CITY OF ST. CATHARINES

Corporate Report

Report from: Office of the Chief Administrative Officer, Director Corporate Services, Commissioner Legal and Clerks Services, Director

Date of Report: October 6, 2015 **Date of Meeting:** October 20, 2015

Report Number: LCS-290-2015 **File:** 35.60.19

Subject: Merger of Horizon Holdings Inc., Enersource Holdings Inc. (following its formation) and PowerStream Holdings Inc., to be followed by the merger of Horizon Utilities Corporation, Enersource Hydro Mississauga Inc. and PowerStream Inc., and subsequent reorganization transactions (the merged business is referred to as "**Mergeco**"); and

Acquisition of Hydro One Brampton Networks Inc. ("**HOBNI**") (collectively, the "**Transactions**")

Recommendations

That Council:

1. Receive the recommendations made by Horizon Holdings Inc. and Horizon Utilities Corporation ("**Horizon**"); and

2. Receive the recommendations and resolutions presented by St. Catharines Hydro Inc. ("**SCHI**"); and

3. Approve and authorize the Transactions on behalf of The Corporation of the City of St. Catharines (the "**City**") and as sole shareholder of SCHI; and

4. Direct that the City Solicitor prepare the necessary by-law(s) to authorize the Mayor and the City Clerk to execute and deliver the following:

   (i) the Merger Participation Agreement pursuant to which the merger of Horizon, PowerStream and Enersource will be completed;

   (ii) the Unanimous Shareholders Agreement that will govern the relationship between the shareholders of Mergeco and its subsidiaries;

(iii) a written instrument confirming the City's approval of the foregoing agreements as well as Horizon's entry into a Share Purchase Agreement for the acquisition of the shares of HOBNI;

(iv) the resolution of the sole shareholder of SCHI on behalf of the City; and

(v) such further and other documents as may be necessary or appropriate to fulfill the intent of the Transactions and perform the City's obligations under the agreements referred to above.

All with such non-material modifications and amendments as are approved by the Chief Administrative Officer and the City Solicitor. FORTHWITH

Summary

The transactions are anticipated to deliver benefits to: 1) Horizon customers; 2) the Community and 3) the City of St. Catharines, which are outlined in this report.

City staff and SCHI have retained external advisors and been provided with diligence reports that support these conclusions.

The anticipated increase in annual dividends will result in a financial benefit to the City.

Background

Horizon was established March 1, 2005 as a result of the merger between St. Catharines Hydro Utility Services Inc. and Hamilton Hydro Inc. One of the objectives set out at that time for the merged company is to increase shareholder value through mergers and acquisitions.

City Council provided its initial approval to develop the business case for the Transactions on March 23. 2015, an update was presented to City Council by Horizon on July 6, and the final presentation was made on October 5, 2015. On July 6, 2015 Councillor Harris requested a staff report on the information presented by Horizon be provided to Council.

Horizon also held a public consultation session on August 25, 2015, and Horizon provided information to the public before Council on October 5, 2015.

In addition, the Board of SCHI, as the direct shareholder of 21.1% of the shares of Horizon Holdings Inc., received a detailed presentation from Horizon on September 9, 2015, and reviewed and approved the Transactions on September 24, 2015. Each of Horizon and SCHI recommend that the City, on its own behalf and as the sole shareholder of SCHI, approve the Transactions.

Attached are the following:

Appendix 1 - Synopsis of the Transactions
Appendix 2 - Horizon Presentation Materials - October 5, 2015 meeting
Appendix 3 - Merger Overview dated October 7, 2015

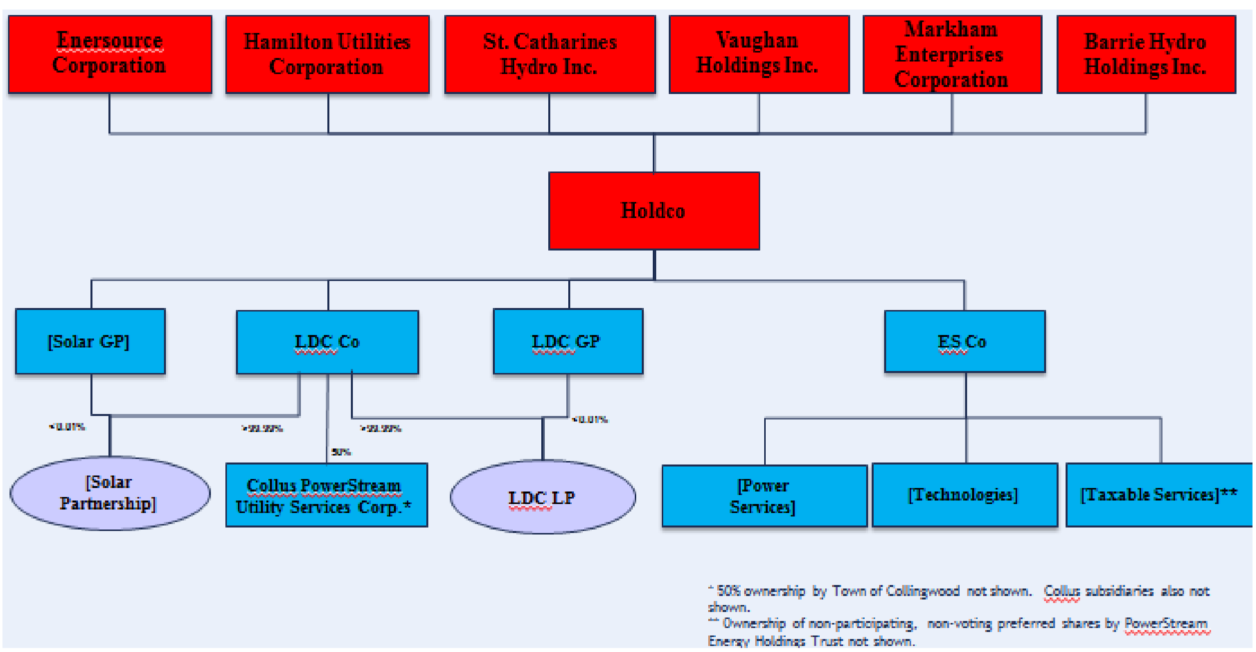
Rather than repeat the content of the Appendices in this summary report, we commend these materials to you for your review.

The approval of Council on behalf of the City as shareholder of SCHI, and the approval of SCHI are both required in order to proceed with the Transactions. Approvals of all of the merging parties and their respective shareholders, including the City and SCHI, will be required.

There will be no change in the ownership by the City of SCHI and by SCHI of St. Catharines Hydro Generation Inc. as a result of the Transactions.

There will however be a change in the shares in Horizon held by SCHI as a result of the merger of Horizon with PowerStream and Enersource, in that SCHI instead of holding 21.1% of the shares of Horizon, it will hold approximately 4.85% of the resulting larger merged entity referred to above as "Mergeco". The City will be one of six municipal indirect shareholders of Mergeco.

The proposed final structure is provided below.



Holdco is effectively a holding company for all of the businesses of Mergeco. Holdco will warehouse corporate functions including the Chief Executive Officer, legal, finance, treasury, communications, and public and investor relations.

