TO:	**CHAIR AND MEMBERS STRATEGIC PRIORITIES AND POLICY COMMITTEE MEETING OF FEBRUARY 13, 2017**
FROM:	**MARTIN HAYWARD MANAGING DIRECTOR, CORPORATE SERVICES & CITY TREASURER, CHIEF FINANCIAL OFFICER**
SUBJECT:	**ASSET REVIEW: LONDON HYDRO INC. – DISCUSSION PAPER**

RECOMMENDATION

That on the recommendation of the Managing Director, Corporate Services and City Treasurer, Chief Financial Officer the following actions regarding the review of London Hydro Inc. be taken:

1) the discussion paper regarding London Hydro and potential alternatives provided in Appendix 'A' **BE RECEIVED** for information;

2) in order to fulfil previous direction from Municipal Council on December 6, 2016, Civic Administration **BE AUTHORIZED** to engage a consultant with industry-specific knowledge to assist with a strategic review of London Hydro, addressing financial, economic and legal implications related to possible mergers, acquisitions, amalgamations, partnerships and dispositions.

PREVIOUS REPORTS PERTINENT TO THIS MATTER

December 13, 2016: "Review of Corporate Assets: Initial Scoping Report," Strategic Priorities and Policy Committee

December 5, 2016: Delegation by London Hydro regarding a possible merger opportunity, Strategic Priorities and Policy Committee

July 28, 2014: "London Hydro Promissory Note to the City of London," Strategic Priorities and Policy Committee

October 21, 2013: "Proposed Public Education, Dialogue, and Consultation Plan for Future of London Hydro Inc.," Strategic Priorities and Policy Committee

June 10, 2013: Presentation by Navigant Consulting titled "London Hydro Strategic Refresh," Strategic Priorities and Policy Committee

PURPOSE OF REPORT

On December 6, 2016, Municipal Council resolved the following:

> *That the Civic Administration BE DIRECTED to report back at a future meeting of the Strategic Priorities and Policy Committee, with respect to potential financial, economic and legal implications that may result from London Hydro investigating possible mergers, acquisitions, amalgamations and dispositions, which may include taking on strategic partners.*

In addition, Council has given direction for the scoped review of municipally-owned assets, including corporations wholly owned by the City of London, such as London Hydro.

This report provides a preliminary response to those directions and requests authorization to engage external advice for a strategic review of London Hydro.

BACKGROUND

For more than a decade, successive municipal councils have considered the future of London Hydro Inc., taking a variety of positions regarding one of the community's most significant assets. Although the utility provides consistent returns to the City as the sole shareholder, there has been a growing desire to assess whether or not additional opportunities should be pursued.

A delegation was made by London Hydro at the December 5, 2016 Strategic Priorities and Policy Committee concerning a potential merger opportunity and the need to explore options due to the evolution of the local electricity distribution sector. The conversation prompted Council to request further information from Staff about London Hydro and potential alternatives

Since that meeting, London Hydro has informed the Civic Administration that the merger opportunity has not materialized. As a result, there will not be a pressing need for Council to make a determination on London Hydro's future based on an emergent issue. The ongoing asset review process provides an appropriate vehicle for an assessment of London Hydro and potential alternatives available to Council.

To assist with conversations about the future of London Hydro, Staff engaged Dr. Philip Walsh to prepare a discussion paper about the Ontario local electricity distribution sector, London Hydro's financial performance, and potential alternatives for the future of the utility (Appendix 'A'). Dr. Walsh is an associate professor at Ryerson University's Ted Rogers School of Management and has published extensively on the Ontario electricity generation and distribution sectors. The discussion paper was principally authored by Dr. Walsh, with input and information from London Hydro and City staff.

The discussion paper has been structured in a "Questions and Answers" format to provide information that is anticipated to be of help at the start of the review process. The questions are as follows:

- *"How did the Ontario electricity sector evolve to date and what future evolution is likely?"*
- *"Who controls what aspects of the Local Distribution Company?"*
- *"How has London Hydro performed?"*
- *"What are the City's options for London Hydro?"*
- *"What are some Municipally-owned LDCs from other jurisdictions doing?"*

Additionally, the paper presents high-level benefits and challenges associated with the alternatives. These are presented without bias and are based on industry-accepted perspectives. No recommendations are suggested by the discussion paper.

DISCUSSION

Staff do not believe that in-house expertise exists to assist Council with a detailed evaluation the issues and alternatives identified in the Council resolution and presented in the discussion paper. Such analysis would include strategic, legal, social and environmental considerations, as well as a financial assessment of valuation and potential returns through a merger, acquisition or sale. Importantly, the analysis will also flesh out the "Status Quo" alternative, which may be the ultimate recommended course of action.

The MaRS Advanced Energy Centre has produced an aid[1] to assist with envisioning the types of issues that Council will need to have addressed. A sample of strategic questions include:

- Will companies like (London Hydro) still exist in the future?
- Whose interest(s) are you including in your business case?
- What does the consumer expect of its utilities?
- How do we maximize existing assets?
- What is required from the regulatory body for utilities to get to where they want to go?
- How do utilities mitigate the risks of legal frameworks lagging behind sector evolution?
- How proactive should utilities be to anticipate the regulatory changes that impact their business?
- What partnerships need to be made with other companies, outside of the utility sector?

