpose of the proposed “restructuring” is to separate the regulated and unregulated businesses. That can be achieved through either structure. Under either structure, LHI would continue to pursue opportunities to develop its retail business on an interim basis as it has proposed. A new corporation can be created and ready to receive the generation assets and retail business when conditions warrant.

There is no business advantage to transferring ownership of LHI to the Holdco at this time, as the Holdco has no real purpose until the retail business has grown and requires separation from LHI.

As a note, the electricity regulator, the Ontario Energy Board, encourages electricity distributors, such as LHI, to maintain transparency with respect to the rates charged for electricity, regardless of the corporate structure adopted. The OEB, in its “Handbook to Utility Rate Applications”, comments that:

“*There may be aspects of the corporate business plan that are not relevant to the OEB’s review of a rate application. The OEB will consider non-regulated activities and transactions with affiliates in the context of their effect on the regulated rates to customers to ensure there are no cross subsidies that negatively affect these regulated customers.*

Depending on the corporate structure of the utility, this could include an assessment of:

- *The reasonableness of the costs allocated to non-regulated activities within the regulated utility*
- *The costs to be charged to the regulated utility from an affiliate*
- *The revenues forecast to be received from an affiliate for services provided by the regulated utility*
- *Whether these activities affect the quality of services to be delivered to the customers of the regulated utility*
- *Whether non-regulated activities will affect the financial viability of the regulated utility or introduce a significant enough risk that it affects debt financing costs”.*

The separation of the regulated and unregulated businesses can assist the review process by segregating the income and expenses of each. Either structure can achieve that advantage.

3.2 Options and Next Steps for Council

Municipal Council has the following options to consider:

1. Leave the London Hydro structure as it is indefinitely, in which case, LHI will continue to develop the retail business within the parameters permitted by the OEB,
2. Approve the creation of a new Ontario Business Corporation, owned by the City, for the purpose of assuming and conducting the unregulated retail businesses and receiving ownership and control of the solar generation assets of LHI at such time as LHI may recommend, or;
3. Approve the proposed restructuring model originally suggested by LHI, which is to transfer ownership of LHI to a new holding corporation, owned by the City, where the holding corporation would thereafter own and control both the regulated and unregulated activities currently performed by LHI.

Civic Administration would need to return with a further report based on the option selected by Municipal Council including a draft shareholder declaration if applicable (not required for option one).

Should Council wish to obtain more information about the business for the proposed unregulated entity this information would need to be received in camera given the trade secret or scientific, technical, commercial, financial or labour relations information, supplied in confidence to the municipality, which if disclosed could reasonably be expected to prejudice significantly the competitive position or interfere significantly with the contractual or other negotiations of London Hydro Inc.

Conclusion

Civic Administration and London Hydro staff have reached the conclusion that a Municipally Owned Retail Subsidiary ("Newco") and the proposed LHI restructuring with a Holding Company ("Holdco") are not materially different, provided that Newco takes the solar generation assets and qualifies as a Municipal Electricity Utility, regardless of the name it takes, who owns the shares, and whether Newco performs a holding function or the actual retail business. Differences between the two options for an unregulated retail affiliate entity are mainly related to the consequences of direct municipal ownership.

Recommended by:	**Lynne Livingstone, City Manager**
Concurred by:	**Barry Card, Managing Director, Corporate Services and City Solicitor**
Concurred by:	**Anna Lisa Barbon, Managing Director, Corporate Services and the City Treasurer, Chief Financial Officer**

c. V. Sharma, CEO London Hydro
G. Valente, Chair London Hydro

Appendix “A”

To: Barry Card, City Solicitor, City of London

From: Vinay Sharma, CEO, London Hydro

Date: January 11, 2021

Subject: Evaluation Framework for Comparison of Two Options

This memo is a follow up to our recent meetings and exchange of emails regarding the comparison of the municipally-owned subsidiary “Newco” option and the London Hydro proposed “Holdco” option. Although there are many similarities between the two options as outlined in the Evaluation Framework, there are also some important differences between the two which are not so apparent in the framework, but which have implications for business challenges, performance and risks.