The LDC Co holds the local electricity distribution company ("**LDC**") business and assets as well as the solar generation assets. The Energy Services Company or "**ES Co**" holds all other non-regulated business interests. The businesses of PowerStream, Enersource, and Horizon are effectively merged in LDC Co and ES Co. HOBNI is thereafter acquired as part of the business of LDC Co. With the exception of the shareholders of Enersource, Mergeco is held directly by municipal holding companies that, in turn, are held directly by their respective municipalities. BPC Energy Corporation ("**BPC**", a wholly owned subsidiary of OMERS) and the City of Mississauga continue to hold their respective shareholder interests in MergeCo through Enersource. This is necessary, as BPC having a direct interest in Mergeco would trigger significant tax consequences for Mergeco. BPC owns 10% of Enersouce's shares and the City of Mississauga owns the remaining 90%.

Mergeco is expected to adopt a partnership structure for each of its electricity distribution and electricity generation businesses. The use of a partnership is expected to permit additional private investment in a tax efficient manner not available to more traditional corporate structures. Mergeco will require financial flexibility and outside investment to support its growth objectives. Otherwise, Mergeco growth is effectively limited to its ability to issue debt. The partnership structure (LDC LP) is expected to be adopted subject to: (i) the receipt of appropriate and favourable tax rulings and interpretations; and (ii) regulatory (OEB) acceptability.

Assuming the partnership structure is adopted, the LDC assets of Mergeco would be transferred to LDC LP on a tax deferred basis. The solar generating assets of Mergeco could be similarly transferred to a separate solar partnership to provide similar financial flexibility benefits.

Report

In reviewing the proposed Transactions and related legal and business documents, and having had an opportunity to receive briefings and to make comments on such documents during the negotiation and documentation process conducted by Horizon, Enersource, and PowerStream, City Staff make the observations set out in this Report.

1. History of the Transactions

On April 16, 2015, four of Ontario's largest LDCs announced they would work together to form a new utility that would serve almost a million customers in York Region, Simcoe County, Peel Region, Hamilton and St. Catharines. In order to achieve this goal, the LDCs have been working on the proposed Transactions, which comprise in essence the following:

> (a) a merger of the regulated and non-regulated business activities of Horizon Holdings Inc., Enersource Holdings Inc. (following its formation) and PowerStream Holdings Inc. and subsequent reorganization transactions; and

(b) an acquisition by the merger parties of the regulated electricity distribution business of HOBNI for gross proceeds of $607MM subject to adjustments in accordance with the corresponding share purchase agreement.

The proposed Transactions aim to allow a new, larger company to use its collective resources to deliver a favourable impact on distribution rates, more efficient services and innovative technologies for customers while also providing significant benefits for communities and shareholders. The Transactions are consistent with various governmental initiatives which are designed to increase efficiencies in the electricity distribution sector.

2. Advisors and Due Diligence

Horizon, the City, and SCHI retained Ernst & Young LLP as their financial advisors. The City and SCHI retained Bennett Jones LLP as their legal advisors.

A Relative Business Valuation was prepared by Deloitte LLP for Horizon, PowerStream and Enersource, and a confidential business plan was prepared by Horizon, PowerStream and Enersource. As independent advisor to Horizon and its shareholders, Ernst & Young LLP reviewed the Relative Business Valuation prepared by Deloitte LLP and prepared a valuation report. The results of the Ernst & Young review are consistent with the Deloitte Relative Business Valuation.

Comprehensive diligence reports were prepared regarding each of Horizon, PowerStream, Enersource and HOBNI, by counsel to Horizon, PowerStream and Enersource, and may be relied upon by Horizon, PowerStream, Enersource and their respective shareholders, including the City and SCHI.

Other independent reports were also prepared, including the Vanry Report on environmental matters, and a review of technology by Oracle and Accenture in support of the business plan.

3. Business Case

As described in detail in the Appendices, it is expected that the Transactions will benefit customers/ratepayers, Mergeco and the shareholders of Mergeco (which include SCHI), and the local community.

Benefits to Customers

1. <u>Lower Rates for Customers</u>
Customers are expected to benefit from lower rates than the rates that will be charged over time if the Transaction does not occur.

The Transaction is expected to deliver 5.9% lower average annual rates through the entire 25 year forecast period (2016 - 2039); and 8.0% lower average annual rates after 10 years compared to what the rates would be without the Transaction. The Transaction would on average require $9 million less per year from customers, or about $40 less on average per customer per year.

Affordable and reliable energy is integral to economic productivity and prosperity in the community. The IESO is forecasting that over the next five to ten years the cost of electricity is going to continue to rise. The Ministry of Energy's Ontario's Long Term Energy Plan forecasts electricity bills will increase by 34% over the next ten years, Industrial bills are expected to increase by 25% over this same forecast period.

The proposed Horizon Utilities merged entity will deliver efficiencies and economies of scale that would ultimately translate into savings for ratepayers while maintaining the same safe and reliable service we have today. Furthermore, the merger will assist local industries with job creation and retention, growing the community's employment base and resiliency.

While some operations are more energy-intensive than others, reducing energy costs is always an important consideration in the site-selection process. Enhanced customer service at competitive/reduced hydro rates through the proposed merger has the ability to make our community more attractive to investors.

The business plan presented by Horizon indicates that rates in the Horizon franchise area will continue to be competitive going forward as a result of the merger.

2. <u>Not Harmonizing Rates</u>
Horizon's commercial and industrial electrical distribution rates are among the lowest in Niagara and very competitive with the rates in the franchise areas of the Enersource and PowerStream.

The parties have agreed that Mergeco will not harmonize the distribution rates for distribution customers of its predecessor local distribution companies until the differences between the rates for such customers are immaterial. Details and consequences are set out in the Appendices.

3. <u>Service Levels</u>
The levels of service to customers (including outage response) after the Transactions are expected to be at a minimum maintained and in some respects improved.

4. Local Impacts

The parties have agreed that for a period of no less than ten years after the date of this Agreement, Mergeco will maintain its call centre in St. Catharines in accordance with the business plan, subject only to a determination of the board of Mergeco, after having consulted with each of the Shareholders of Mergeco at a meeting called for such purpose, that there is a commercially sound business reason for relocating its call centre. The business plan indicates that 15-20 additional jobs are expected to be created as a result of the Transactions with potential for more growth assuming performance levels are met.

Benefits to Mergeco

Horizon anticipates that there will be significant savings resulting from the merger in operating costs and capital expenditure savings, which after transition costs are expected to yield $426 million of net cash savings in the first 10 years and $51 million per year of savings sustained after 10 years. Mergeco will have a platform large enough to take full advantage of the combined company strengths.

Benefits to the City as Shareholder

Horizon anticipates that there will be, for St. Catharines, an increase in the average annual earnings over the next 25 years from $3.5 million per year to $4.5 million per year and overall, a 29% increase in dividends over the status quo.

4. Next Steps

Once the Transactions have been approved and the agreements signed, the closing of the Transactions is expected to take approximately 6 months. Completion of the reorganization will follow. No further approvals will be required to close the Transactions. City Staff will provide periodic updates as to the status of this work.