[1] Newtonian Shift Workshop materials, provided by MaRS to the London Hydro Board of Directors (Dec. 2016).

It is therefore recommended that Administration be authorized to engage a consultant(s) for the detailed review. It should be noted that reviews of local distribution companies is a highly specialized field, with a small number of firms that have sufficient experience, knowledge and expertise.

London Hydro is supportive of this approach and has provided additional topics for consideration by the consultant:

- Current Ontario Local Distribution Company industry landscape, including merger, acquisition, amalgamation and divestiture activities;
- Corporate evaluation of London Hydro;
- Regulatory and legislative risks for London Hydro;
- Cap and trade risks for London Hydro;
- Future business risks for London Hydro (e.g., capital needs to enable the utility to serve as a Distribution System Operator);
- Dividends risks; and,
- Risk mitigation plans.

It is estimated that the cost of a consulting engagement could be upwards of $30,000. Figure 1 below provides a suggested review timeline.

Figure 1: Proposed Review Timeline

Action	Timing	Notes
Engage consultant	March 2017	Administration will engage the consultant that provides the best value to the City.
Committee discussion regarding vision, principles and priorities	April 2017 SPPC	The consultant will facilitate a discussion to help frame the review and expectations.
Analysis of alternatives by consultant	April 2017 – September 2017	Analysis of alternatives will include information and support from City staff and London Hydro staff.
Report to Committee regarding alternatives and recommendations	October 2017 SPPC	The report will provide recommendations and next steps for Committee and Council consideration.

External Interest in London Hydro

As a result of the efforts of a member of Council, Staff have received correspondence from several interested parties about the review process and to request an opportunity to express the value they could contribute to the City from a partnership or through the acquisition of London Hydro. These individuals have been informed that further direction is being sought from Council through this report and that no decision has been made about the future of the utility at this time.

Should Council wish to explore all options associated with London Hydro, it is suggested that interested parties be provided an opportunity to articulate their perspectives on the Local Distribution Company sector and interests in London Hydro.

CONCLUSION

A discussion paper providing background information on London Hydro and potential alternatives is provided in Appendix 'A'. The paper serves as a foundation for future discussions about the utility.

Staff are requesting authorization to engage a consultant to assist with a strategic review. Over the coming months, the consultant will perform extensive analysis of the financial, legal, social and environmental considerations regarding alternative futures for London Hydro. In conjunction with the consultant, Civic Administration will return with information and recommendations for Committee and Council consideration later this year.

Acknowledgement: This report was prepared with the assistance of Jon-Paul McGonigle, Manager, Information Technology. It is noted that Dr. Philip Walsh prepared the discussion paper without compensation. Administration would like to extend appreciation to Dr. Walsh for providing a well-researched discussion paper in a tight time period.

PREPARED AND SUBMITTED BY:
PAUL YEOMAN **BUSINESS PLANNING PROCESS MANAGER** **FINANCE AND CORPORATE SERVICES**
REVIEWED AND RECOMMENDED BY:
MARTIN HAYWARD **MANAGING DIRECTOR, CORPORATE SERVICES AND CITY TREASURER, CHIEF FINANCIAL OFFICER**

cc. Art Zuidema, City Manager
Jennifer Smout, Solicitor II

Appendix 'A': Discussion Paper on the Role of London Hydro

Appendix ‘A’: Discussion Paper on the Role of London Hydro

Discussion Paper for the Role of London Hydro

February, 2017

London Hydro

Prepared by:
Philip Walsh, Ph.D., Associate Professor, Ryerson University
Finance & Corporate Services, City of London
London Hydro, Inc.

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London
CANADA

London Hydro

At the request of City Council, the following Discussion Paper has been prepared to form part of the review of London Hydro Inc. (“London Hydro”). This review of London Hydro’s future will include consideration of the long term sustainable value of the utility to its sole shareholder, the City of London.

This Discussion Paper is intended to provide information about London Hydro and the Local Distribution Company (“LDC”) sector and is organized around 5 principal topics:

i. **Sector Structure Evolution:** An overview/background of the electricity distribution sector in Ontario including the current regulatory environment and its future direction.

ii. **Control Considerations:** A discussion of who controls what aspects of a LDC, such as London Hydro.

iii. **Performance Considerations:** A review of London Hydro’s performance.

iv. **Options:** Strategic options available to the City of London including maintaining the status quo of London Hydro, merging London Hydro with another LDC, having London Hydro acquire another LDC, for selling all or part of London Hydro.

v. **Examples:** Examples from other jurisdictions regarding municipally-owned electric utilities are illustrated.

Specific questions were developed to address each of these topics; the answers endeavour to provide Council and the community with preliminary information needed to make informed decisions about the future of the utility.

Sector Structure Evolution

Q.

How did the Ontario electricity sector evolve to date and what future evolution is likely?

A.

