
REPORT TO: Council

DATE OF MEETING: December 13, 2021

SUBMITTED BY: Jonathan Lautenbach, Chief Financial Officer

PREPARED BY: Jonathan Lautenbach, Chief Financial Officer

WARD(S) INVOLVED: All Wards

DATE OF REPORT: Dec 9, 2021

REPORT NO.: FIN-2021-68

SUBJECT: Final Shareholder Approval of Kitchener-Wilmot Hydro and Waterloo North Hydro Merger

RECOMMENDATION:

That Council provide final approval to proceed with the proposed merger between Kitchener Power Corp. and Waterloo North Hydro Holding Corporation and their subsidiaries Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc.;

WHEREAS on October 4, 2021 Council of The Corporation of the City of Kitchener approved the Memorandum of Understanding (MOU) between The Corporation of the City of Kitchener, The Corporation of the Township of Wilmot, The Corporation of the City of Waterloo, The Corporation of the Township of Woolwich, The Corporation of the Township of Wellesley, Kitchener Power Corp. (KPC), and Waterloo North Hydro Holding Corporation (WNH), regarding the proposed merger between Kitchener Power Corp. and Waterloo North Hydro Holding Corporation and their subsidiaries Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc.;

AND WHEREAS The Corporation of the City of Kitchener is the beneficial and registered owner of 92.25% of the issued and outstanding shares in the capital of KPC and The Corporation of the Township of Wilmot is the beneficial and registered owner of 7.75% of the issued and outstanding shares in the capital of KPC;

AND WHEREAS the Corporation of the City of Waterloo is the beneficial and registered owner of 73.2% of the issued and outstanding shares in the capital of WNH, the Corporation of the Township of Woolwich is the beneficial and registered owner of 20.2% of the issued and outstanding shares in the capital of WNH, and The Corporation of the Township of Wellesley is the beneficial and registered owner of 6.6% of the issued and outstanding shares in the capital of WNH;

AND WHEREAS KPC owns all of the issued and outstanding shares in the capital of Kitchener-Wilmot Hydro Inc. (“KWHI”) (an OEB-regulated electricity distributor) and Kitchener Energy Services Inc. (“KESI”), and has minority interest in Grand River Energy Solutions Inc.;

AND WHEREAS WNH owns all of the issued and outstanding shares in the capital of Waterloo North Hydro Inc. (“WNHI”) (an OEB-regulated electricity distributor) and Alliance Metering Solutions Inc. (“AMS”), and has a minority interest in Grand River Energy Solutions Inc. and Eyedro Green Solutions Inc.

AND WHEREAS the conditions set out in the MOU have been satisfied and incorporated into a more detailed “Merger Participation Agreement” (MPA), to be signed by all parties;

AND WHEREAS KPC and WNH recently completed a public input process related to the proposed merger, referred to as “Connecting Local Power”, with no major concerns being raised by members of the public that would prevent the parties from proceeding with the proposed transaction;

AND WHEREAS all parties agree that it is beneficial for KPC and WNH to proceed with a proposed merger to amalgamate KPC and WNH and related subsidiaries under a new municipally owned corporation (Amalco Holdco) with municipal ownership share as follows (rounded):

- **City of Kitchener 53.4%**
- **City of Waterloo 30.8%**
- **Township of Woolwich 8.5%**
- **Township of Wilmot 4.5%**
- **Township of Wellesley 2.8%**

AND WHEREAS a Unanimous Shareholders’ Agreement (USA) has been prepared, to be signed by all parties after the merger has been approved by the Ontario Energy Board, that outlines governance and other corporate considerations for the newly formed entity;

NOW THEREFORE IT BE RESOLVED that the Council of The Corporation of the City of Kitchener hereby grants its approval as Shareholder, to proceed with the proposed merger between Kitchener Power Corp. and Waterloo North Hydro Holding Corporation and their subsidiaries Kitchener-Wilmot Hydro Inc. and Waterloo North Hydro Inc.; in accordance with the provisions of the MPA and USA Agreements; and further

That the Mayor and Clerk be authorized to execute the MPA and USA agreements as well as any incidental documentation determined to be necessary, by their Legal Counsel in consultation with the City’s Chief Administrative Officer, to complete this merger; said agreements /documentation to be to the satisfaction of the City’s Legal Counsel; and

Further that an application (MAADs application) under the *Ontario Energy Board Act 1998* be submitted jointly by KWHI and WNH to seek approval of the merger and related relief from the Ontario Energy Board.