Financial Implications

Based on the business case presented by Horizon, it is expected that the City will receive a $1.0M average increase per year in dividends over the forecasted period from 2016-2039, from $3.5M to 4.5M, representing a 29% increase in dividends over the status quo.

Alignment to Strategic Plan

Economic sustainability objectives of Council's Strategic Plan are supported by providing anticipated increases in revenue to the City through additional dividends. Both the additional anticipated dividends and the expected lower rates compared to the status quo, assist in attracting investment and supporting local businesses and by making the City more affordable.

Conclusion

Based on the information and recommendations provided by Horizon and SCHI, and as a result of our review with the assistance of our external legal and financial advisors, City Staff recommends the proposed Transactions to Council for approval on behalf of the City, and as sole shareholder of SCHI.

Prepared, submitted and approved by:

Dan Carnegie Chief Administrative Officer	Shelley Chemnitz Commissioner of Corporate Services / City Treasurer	Nicole Auty Director of Legal and Clerks Services / City Solicitor

horizon UTILITIES Looking beyond...

Merger Synopsis

Utility mergers have been hugely successful in lowering cost of living and lowering cost of doing business, resulting in better service for all concerned. Indeed, Hamilton's own experience in 2000 and Hamilton's and St. Catharines' experience in 2005 is consistent with this outcome. Across Ontario, 40% of all customers are currently served by municipally merged companies.

Customer Benefits of this Merger:

- 5.9% lower average annual rates throughout entire 25 year forecast period from cost savings, 8% lower after first 10 years
- No deterioration in service levels or response time – service response will be exactly the same as prior to merger
- No changes to service centres – Hamilton and St. Catharines facilities
- 15% operating cost savings in first 10 years
- $426 million of net cash savings from operating and capital costs in the first 10 years
- $51 million approximately of sustained net cash savings thereafter per year

Community Benefits of this Merger:

- Three companies based in three separate communities
  - Utility head office in Hamilton
  - Corporate head office in Mississauga
  - Sustainability and Innovation head office in Vaughan
- Utility head office to reside in Hamilton downtown core
  - Located at current Horizon office 55 John St. North
  - New utility will have 960,000 customers – Horizon currently serves 242,000
  - Utility head office will house utility President and Executive Team with responsibility for majority of employees in new company and all utility operations and capital investments
- Existing operations service centres ideally located, will continue to serve communities from: Hamilton, St. Catharines, Mississauga, Brampton, Barrie, Markham, Vaughan

Shareholder Benefits of this Merger:

- Maintain existing municipal ownership, just more shareholders of a larger business
- No single controlling shareholder
- 29% average increase in dividends for Horizon shareholders or $4.8 million per year over status quo, from $16.6 to $21.4 million
  - $3.8 million average increase in Hamilton dividend, from $13.0 to $16.8 million
  - $1.0 million average increase in St. Catharines dividend, from $3.5 to $4.5 million

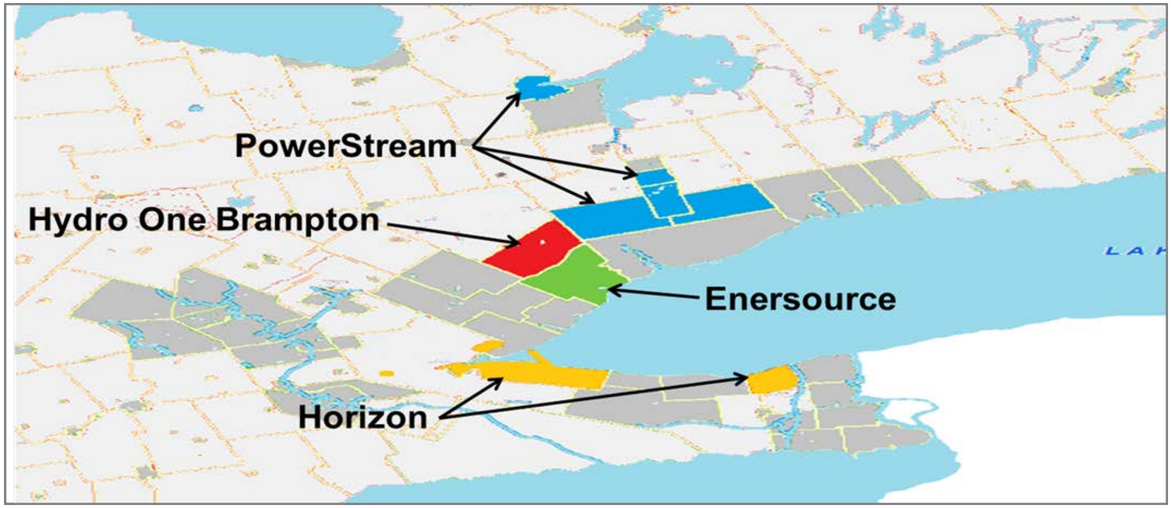
Transaction Specifics:

- A three-way merger of the holding companies of Horizon Utilities, Enersource and PowerStream with joint acquisition of Hydro One Brampton
- Amalgamation of the respective local distribution businesses of Horizon Utilities, Enersource and PowerStream into one local distribution subsidiary company

- Amalgamation of the respective energy services companies of Horizon Utilities, Enersource and PowerStream into one commercially competitive subsidiary company
- New merged regulated local distribution company acquires Hydro One Brampton Networks Inc.
- Necessary human resource efficiencies will utilize voluntary initiatives to the greatest extent possible

In summary, the key aspects of the proposed merger are:

- Affordability/Local Competiveness
    - Mitigate future rate increases – residents and businesses
- Municipal Revenue
    - Provide enhanced utility dividend revenues to municipal shareholders to fund other community initiatives
- Stronger Company
    - Financial Resources – more strength and resilience
    - Human Resources – better training and wider opportunities
    - Technology & Innovation – more investment in future
- Industry Leadership
    - Increased influence on Provincial Policy and Regulations