The genesis of today's Ontario electrical generation, transmission and distribution sector began in the early 1900's with a campaign by Ontario's business leaders and politicians, including London's own Sir Adam Beck, to develop facilities to connect communities in the Province to the electricity that was then being generated at Niagara Falls.

In 1906, the Government of Ontario established the Hydro-Electric Power Corporation (eventually known as Ontario Hydro) to manage the transmission of electricity from Niagara Falls to new and existing LDCs.

By 1923 there were over 390 LDCs supplying electricity to customers in municipalities across the province. Ontario Hydro supplied almost all of these LDCs with electricity through its own generation and transmission facilities. This remained the structure of Ontario's electricity sector for a further 73 years. The structure was and is unique in Canada – no other province has more than a few municipally-owned distribution utilities. LDCs were structured as public utility commissions and did not generate profits for their municipalities.

In 1996, the Ontario Government appointed the Macdonald Commission to review the industry's structure. Among other things, the committee recommended that the 307 municipally-owned LDCs be merged along with Ontario Hydro's rural distribution system to create large LDCs whose distribution areas would extend to regional and county boundaries. Although the Macdonald Commission's recommendation was not followed by the Government of Ontario, municipal governments were subsequently required to convert their LDCs from public utility commissions into business corporations, in a move that was conceived to enable larger LDCs to purchase smaller LDCs.

Sector Structure Evolution

In 1998, the Independent Electricity System Operator ("IESO") was created to manage the new electricity marketplace and to ensure reliability of provincial supply and service to the LDCs. After 1998, the manner in which LDCs distribution rates were regulated also changed. Previously Ontario Hydro regulated distribution rates but after 1998 the Ontario Energy Board ("OEB") was granted regulatory authority over services and rates for LDCs and electrical transmission companies.

By 2000, the number of LDCs had reduced from 307 to 89.[1] Some of the reduction in LDC numbers occurred through mergers of smaller LDCs into larger ones. Many small LDCs, however, were sold outright. Of the many small LDCs acquired, 88 were bought by Hydro One Networks, created along with Ontario Power Generation when the provincially-owned Ontario Hydro was split into an electric distribution company (Hydro One) and an electric generation company (Ontario Power Generation). The break-up of Ontario Hydro was part of a broader process that saw the introduction of a competitive electricity market and separation of competitive activities such as generation from monopoly activities such as transmission and distribution.

Subsequently, a number of other significant changes have occurred:

- In 2004, the Ontario Power Authority was created to provide planning for all aspects of the province's electricity system and the acquisition of renewable power.
- In 2009, LDCs were given the power to develop and operate their own small-scale renewable energy and distributed generation facilities. They were also now encouraged to implement conservation and demand management initiatives such as smart meters and smart grid technologies.

In April 2012, in response to concerns over rising electricity costs, the Provincial Government established the Ontario Distribution Sector Review Panel to provide expert advice on how to improve efficiencies in the sector with the aim of reducing the financial cost of electricity distribution. The Panel recommended consolidation of the 73 remaining LDCs into 8 to 12 larger regional LDCs and that the Government of Ontario use its powers to achieve this consolidation. To date the Province has not followed through on this recommendation, hoping instead that consolidation will occur through voluntary action on the part of LDCs.

Figure 1 provides a graphic illustration of Ontario's electricity supply chain, demonstrating London Hydro's "fit" in the broader system.

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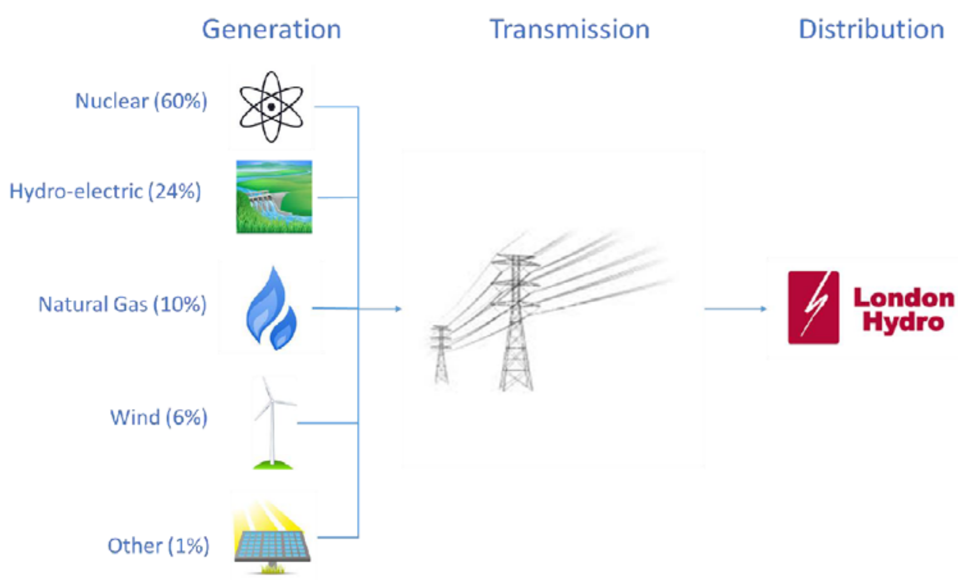
[1] Electricity Distributors Association, The Power to Deliver – Recommendations for the future of electricity distribution in Ontario, August 8th, 2012.