REPORT HIGHLIGHTS:

- A proposed merger between Kitchener-Wilmot Hydro and Waterloo North Hydro was announced on October 1, 2021
- The City of Kitchener is the majority shareholder of Kitchener-Wilmot Hydro and any proposed merger requires shareholder approval
- A Memorandum of Understanding was approved by Kitchener on October 4th and signed by all parties that outlined the main elements of the proposed merger
- A Merger Participation Agreement has been prepared that further outlines the details of the proposed transaction and is a required to be submitted with as part of a MAADs application to the Ontario Energy Board for final merger approval
- A draft Unanimous Shareholder's Agreement has been prepared for the new entity that would be signed once approval of the merger is provided by the Ontario Energy Board
- The City of Kitchener would hold a 53.39% ownership share in the new entity under the proposed merger

BACKGROUND:

Kitchener-Wilmot Hydro (KWH) and Waterloo North Hydro (WNH) announced on October 1, 2021 that they intended to move forward with a merger of the two utilities. The City of Kitchener is currently the majority shareholder of KWH with a 92.25% ownership share and as such, any merger involving KWH requires City of Kitchener approval.

A Memorandum of Understanding (MOU) that outlined the main elements of the proposed merger was approved by Kitchener Council on October 4th and signed by two utilities and their respective municipal shareholders. A public consultation process was also launched on October 5th by the utilities to provide the public with an opportunity to learn more about the proposed merger and to provide feedback. This consultation process is now complete, with no major concerns being raised that would prevent the parties from moving forward with the proposed transaction.

Under a proposed merger, the City of Kitchener would continue to be the majority shareholder of the larger newly formed entity with a 53.39% ownership share. The proposed merger is expected to be beneficial for both utilities, municipal shareholders, and KWH and WNH customers.

A Merger Participation Agreement (MPA) has been drafted that outlines specific details of the proposed transaction and is a legal document that is required to be signed by all parties, prior to seeking final merger approval from Ontario Energy Board (OEB). As a final step in the process, the Kitchener Power Corp (KPC) Board and Staff are recommending that Council provide Kitchener Shareholder approval to move forward with the proposed merger by adopting the resolution outlined in the recommendation of this report.

REPORT:

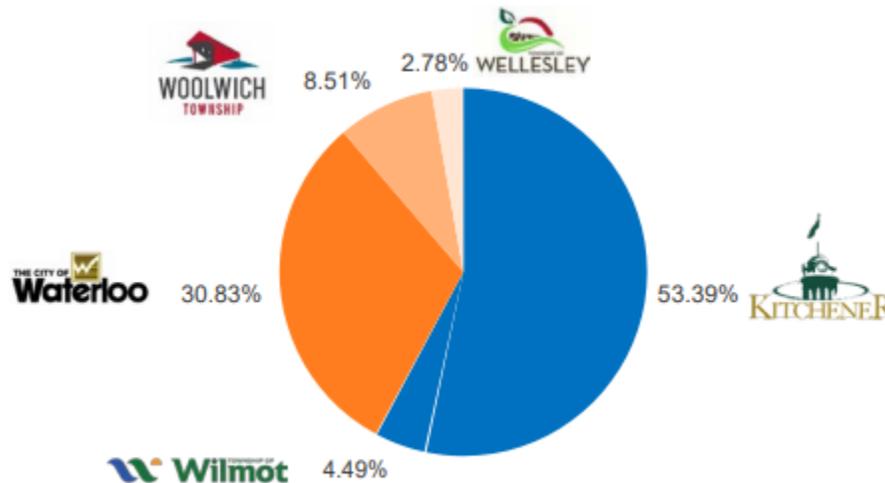
The electricity distribution landscape in Ontario has been changing, with more mergers and acquisitions taking place involving Local Distribution Companies (LDCs) in recent years. Recent and proposed mergers include Veridian and Whitby Hydro, Guelph Hydro and Alectra, Peterborough Hydro and Hydro One, Orillia Power and Hydro One, Energy Plus and Brantford Power. This trend in mergers and acquisitions is a result new regulatory and policy changes that has made merger opportunities more attractive for LDCs. In addition, consolidation of LDCs has been encouraged by the Province in order to ensure stable and reliable energy distribution for communities across Ontario.

Preliminary discussions regarding the proposed merger between KWH and WNH, and the potential benefits that a merger could provide, began in 2019. Grant Thornton was engaged by the utilities to explore what a potential merger may look like and to better understand the benefits that it could provide, both from an individual utility and an existing shareholder perspective. Municipal shareholders were engaged early in the process as any merger involving both parties would require approval of municipal shareholders.

The City of Kitchener is currently the majority shareholder of KWH with 92.25% ownership share. The Township of Wilmot is the minority shareholder with a 7.75% equity stake.

The City of Waterloo is currently the majority shareholder of WNH with a 73.2% ownership share. The Township of Woolwich and Township of Wellesley own 20.2% and 6.6% equity stake respectively.

Under the proposed merger the ownership share for municipal shareholders would be adjusted as follows:



Kitchener will remain a majority shareholder of the new utility with a 53.39% ownership share. Making sure that the new entity continues to be locally owned is an important consideration. By merging with WNH now, it is expected that the new utility will remain responsive to community and customer needs.