Reducing the Rising Cost of Electricity

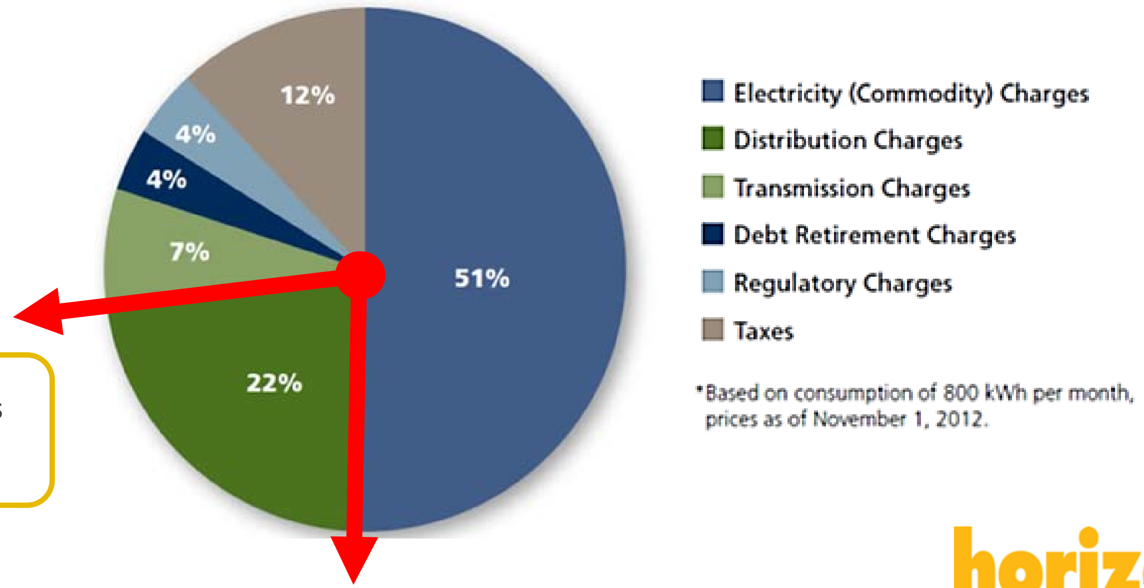
Overview of the Proposed Merger of

Horizon Utilities to City of St. Catharines

October 5, 2015

Horizon's vision and its goal in mergers?

- Keep cost electricity distribution as low as possible for customers
- Strategy, as supported by council, has been:
  - Delivering value to customers and growing business profitably
  - Pursue mergers to enhance value for municipality and customers
- Results – top performer, responsible growth, St. Catharines & Hamilton merger, track record of excellence



In **1996,** distribution charges represented **15%** of the bill

Source: Ontario Distribution Sector Panel

What has Horizon done on higher costs?

Create economies of scale through mergers.

2000 Merger of 5 utilities created Hamilton Hydro

2005 Merger of St. Catharines Hydro and Hamilton Hydro created Horizon

100% Municipally-owned	242,000 customers	425 employees	$675 million in total assets

2015 Proposed merger of Horizon with Enersource, PowerStream and Hydro One Brampton – option to purchase Hydro One Brampton

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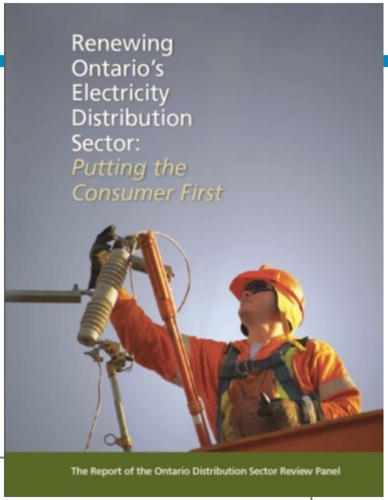
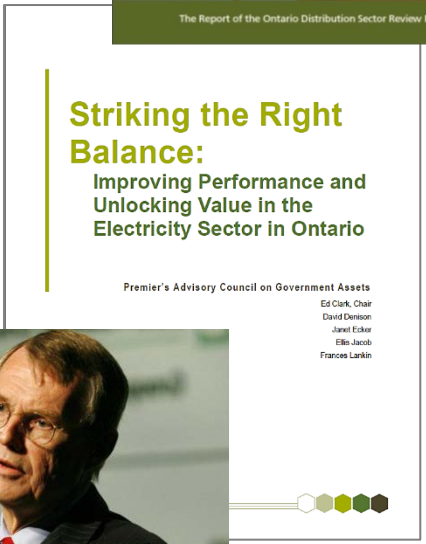
What do experts now recommend?

2012 and 2015

- Ontario Distribution Sector Panel report favoured 8 to 12 regional utilities
  - $1.7B in operating cost savings and $1.3B in avoided infrastructure investment in first 10 years from consolidation
- Clark Panel favoured just “three of four strong distribution players”, down from 73 currently
- Hydro One Brampton seen as being “key to breaking deadlock” and proposed merging utility with other urban utilities to achieve consolidation

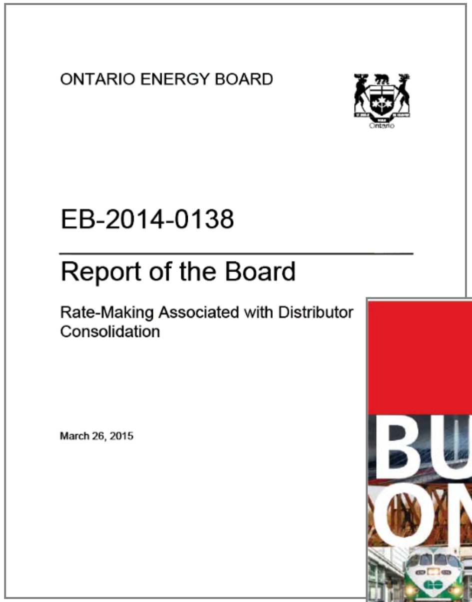




What has Regulator and Ontario budget done?

2015

- Ontario Energy Board introduced new rules to incent utility mergers
- Mergers now less risky for shareholders by ensuring recovery of transition costs
- All cost savings eventually go to customers in lower rates – still strong protections for customers
- Provincial budget lowered rate of Transfer Tax for municipal utilities and provided holiday from Departure Tax

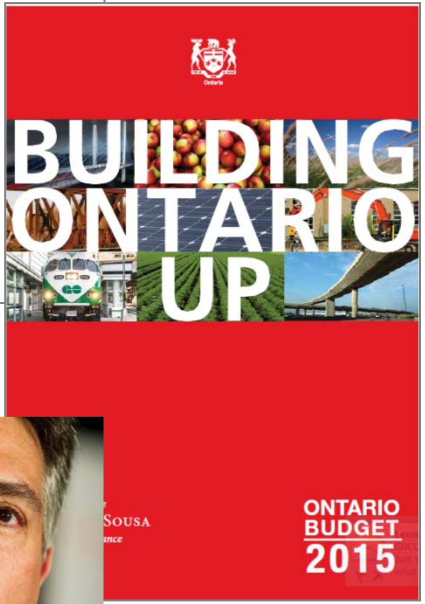

ONTARIO ENERGY BOARD

EB-2014-0138

Report of the Board

Rate-Making Associated with Distributor Consolidation

March 26, 2015



New municipal utility – same shareholders

Shareholders:

- St. Catharines (Horizon)
- Hamilton (Horizon)

- Enersource (Mississauga and Borealis/OMERS)*

- Barrie (PowerStream)
- Markham (PowerStream)
- Vaughan (PowerStream)

+

Not a Shareholder:

Acquire
Hydro One
Brampton Inc.