Sector Structure Evolution

Figure 1: 2015 Ontario Electricity Supply Chain (Generation Source Percentage)[2]



The future for Ontario's electricity distribution sector will see a continued move to lower or maintained LDC costs either through efficiencies created by consolidation with other LDCs or by those LDCs who can create opportunities to lower costs through operational improvements. By 2014, the Ontario Energy Board (OEB) had two initiatives underway to help encourage LDCs to lower costs as part of a renewed regulatory framework for the electricity sector:

- A policy review regarding mergers, amalgamations, acquisitions and sales to determine what changes are needed to encourage LDC transactions.
- A review to identify those policies that might discourage operational improvements on the part of LDCs, with the goal of removing any disincentives for consolidation or efficiency improvement.

[2] Graphic prepared by author based on information available on the IESO website.

Control Considerations

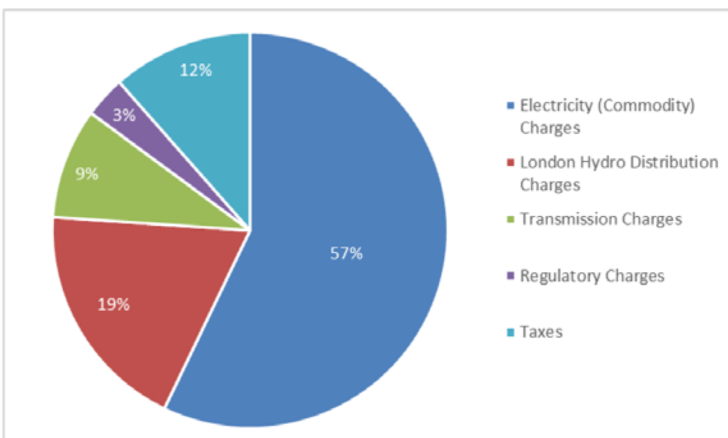
Q.

Who controls what aspects of the Local Distribution Company?

A.

London Hydro distributes electricity and provides related services to customers in the City of London as a City-owned LDC. As reflected in Figure 2, distribution of electricity represents approximately one-fifth of the average cost of supplying electricity to end-users.[3] London Hydro purchases electricity from the market operator (the IESO) and pays for the transmission of that electricity from its source to the service area of the City of London. The costs associated with electricity generation and transmission are passed through to the customer.

Figure 2: Percentage Breakdown of Charges (Typical London Hydro Residential Electricity Bill)[4]



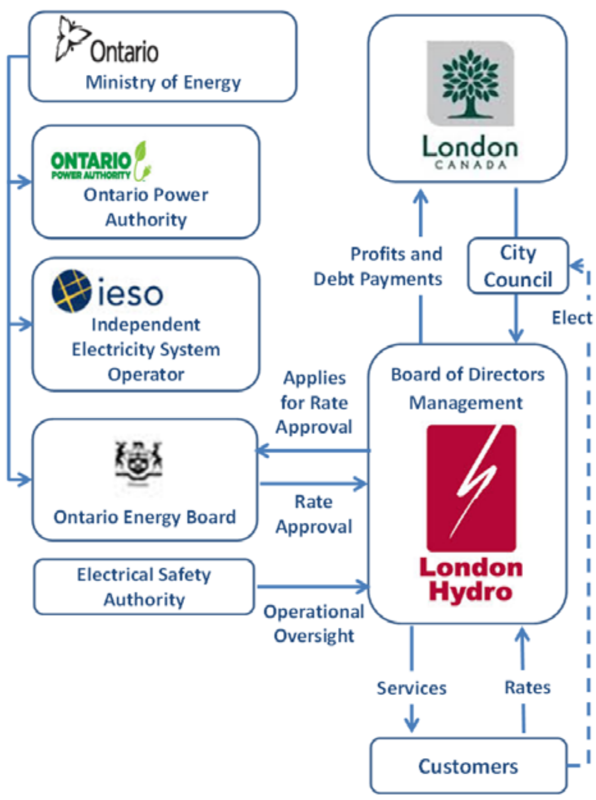
[3] The proportion is somewhat higher for residential customers and lower for large industrial and commercial customers.

[4] Based on average monthly usage of 646 kilowatt hour and OEB model for average residential time of use rates for London Hydro customers. Residential distribution costs determined from OEB 2015 Electricity Distributor Yearbook data for London Hydro.

Control Considerations

In 1998, under a shareholder agreement adopted by the London City Council, all of the employees, assets, liabilities, rights and obligations of what was then the electrical distribution business of the City's Public Utilities Commission were assigned to a new corporation established under the Ontario Business Corporations Act and named "London Hydro". As the only shareholder, the City of London as represented by City Council can change London Hydro's by-laws, share structure and the composition of its Board of Directors. The City can also change the ownership of London Hydro or dissolve the corporation and sell all or substantially all of its assets, subject to Ontario Energy Board approval. London's City Council approves who is on the Board of Directors of London Hydro and the Board has the responsibility to oversee the management and operations of the utility.