After completing financial and legal due diligence process, an MOU was approved by Kitchener Council on October 4th and entered into by all parties on October 5th. The MOU outlined several objectives/benefits that the merger between KWH and WNH is expected to achieve:

- Customers will enjoy ten-year distribution rate stability and distribution rates as low or lower than in a standalone alternative
- Distribution rates of the former KWH and WNH service territories will harmonize over time
- Continued excellence in customer service
- Total cost savings to be shared amongst the Municipal Shareholders and customers
- Stronger and more sustainable cash flow to Municipal Shareholders via interest and dividends
- The ability to dedicate significant leadership and focus on innovation and growth
- A larger entity with a stronger balance sheet capable of supporting future growth
- Improved service reliability leveraging best practices and capabilities of both LDCs
- A stronger energy and infrastructure partner for local businesses and communities
- Alignment with provincial government policies encouraging consolidation in the electricity distribution sector
- Increased ability to access financial and other resources available to invest in non-regulated energy services, businesses and solutions for customers

From a shareholder perspective, the newly formed utility will provide additional dividends for Kitchener which are outlined in the financial implications section of this report. These additional dividends will be allocated through the City's annual budget process.

The signing of the MOU signaled the intent of all parties to proceed with the proposed transaction and a public consultation process was launched by the utilities on October 5th. This public engagement process, referred to as "Connecting Local Power", provided an opportunity for the public to learn more about the planned merger and to provide feedback regarding the proposed transaction. The summary of the activities that were included as part of the consultation process are included in an appendix to this report (see attached public engagement report – Appendix A).

The feedback from the public consultation process was mostly positive with no major concerns being raised that would prevent the parties from moving forward with the proposed merger.

An MPA has been drafted that outlines the specific details of the proposed transaction. The MPA is a legally binding agreement that is required to be signed by all parties prior to seeking final approval from the OEB. Kitchener Council has had the opportunity to review this draft agreement prior to bringing this report forward to seek final shareholder approval. Some of the key elements that are included in the MPA have been outlined in a letter provided by the City's legal counsel (see attached letter – Appendix B)

In addition to the MPA, a Unanimous Shareholder Agreement (USA) has been drafted and will be signed by all parties once the OEB provides approval of the proposed merger. The USA is also a binding legal agreement that outlines important corporate governance

considerations for the newly merged utility. Some elements that this agreement covers are outlined in Appendix B.

Proceeding with a merger between KWH and WNH will ensure that customers of both utilities continue to receive reliable and stable electricity distribution, both now and in the future.

After extensive discussions, the completion of financial and legal due diligence, and finalization of legal agreements that are required to proceed with the proposed merger, staff are recommending that Council provide final shareholder approval to move forward with the proposed merger by adopting the resolution included in the recommendation of this report.

The KPC board has already approved moving forward with the proposed merger and are also recommending that Council provide shareholder approval for Kitchener (see attached letter - Appendix C).

If the shareholders for KWH and WNH provide final approval to move forward with the proposed merger, authorizing the signing of the MPA, a joint Mergers, Acquisitions, Amalgamations, and Divestitures (MAADs) application would be prepared by the utilities as the next step in the process and submitted to the OEB for final merger approval. If the merger is approved by the OEB the USA would then be executed by all parties as the final step in the process.

Jerry VanOoteghem, CEO of KWH, and Jim Phillips, KPC Board Chair, will be in attendance to provide a presentation for Council and answer any questions that Council may have regarding the proposed merger.

STRATEGIC PLAN ALIGNMENT:

This report supports the delivery of core services.

FINANCIAL IMPLICATIONS:

The City of Kitchener currently receives approximately \$6 million in annual dividends and interest from KWH.

Under the proposed merger it is estimated that the City of Kitchener will receive incremental returns of \$9.6M over a 20-year timeframe.

In addition to the incremental returns that are a direct result of a proposed merger, a dividend policy change that would be required to align with WNH's dividend policy will provide an increase of an estimated \$28 million for Kitchener over a 20-year timeframe.

Dividends from ownership of the hydro utility are allocated through the City's annual budget process help address both the City's operating and capital need. It is anticipated that increased incremental returns from the merger will be considered through the City's 2024 budget process.

COMMUNITY ENGAGEMENT:

INFORM – This report has been posted to the City's website with the agenda in advance of the council / committee meeting.

A public engagement process, "Connecting Local Power", was launched by the two utilities on October 5th. A public engagement report that summarizes the activities and feedback received regarding the proposed merger is attached as Appendix A

APPROVED BY: Dan Chapman, CAO

ATTACHMENTS:

Appendix A – Public Engagement Report – Prepared by National PR

Appendix B – Summary of Legal Agreements – Prepared by BLG

Appendix C – Letter from KPC Board – Prepared by Jim Phillips, KPC Board Chair