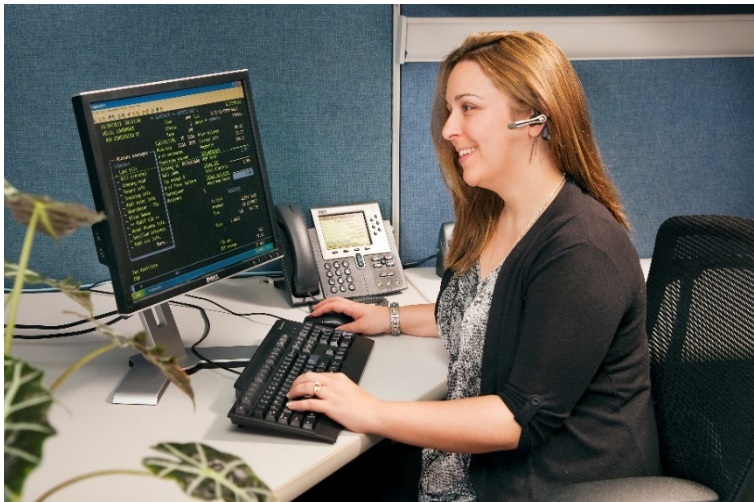
* Enersource would be the actual shareholder, since Borealis (a division of OMERS) cannot be a direct shareholder).

Community benefit – Hamilton

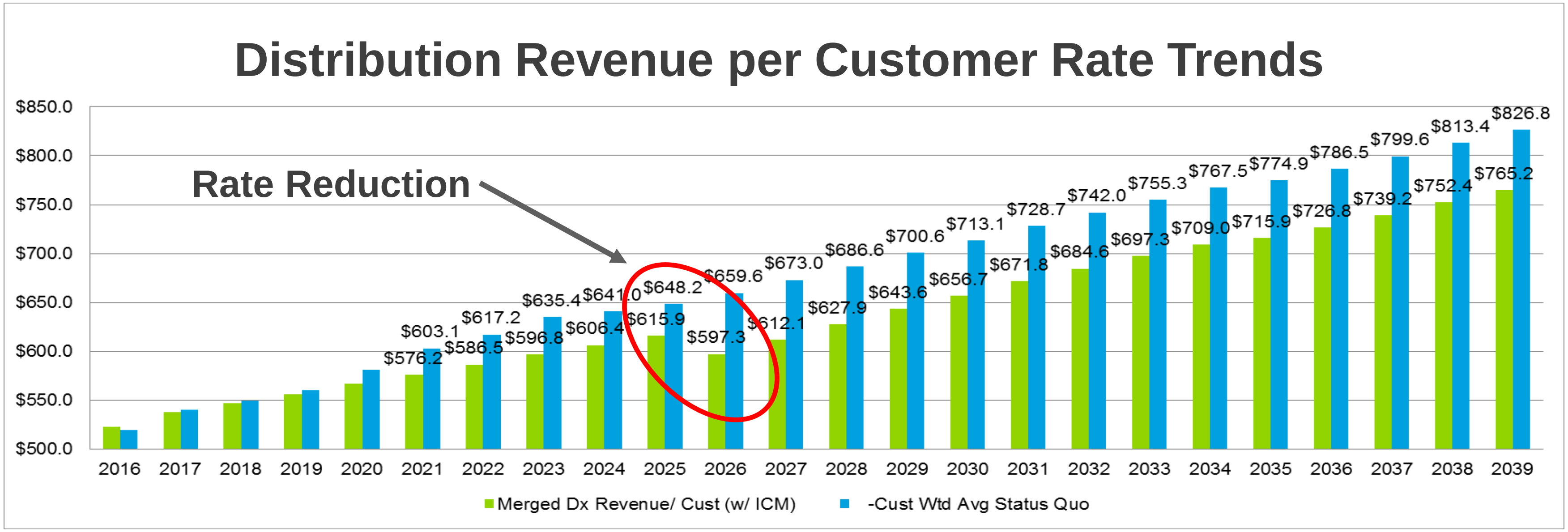
- Regulated utility to be located in Hamilton at Horizon office
  - New 960,000 customer utility to be based in Hamilton – Horizon is 242,000
  - $7 million in recent building renovations
  - $4-6 million planned renos for 2016-20
- Utility company President and executives located in Hamilton – responsible for:
  - Majority of employees in new company
  - Positions Hamilton as an attractive place to work
  - Utility operations / capital investments
- City benefits from increased activity – hotels, restaurants, etc.
- Location ideally suited to benefit from future utility consolidations and corresponding employment growth, centrally located

Community benefit – St Catharines

- St. Catharines will be location of one of two call centres for whole utility company



Customer benefit – lower rate impact



- Merger provides **5.9%** lower average annual rates through entire 25 year forecast period 2016-39, **8%** lower after 10 years
- Merger would, on average, require $9 million less per year from customers, or about $40 less on average per customer per year
- *NB: blue bars show existing projected average revenue per customer and green bars show projection under merger*

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Customer benefit – service levels

- No changes to service centres
- Service centres ideally located and will continue to remain in place – St. Catharines and Hamilton
- Service response will be exactly as prior to merger
- No deterioration in service levels or response time

Vansickle Rd., St. Catharines

Nebo Rd., Hamilton

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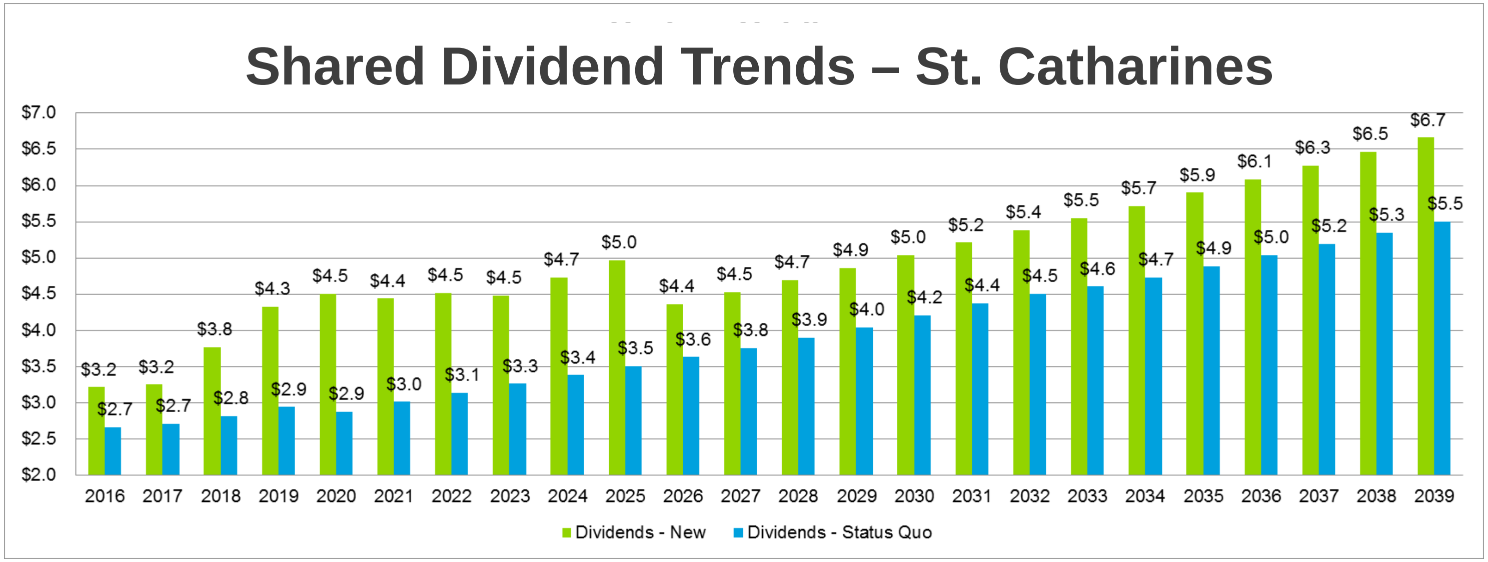
Shareholder benefit – significant cost savings