Figure 3: Current Governance Structure for London Hydro, Inc.



Control Considerations

London Hydro's customers receive services related to the distribution of electricity and pay for these services through distribution rates. London Hydro's management is responsible for proposing distribution rates by application to the OEB, which then approves and sets these rates. The OEB is an independent self-financing, provincially-owned corporation whose responsibility includes regulating the province's electricity sector to, among other things, protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service.

As the only shareholder, the City of London earns 100% of the profit generated by London Hydro as well as interest payments on the value of certain assets provided to the utility when it was formed. London Hydro's customers fund 100% of its costs through rates.

In addition to the OEB, London Hydro interacts with the following organizations:

- Independent Electricity System Operator ("IESO"), an independent non-profit provincially-owned corporation whose role involves managing the reliable production and transmission of electricity to LDCs such as London Hydro. The Independent Electricity System Operator's costs are regulated by the Ontario Energy Board and its operations are over-seen by the Ministry of Energy. Additionally, the IESO influences the activities of London Hydro through its responsibility for the co-ordination of electricity conservation programs in the province, the long term plan for Ontario's electricity system and the contracting of new generation, including renewable electricity supply such as wind power and solar power. Costs of the IESO are allocated to LDCs and collected as a billing item.
- The Electrical Safety Authority ("ESA"), an independent, not-for-profit corporation acting on behalf of the Government of Ontario with specific responsibilities for electrical safety. These responsibilities include regulating electricity distribution system safety. The ESA is funded through the collection of fees for their inspection and other services.

The above relationships and present governance arrangement is illustrated in Figure 3 above.

Performance Considerations

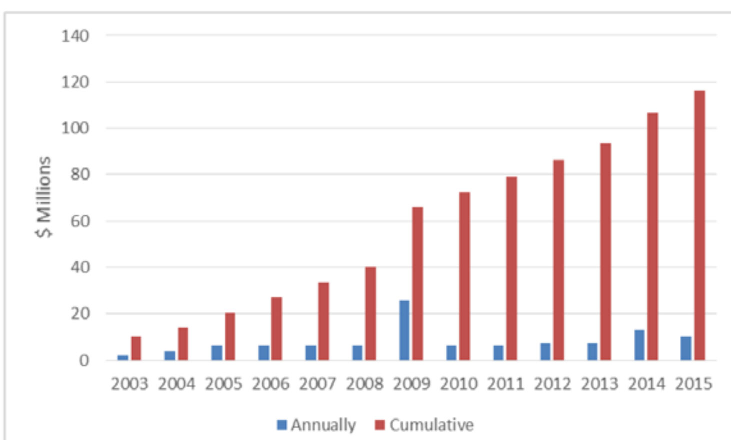
Q.

How has London Hydro performed?

A.

In 2015 London Hydro Inc. had 309 employees who manage the distribution of electricity to approximately 154,000 customers, including residential consumers, businesses and institutions within the City of London.[5] Since 2003, London Hydro Inc. has provided a positive contribution to the City totaling approximately $118 million as of 2015 (see Figure 4). In addition, the City of London has seen the value of its equity stake in London Hydro grow to over $148 million, as measured by the utility's financial statements. In 2014 a $70 million promissory note held by the City of London was called resulting in the payment of that amount to the City by London Hydro. London Hydro borrowed $85 million from the Royal Bank of Canada which was used, in part, to pay off the note. These equity changes are reflected in Figure 5.

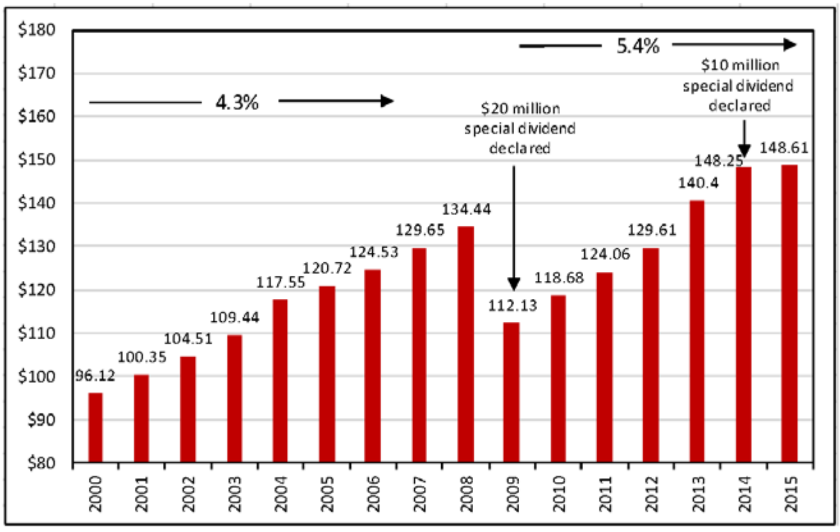
Figure 4: Annual and Cumulative Contributions from London Hydro to the City of London[6] (in millions of dollars)



[5] London Hydro website home page, www.londonhydro.com
[6] Data from London Hydro presentation to London Chamber of Commerce, September 12th, 2013 and updated to 2015 using London Hydro annual reports, 2013 to 2015.