1. The Holdco option will achieve stronger synergies and strategic coordination

While in theory an independent corporation such as Newco could undertake the marketing of London Hydro-developed technologies, separating it from oversight of a Holdco would hinder ongoing coordination with London Hydro and limit the achievement of synergies between the two entities. One reason why firms in the private sector establish holding company structures is to ensure that separate businesses operating at different stages of the value chain – such as technology development and marketing – are centrally coordinated in their strategic planning and operational activities so that they pursue a set of common goals. Holdco management and directors are responsible for integrating the strategies of the different businesses, continuously monitoring joint performance, and resolving any differences that may occur.

An independent Newco, which would be overseen by and report to the Corporation of the City of London, would not be able to replicate the same degree of ongoing coordination and strategic integration with London Hydro as would be achieved under the Holdco option. The appointment of some common directors to the board of Newco could provide a channel for coordination but, ultimately, as an independent corporation its management and board would have to pursue their own strategy and could potentially diverge from that of London Hydro.

2. The Holdco option has relatively lower downside risk

Another difference between the two options is in the level of upfront investment costs and the approach to managing risk/reward as marketing and business development activities grow over time. The Holdco option pursues an incremental strategy in parallel with the growth of the Holdco’s market share, thus requiring minimum upfront investment. There are two incremental steps: in the first, new sales opportunities would be explored through the Holdco, which reduces the administrative cost of growing the business. Only if sales development is successful and achieves sufficient scale would the second step be taken – which would be to establish a new marketing subsidiary with its own employees.

Unlike the Holdco option (which is scalable and incremental), the Newco option would take on the risk of being fully independent right from its inception. This “step change” approach means that Newco would have to develop its own independent business strategy, marketing strategy as well as sales strategy from the onset, thus requiring a larger initial investment than that of the Holdco option.

3. The Holdco option is the norm among municipal hydros

Our recommendation of the Holdco option is consistent with best practice in Ontario’s electricity sector for structuring unregulated subsidiaries. There are 65 LDCs in Ontario, of which a large majority (59%) have created Holdco's for their subsidiaries. Examples include LDCs in mid-sized cities such as Burlington, Oakville and Ottawa. We do not know of any municipality that has created an independent, free-standing corporation – as envisaged in the Newco option – to develop LDC-related businesses. We believe that the consensus choice of Holdco structures among other municipalities reflects the superior business risk/reward balance achieved by the Holdco option relative to other options.

We appreciate the fact that the Holdco option would introduce a governance entity between London Hydro and Council. Nevertheless, Holdco is directly accountable to Council, who can exert its control and oversight over London Hydro through various mechanisms enshrined in the Shareholder Agreements. To this end, we have proposed statutory rights as well as additional approval rights of the shareholder in the previously submitted draft shareholder agreements. Equally apropos to those rights, it is suggested to provide tools to allow for the growth of the unregulated business i.e. seeking partners to expand marketing opportunities. If needed, additional statutory rights of the shareholder could be considered for inclusion in the Shareholder Agreements while keeping in balance a measure of flexibility to allow Holdco to grow the unregulated business opportunities. In other words, the above mechanisms would ensure there is no less degree of control for Council under the Holdco option than the Newco option. It is important to emphasize that municipal control need not be a variable under the two options.

The major difference between the two options is the relatively larger business, operational and financial risk associated with the Newco option. Having been very close to the development of key London Hydro technologies and services and with experience in marketing these services, I believe that the Newco would be a high-risk business model. In spite of this, if the City of London elects to follow the Newco approach, then London Hydro would assist. However, as an independent, unregulated corporation, the Newco would be legally responsible for formulating its own business, marketing and sales strategies.

4. Summary

London Hydro has developed a strong technology and innovation culture over the last 10 years which has led to the creation of a new utility technology platform and process automation services. Commercializing these resources and capabilities can benefit all the stakeholders of London Hydro. However, given the symbiotic relationship between technology development and marketing, structural separation of marketing in an independent Newco would introduce considerable hurdles to its success. Thus, from my perspective, there are only two practical options for achieving the goal of continued growth of London Hydro's unique technologies: (i) the Holdco option proposed previously, or (ii) the status quo. In the status quo option, London Hydro would continue to sell its technologies and services in a limited manner in accordance with the OEB sanctioned Bill 112 approval – London Hydro would periodically seek renewal of this approval.