- **$355 million** or 15% of operating cost savings in first 10 years
- **$168 million** of capital expenditure savings in first 10 years
- **$97 million** transition costs
- **$426 million** of net cash savings in the first 10 years
- **$51 million** per year of savings sustained after 10 years

Shareholder – stronger St. Catharines dividends



- 29% average increase in dividends over status quo
- $1.0 million average increase per year in dividends of across entire forecast period 2016-39
- Dividend increases from average of $3.5 million per year to $4.5 million per year
- *NB: blue bars show existing dividends and green projected*

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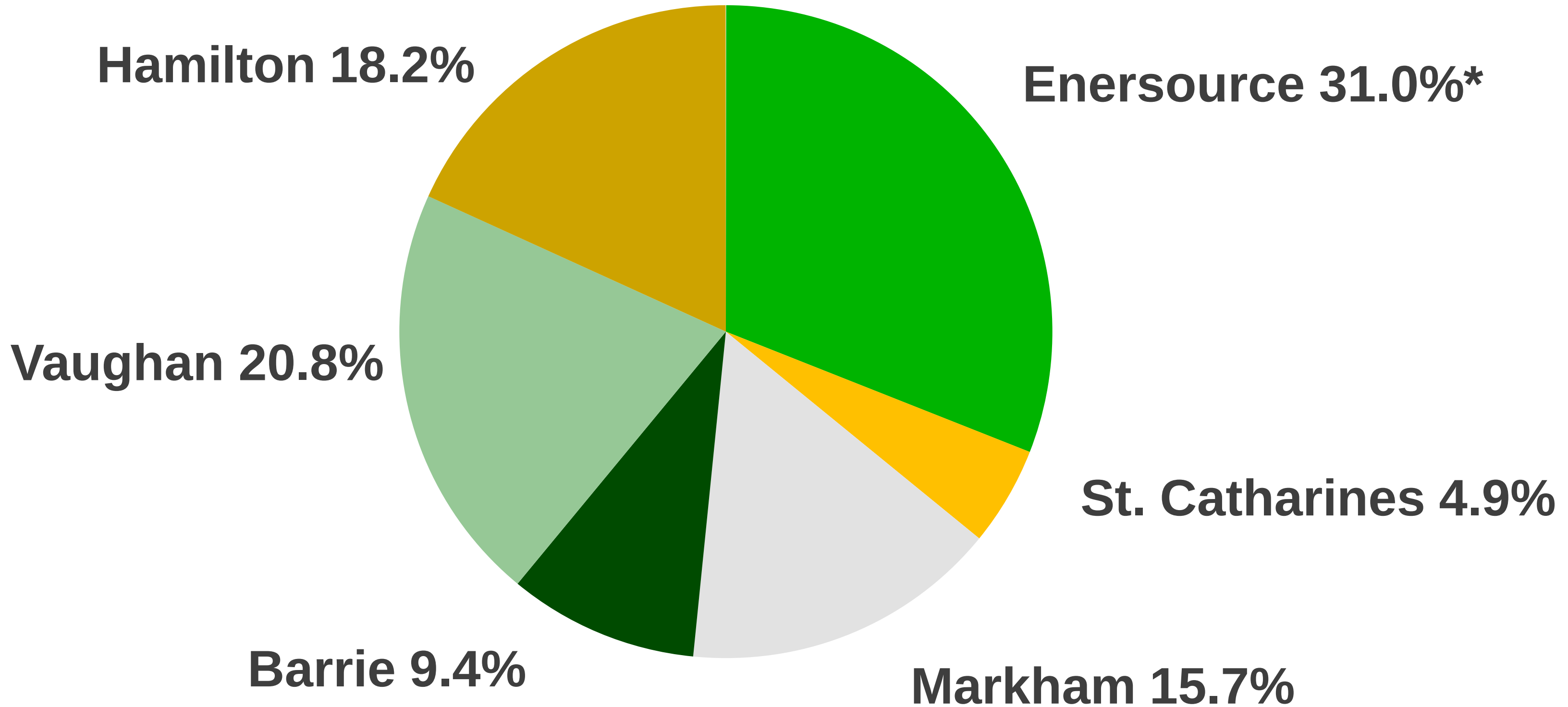
Shareholders – no controlling interest



* Enersource is 90% owned by City of Mississauga and 10% owned by OMERS (Borealis). Enersource is the shareholder rather than Mississauga or Borealis because Borealis cannot be a direct shareholder of a merger.

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Benefits for St. Catharines

The CUSTOMER

- Lower cost of living and cost of doing business with great customer service
- Combined industry leadership on smart grid, community planning, sustainability, conservation and energy mapping
- Efficiency savings result in lower customer rates than business as usual

The SHAREHOLDER

- Lower enterprise risk with consistent and strong shareholder performance
- Larger dividend payments possible without otherwise higher customer costs – more return from the same assets, less pressure on municipal taxes

The COMMUNITY

- Contribute to shareholder communities being great places to live and work through technological innovation and community sustainability principles
- Build a great company together on a platform large enough to take full advantage of the combined company strengths

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Merger Overview

Horizon Utilities Corporation

October 7, 2015

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Merger Introduction

In this document, Horizon Utilities Corporation, your local electric distribution company in Hamilton and St. Catharines, is pleased to share the highlights of the business analysis for a proposed new local electricity distribution and services utility with our customers, our shareholders and our employees.

If approved, the new company will be formed with the merger of Horizon Utilities, Enersource, and PowerStream and the acquisition of Hydro One Brampton. This is a very important time for our shareholders, the City of Hamilton and the City of St. Catharines. This transaction represents an exciting opportunity and considerable value to customers and the municipalities.

This plan demonstrates that the new utility Horizon Utilities proposes to create will, first, reduce the rising cost of electricity for our customers and, second, provide significant and enhanced new revenues for our municipal shareholders that are sustainable on an ongoing basis. At the same time, it will allow us to sustain and improve the reliability of our service and our ability to maintain it.

If approved by our shareholders, all other parties to this transaction, and ultimately the Ontario Energy Board, our new utility will ensure that:

- Our electricity rates remain as affordable as possible in the markets we serve
- Our shareholders will see an increased return on investment
- Our organization has deeper financial resources, strengthened human resources – through training and more opportunities, and more investments in technology and innovation
- Our customers' and shareholders' voices will have more influence on the energy policies of our province and the regulations that support it.

At Horizon Utilities, we have a history of successful mergers – all of which were focused on reducing upward pressure on rates and increasing shareholder value. We look forward to continuing to build on this history with this proposal.