Performance Considerations

Figure 5: Growth in the Value to the City of London in Owning London Hydro[7]
(in millions of dollars)



From an operational and financial perspective in 2015 London Hydro, when compared to 71 other utilities in the province, ranked 11th in having the lowest operating, maintenance and administration costs per customer; 40th in net income per customer; and, 46th in service quality[8] according to information from the Ontario Energy Board. Its reliability performance, measured in terms of the frequency and duration of power outages ranked 32nd.

London Hydro is a provincial leader in the fields of energy conservation and LDC technology development. It has implemented over 250 energy-efficiency projects within London's commercial business sector and continues to provide innovative solutions for its customers.

In 2015, London Hydro continued its commitment to the community of London as a local employer hiring 15 new full time, 6 apprentice and 25 co-op/summer employees.[9]

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[7] Data from London Hydro presentation to London Chamber of Commerce, September 12th, 2013 and updated with information from London Hydro's annual reports, 2013-2015.
[8] Based on average ranking of the sum ranks of the following service quality measures; low voltage connections, telephone accessibility, appointments met, written response to enquiries, emergency urban response, telephone call abandon rate, appointment scheduling, reconnection performance standards, and billing accuracy.
[9] London Hydro 2015 Annual Report, pg. 5

Options

Q.

What are the City's strategic options for London Hydro?

A.

As the only shareholder, the City of London has a number of strategic options regarding the future of London Hydro Inc. These options include:

1) Status Quo
2) Merger
3) Acquisitions
4) Sale

These options and sample benefits and challenges are discussed in more detail below.

1) Status quo

The City of London can choose to maintain London Hydro's current structure. This would mean that the City would continue to own and manage 100% of the electricity distribution network within its service area. Any profits and increased shareholder value generated by London Hydro would then remain with the City. Strategies for the development and operation of distribution facilities within London Hydro's service area, including conservation and sustainability strategies, would continue to be overseen by the City of London through the utility's Board of Directors. London Hydro can also continue to invest in local electricity generation assets. Distribution rates would continue to be overseen by the utility's Board of Directors prior to their submission to the Ontario Energy Board for approval.

Figure 6: Comparison of Status Quo Benefits and Challenges

Status Quo Benefits	Status Quo Challenges
• The City maintains its understanding of how its electrical distribution utility is operating. • Profits accrue 100% to the City. • Customers have greater control over their electricity distribution service and costs indirectly through the electoral process.	• The City is responsible for underwriting 100% of required capital costs and deficits arising from operations. • City equity tied up in its electrical distribution utility could potentially provide higher returns if invested elsewhere. • *Value may erode over time as the LDC sector evolves (Finance & Corporate Services).*

2) Merger

A merger between London Hydro and another LDC could take place with the City of London's approval. A merger typically involves combining the operations and assets of two LDCs into one larger one. The shareholders of the participating LDCs receive ownership in the merged entity equal to their relative contributions. For example, if a participating LDC contributes assets that make up 70% of the new merged utility, the shareholder of that LDC will typically receive 70% of the equity shares in the new corporation.

A merged utility will typically be operated under the terms of a shareholders' agreement between the owners of the two LDCs. Under such an agreement, the largest shareholder generally has the greatest influence on the management and operation of the merged company, including on its strategic direction and policies for the distribution of profits.

In 2009, PowerStream Inc., an LDC then owned by the City of Vaughan (57%) and the Town of Markham (43%), merged with Barrie Hydro Distribution Inc., which was the City of Barrie's LDC. As part of the merger agreement, Barrie contributed 100% of its LDC's asset value; this was equal to 20.5% of the value of the new merged firm, which retained the PowerStream name. The transaction reduced the ownership shares of the City of Vaughan and the Town of Markham in PowerStream to 45.3% and 34.2% respectively.

Other mergers that have occurred since restructuring include: Veridian, a merger of LDCs from Pickering, Ajax, Belleville and surrounding communities; Horizon Utilities, a merger of the LDCs of Hamilton and St. Catharines; and Entegrus Powerlines, a merger of community LDCs in the Municipality of Chatham-Kent.

In 2016, a merger between Powerstream, Enersource (Mississauga) and Horizon Utilities was announced along with the intention of the merged entity to purchase Hydro One Brampton. The merger was approved by the OEB in December of 2016. It results in the second largest municipally-owned electric utility company in North America based on the number of customers.

On December 20th, 2016 it was announced that St. Thomas Energy was merging with Entegrus Powerlines conditional upon the approval of the OEB in 2017.