Merger Synopsis

Utility mergers have been hugely successful in lowering the cost of living and the lowering cost of doing business, resulting in better service for all concerned. Indeed, Hamilton's own experience in 2000 and Hamilton's and St. Catharines' experience in 2005 is consistent with this outcome. Across Ontario, 40% of all customers are currently served by municipally merged companies.

Customer Benefits of this Merger:

- 5.9% lower average annual rates throughout entire 25 year forecast period from cost savings, 8% lower after first 10 years
- No deterioration in service levels or response time – service response will be exactly the same as prior to merger

- Service Centres will remain in Hamilton and St. Catharines.
- 15% operating cost savings in first 10 years
- $426 million of net cash savings from operating and capital costs in the first 10 years
- $51 million approximately of sustained net cash savings thereafter per year

Community Benefits of this Merger:

- One company with three separate business area head offices in three separate communities
  - Utility head office in Hamilton
  - Corporate head office in Mississauga
  - Sustainability and Innovation head office in Vaughan
- Utility head office to reside in Hamilton downtown core
  - Located at current Horizon office 55 John St. North
  - Utility will have primary responsibility for providing electricity distribution services to 960,000 customers – Horizon currently provides serves 242,000 customers
- Existing operations service centres ideally located, will continue to serve communities from: Hamilton, St. Catharines, Mississauga, Brampton, Barrie, Markham, Vaughan.

Shareholder Benefits of this Merger:

- Maintain existing municipal ownership, just more shareholders of a larger business
- No single controlling shareholder
- 29% average increase in dividends for Horizon shareholders or $4.8 million per year over status quo, from $16.6 to $21.4 million
  - $3.8 million average increase in Hamilton dividend, from $13.0 to $16.8 million
  - $1.0 million average increase in St. Catharines dividend, from $3.5 to $4.5 million

Transaction Specifics:

- A three-way merger of the holding companies of Horizon Utilities, Enersource and PowerStream with joint acquisition of Hydro One Brampton
- Amalgamation of the respective local distribution businesses of Horizon Utilities, Enersource and PowerStream into one local distribution subsidiary company
- Amalgamation of the respective energy services companies of Horizon Utilities, Enersource and PowerStream into one commercially competitive subsidiary company
- New merged regulated local distribution company acquires Hydro One Brampton Networks Inc.
- Necessary human resource efficiencies will utilize voluntary initiatives to the greatest extent possible

In summary, the key aspects of the proposed merger are:

- Affordability/Local Competiveness
  - Mitigate future rate increases – residents and businesses
- Municipal Revenue
  - Provide enhanced utility dividend revenues to municipal shareholders to fund other community initiatives
- Stronger Company
  - Financial Resources – more strength and resilience
  - Human Resources – better training and wider opportunities
  - Technology & Innovation – more investment in future
- Industry Leadership
  - Increased influence on Provincial Policy and Regulations

Customer Benefits

Customers will benefit greatly in terms of rates from the creation of the merger for a number of very important reasons.

By regulation, it is mandatory that all of the efficiency savings from the utility merger are transferred to customers when the company files a new rate application that allows new assets to be recognized in its rate base ("rebasing"). The maximum length of time post-merger that a utility can go before being required to rebase with the Ontario Energy Board is no later than 10 years. So on the 11^{th} year the utility would be required to file an application and rebase its assets and reduce its revenue requirements to account for the merger savings. The time period prior to the first re-basing is commonly referred to as the deferral period.

Customers will nonetheless also benefit significantly through the deferral period leading up to the first rate re-basing for a very important reason. During the deferral period, and once Horizon's approved rates expire, future rate increases will be prescribed by the Ontario Energy Board and will be less than inflation as a result of its productivity targets. This represents a savings to customers who would otherwise experience higher rate increases.

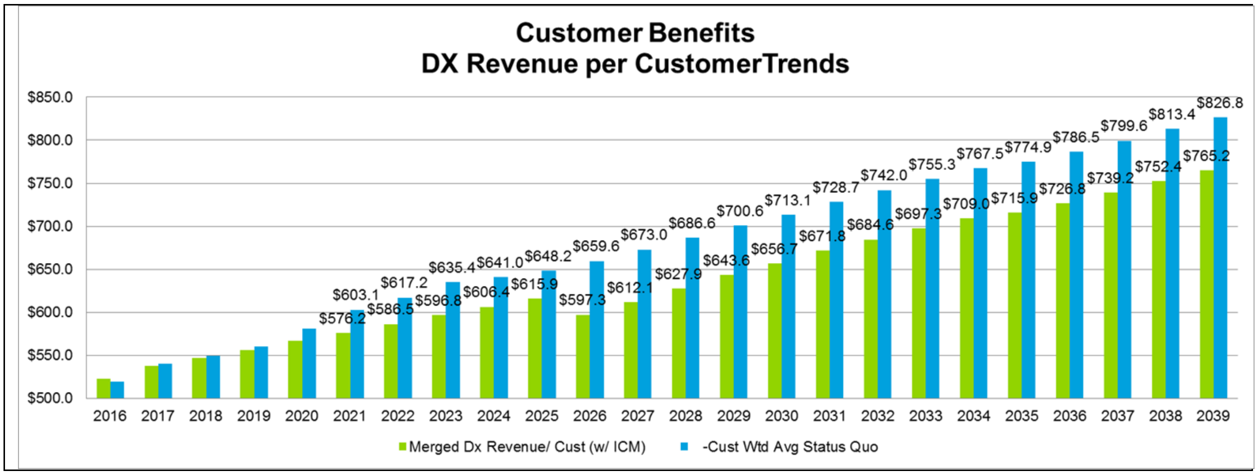
In addition, in the absence of the merger transaction, the three merger partners and Hydro One Brampton would continue to regularly re-base their rates, through successive cost of service applications, in order to recover ongoing increases in their cost structures. Under the merger, no such re-basing occurs during the deferral period. Consequently, as a result of the merger and consolidation generally, customers will benefit from lower rates during the deferral period.

Since each individual merger partner's cost structures prior to merging is different, the merger partners have agreed to maintain separate community rate zones. This would be in place until such time as rate differences are immaterial.

The overall relative benefit to customers under the "merged" versus "status quo" scenarios is illustrated in Figure 1. It shows the merger is expected to deliver lower distribution costs to its customers averaging:

- 5.9% or $48.6 million per year through the entire Forecast Period
- 3.3% or $19.5 million per year through the Re-basing Deferral Period
- 8.0% or $69.3 million per year following transfer of merger benefits to customers in 2026

Figure1: Average Distribution Revenue per Customer Merger vs. Status Quo



The merger rate savings for customers are a result of cost savings from merging. The merger is expected to generate significant savings as follows:

- $355 million or 15% of aggregate gross operations, maintenance and administration expenditure savings over the first 10 years of total OM&A expenditures
- $168 million of aggregate gross capital expenditure savings over the first 10 years
- $96 million of transition costs approximately in the first three years with respect to systems and process integration and human resource costs
- $426 million of net cash savings (pre-tax) in the first 10 years
- $51 million approximately of sustained savings thereafter per year

Shareholder Benefits

Based on the business analysis, the merger is expected to deliver meaningful shareholder benefits summarized as follows:

To the benefit of Horizon Holdings Inc. shareholders:

- 29% increase in the NPV of allocated shared earnings of approximately $73 million from $256 million to $329 million through the Forecast Period relative to the status quo
- 30% increase in the NPV of allocated shared dividends of approximately $47 million from $154 million to $201 million through the Forecast Period relative to the status quo
- $4.8 million average increase in annual dividends across the Forecast Period

The merger expects to adopt a dividend policy with dividend payments to municipal shareholders computed on shared earnings. Earnings would be determined in a manner consistent with that used by the Ontario Energy Board for purposes of its distribution rate-making policies, which uses what is commonly referred to as Modified International Financial Reporting Standards (a modified basis of International Financial Reporting Standards or "IFRS"). The merger's dividend policy as proposed is to have a target dividend payout of up to 60% of earnings, as it is currently for Horizon Holdings.