At present, regulatory policy in Ontario neither encourages nor discourages the merger of municipally- owned LDCs. The Ontario Energy Board must approve of the merger but before doing so determines whether or not the merger would harm customers in regards to rates and reliability. If the decision is that there is no harm, then the merger is approved. To date, the Ontario Energy Board has approved every merger it has been presented with.[10]

Figure 7: Comparison of Merger Benefits and Challenges

Merger Benefits	Merger Challenges
• Expected cost savings from shared assets through economies of scale that create efficiencies in administration, operations and capital spending that can improve the return on assets for the shareholders of the merged utility. • Innovation and best practices from one utility can be employed within the merged entity. • *Greatest opportunity now, due to activity in the sector (Finance & Corporate Services).*	• Difficult to determine equitable balance of ownership in merged utility. • Differences in corporate culture between utilities can result in conflicts between the management and employees of each firm on how to move forward with the integration and this can be a barrier to successful implementation of the merger resulting in less than expected cost savings and/or benefits of innovation and best practices.

[10] Fyfe, S. et al. (2013), Mergers by Choice, Not Edict: Reforming Ontario's Electricity Distribution Policy.

Merger Benefits (continued)	Merger Challenges (continued)
	• Achieving lower costs through reducing combined workforce may inequitably impact one utility's community more than the other resulting in detrimental economic spillover effects. • *Potentially fewer opportunities in the future as LDC consolidation occurs (Finance & Corporate Services).*

3) Acquisitions

Unlike a merger, an acquisition involves the outright purchase of an LDC. The acquisition can be done by one or a number of municipal electric distribution utilities or the acquisition may be of only a portion of the assets of a utility (e.g., rural distribution lines that might be better owned and operated by an adjacent urban utility). If the City of London were interested in having London Hydro acquire another LDC, it would need to ensure that London Hydro has the financial resources to make such an acquisition.

In exchange for the funds received in any purchase transaction, a municipality selling its LDC would transfer ownership of its LDC to London Hydro. The LDC's assets would be then incorporated into the asset base of London Hydro. London Hydro, which would remain wholly-owned and therefore controlled by the City of London as sole shareholder, would assume control and operation of the purchased utility. Customers of the acquired LDC would no longer have a say through their municipal councils in the operation of their electricity distribution service.

Examples of acquisitions of LDCs include Entegrus Inc.'s (Chatham-Kent) acquisition of Middlesex Power Distribution Corporation (Strathroy, Parkhill and Mount Brydges) in 2005, HydroOne Inc.'s acquisition of Brampton Hydro in 2001 and Norfolk Power Inc. in 2013, and the combined entity (Alectra) of Horizon Utilities, Enersource Mississauga, and Powerstream's acquisition of HydroOne Brampton in 2017.

As with a merger of LDCs, the Ontario Energy Board must approve of any acquisition using similar criteria.

Figure 8: Acquisitions Benefits and Challenges

Acquisitions Benefits	Acquisitions Challenges
• Expected cost savings through economies of scale that create efficiencies in administration, operations and capital spending resulting in improved return on assets for the shareholders of London Hydro. • Innovation and best practices garnered from the acquired utility.	• Risk of overpaying for assets acquired resulting in lower return on assets to shareholders. • Differences in corporate culture with management and employees of the acquired firm can result in conflicts regarding how to move forward with the integration of assets and this can be a barrier to successful implementation of the acquisition resulting in less than expected cost savings and/or benefits of innovation and best practices. • *Over time, there may be fewer acquisition opportunities as the number of LDCs decreases (Finance & Corporate Services).*

4) Sale

Again, unlike a merger a sale involves the disposition of all or some of the ownership of London Hydro by the City of London. Should the City of London sell all of its ownership in London Hydro then it would no longer have control and operation of the electrical utility serving the city. If the City of London were to sell part of its ownership in London Hydro, the amount of control it would have on the operation of London Hydro would depend on the amount of ownership it sells, the particulars of the articles of incorporation of London Hydro, and the terms and conditions of the agreement of sale.

As with a merger or acquisition of LDCs, the Ontario Energy Board must approve of any sale using similar criteria.

Figure 9: Sale Benefits and Challenges

Sale Benefits	Sale Challenges
• Alleviates responsibility by the City of London to underwrite major capital expenditures or deficits arising from operations. • City can use funds (net liabilities) from the disposal of London Hydro to invest in higher yielding return investments or to address required capital expenditures elsewhere. • A premium may exist for the asset if it is sold.	• Loses direct control of the operations of the distribution of electricity to its residents. • May not achieve real economic value of London Hydro. • Could result in job losses and related economic spillover effects (as purchaser seeks to maximize return on investment). • There may be less of a premium for the asset in the future. • *May result in higher costs to customers, depending on who buys the utility (London Hydro).*

Examples

Q.

What are some Municipally-owned LDCs from other jurisdictions doing?

A.

At the end of 2015, the following municipally-owned LDCs include those who are the closest to London Hydro in terms of the number of customers served and who are located near London:[11]

Figure 10: Comparative Local Distribution Companies by Number of Customers

	Total Customers
PowerStream Inc. (Markham, Richmond Hill, Vaughan)[1]	358,772
Hydro Ottawa Limited	323,919
Horizon Utilities Corp. (Hamilton and St. Catherines)[1]	241,986
Enersource Hydro Mississauga Inc.[1]	203,466
Hydro One Brampton Networks Inc.[2]	154,105
LONDON HYDRO INC.	**153,947**
Veridian Connections Inc. (Pickering, Belleville, Ajax)	118,481
Kitchener-Wilmot Hydro Inc.	92,404
EnWin Utilities Ltd. (Windsor)	87,212
Entegrus (Chatham)	40,659
Bluewater (Sarnia)	36,208
Erie Thames (Ingersoll)	18,434

1. OEB approved merger of these three utilities to be called "Alectra".
2. To be acquired by Alectra.

[11] This list is based on a presentation to the City of London by Navigant Consulting (June 10, 2013) and updated to most recent available figures.

Examples

As noted in Figure 10 above, London Hydro is the eighth largest electricity LDC in the Province of Ontario (when also including Hydro One and Toronto Hydro), the sixth largest among its peer LDCs and the largest LDC in Southwestern Ontario.

Many municipally-owned LDCs in Ontario have merged with, or have acquired, other LDCs. In some cases, smaller LDCs such as Norfolk Power have simply been sold by their municipal owners in expectation that the investment of sale proceeds will generate annual revenue greater than what the LDC has been able to contribute to the municipality. Following the release of the report of the Ontario Distribution Sector Review Panel and with ongoing pressure for efficiency improvements, many utilities and their municipal shareholders are evaluating their strategic ownership options. Figure 11 summarizes the activities of other municipally-owned LDCs in Ontario from 2005 to 2016.

Examples

Figure 11: Municipal LDC Activity Between 2005 and 2016

LDC	Activity	Resulting LDC
Chatham-Kent Hydro Inc. Municipality of Chatham-Kent	2012 Changed name to	**Entegrus Powerlines Inc.** Municipality of Chatham-Kent
St. Thomas Energy Inc.	2016 Announces merger with	
Dutton Hydro and Newbury Hydro	2009 Acquired by	
Middlesex Power Distribution Corporation Strathroy, Parkhill, Mt. Brydges, Newbury, Dutton	2005 Acquired by	
Clinton Power Corporation	2011 Merges with	**Erie Thames Powerlines Corp.** Ingersoll, Aylmer, Belmont, Port Stanley, Norwich, Tavistock, Thamesford
West Perth Power Inc.	2011 Merges with	
Niagara Falls Hydro Inc. Niagara Falls **Peninsula West Utilities Limited** Town of Lincoln, Town of Pelham,Township of West Lincoln	2007 Merger and name changed to	**Niagara Peninsula Energy Inc.**
Horizon Utilities Hamilton and St. Catharines **Enersource Mississauga** **Hydro One Brampton**	2017 Merge with	**PowerStream Inc.** Markham, Richmond Hill, Vaughan
Barrie Hydro Distribution Inc.	2009 Merges with	
Aurora Hydro Connections Limited	2005 Acquired by	
Oshawa Power and Utilities Corporation and Whitby Hydro	2016 Enter into MOU to explore merger with	**Veridian Connections Inc.** Ajax, Pickering, Belleville
Gravenhurst Hydro Electric Inc.	2005 Acquired by	

Summary

While there is no formal regulatory policy requiring municipalities to merge, acquire or dispose of their electrical distribution utilities there remains Provincial Government support for consolidation of the industry. Driven by the need to address the public's concern about rising electricity prices, the Ministers of Energy over the past 11 years have promoted the concept of consolidation as a way to find cost savings at the distribution level to help reduce rates. The benefits of consolidation seem obvious when the process involves smaller municipal utilities, particularly those with a large rural distribution area, but the evidence supporting mergers and acquisitions of larger, urban utilities remains unclear.

The City of London has 100% of the ownership and control of London Hydro with an elected City Council responsible for London Hydro's by-laws, share structure and the composition of its Board of Directors. The Board of Directors in turn has the responsibility to oversee the management and operations of the utility. London Hydro was incorporated in 1998 and since 2003 has returned approximately $120 million in annual dividends to the City of London. Over the past 16 years the City's equity value in London Hydro has grown from $96 million to in excess of $148 million growing on average approximately 5% per year and providing, in addition to a regular annual dividend, $30 million in additional special dividends.

At the end of 2015, London Hydro was the eighth largest electrical distribution utility in the Province (as measured by number of customers).

A number of options exist for the City of London when considering the future of London Hydro. Each option has its benefits and challenges. A status quo approach which would keep the utility as a 100% City-owned asset that will continue to contribute dividends (currently set at $5 million per year) to the City, assuming its operations continue as they have in the past. Any operating deficits or significant capital spending requirements will remain the responsibility of the City. Merging with another utility or utilities may generate economies of scale that could increase the return to the City of London and its merger partner, but that assumes that there will be a seamless integration, which is rarely the case.

Summary

An acquisition of another utility by the City can also achieve the strategy of generating efficiencies and lower costs, but the risk remains that the City pays too much for the assets and if the integration of the combination fails in any way, the expected returns may not accrue to the City. Finally, an outright disposal of London Hydro will generate funds for the City that could be used elsewhere, either in higher return investments or in areas of the City in need of capital spending. The risk in this option is that a loss of control could result in higher rates to the ratepayers that over the long term, have a net present cost that exceeds the value of the funds earned from the sale of London Hydro.