Community Perspectives and Benefits

The community perspective is important to consider as part of the overall merger plan. This section deals with how service levels will be maintained, the role and presence that each community will have post-merger, and the impact on employment and equitable treatment of employees.

The merger partners undertook a principled approach in the design of an effective organization plan. The following principles were used in the development of the plan:

- Customer service response levels are to be improved, but will be no less than service levels prior to merging in each community
- Merger would continue to maintain a strong local presence post-merger in each community
- All communities share the merger's benefits and cost reductions
- All communities treated fairly and equitably
- Centralized and de-centralized functions would continue in each community
- Management will retain management flexibility to fulfill targets for synergies of bringing the four businesses together

The merger will retain management flexibility to fulfill synergy targets. It recognizes that to achieve the desired customer and financial outcomes, operational processes and skilled employees must be in place to support and deliver on results.

Operational Focus

The merger will implement its business mission and vision by focusing on four operating strategies:

- Improving service delivery to customers
- Improving internal operational cost efficiencies and asset utilization
- Developing and maintaining highly skilled and motivated employees
- Increasing shareholder value through growth and productivity improvements

Employee Focus

The merger's most important resource is its employees. It will focus on four key areas to ensure that employees are fully engaged and contributing at their peak:

- Safe and healthy workplace
- Employee skill development
- Effective internal corporate communications

- Performance-based culture

The merger partners recognize that, to achieve the necessary and desired customer and financial outcomes, operational processes and skilled employees must be in place to support and deliver on results.

Governance - Proportionate Representation

Members of the Board of Directors would be chosen based on proportionate shareholdings of the shareholders. With a board of 13 directors, each shareholder entitled to nominate a proportionate number of individuals as board members as set out Table 1. Each shareholder has the right to nominate one non-independent individual as a board member, if they so wish, from their proportionate number of nominees.

Table 1: Director Appointment Rights

Shareholder	Number of Director Nominees
Barrie Hydro Holdings Inc.	1
Enersource Corporation	4
Hamilton Utilities Corporation	2
Markham Enterprises Corporation	2
St. Catharines Hydro Inc.	1
Vaughan Holdings Inc.	3

Business Organization Structure

Being a significant utility business focused on the safe, reliable, and cost-effective delivery of services to its customers, the merger would be focused on both regulated and competitive (non-regulated) businesses.

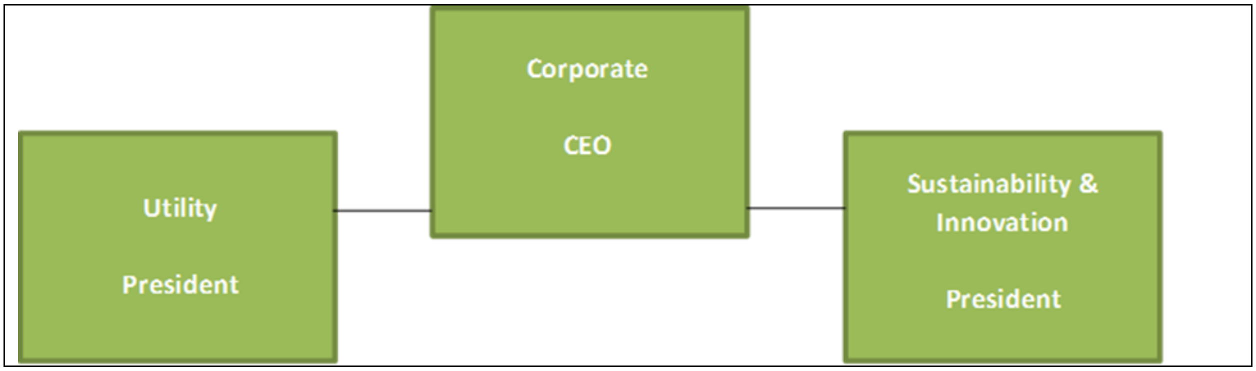
The regulated business activity would have two principal strategies. First, it would be interested in continuing to add value to its customers through continuous improvement. Second, it would be interested in growing through mergers and acquisition with other local distribution companies.

The unregulated business would have a very significant energy services business and renewable generation portfolio simply through amalgamating the competitive businesses of the merger partners. Its goal would be to pursue additional commercially viable, sustainable, and innovative solutions in new and related fields with competitive energy opportunities.

The organization structure of the merger has been designed with these two focuses in mind, making use of three corporate entities as shown in Figure 2.

- Holding company acting as a corporate entity for all companies
- Utility or local distribution company focused on managing the utility business
- Sustainability and Innovation company focused on the future growth

Figure 2: Merger Organizational Structure at Entity Level



The head offices for each of the three companies are to be located in a separate community, taking advantage of existing head office facilities, and will be led by a CEO (for HoldCo) or President (for each of the operating companies). At each head office, a strong local executive presence will exist.

The determination of the location for the head office and each of operating entities was based on practical considerations for both current and future requirements. The head office locations in each community will be guaranteed for 10 years and thereafter can only be changed with a two-thirds majority of the shareholders.

Corporate Head Office

The corporate head office will be located in Mississauga at Enersource's Derry Road administration facility. The Mississauga location is central to the merger's existing business, is readily accessible by multiple highways, is nearly equidistant from the proposed Utility and Sustainability and Innovation offices (noted below), which maximizes efficiency of interaction and travel.

Utility Head Office

The Utility head office will be located in Hamilton at Horizon Utilities' John St. facility. The utility head office in Hamilton will be focused on delivering operational excellence and on future utility consolidations. The Hamilton location aligns well with future consolidation opportunities due to its proximity to a large concentration of local distribution companies.

The priority of the utility business will be to ensure future capital investments and operations occur in a manner that is positioning the utility to be a top performer in terms of customer service, reliability, and cost leadership.

Sustainability and Innovation Head Office

The Sustainability and Innovation Head Office will be located in Vaughan at PowerStream's City View Blvd. facility. The Vaughan Head Office will focus on innovation in such areas as solar, smart grid and new energy services. The Vaughan office has already established a reputation for excellence in innovation.

Service Levels – Utility Business

In merging Horizon, Enersource and PowerStream and acquiring Hydro One Brampton there will be role duplications, given the four utilities have similar business purposes and functions. While all four local distribution companies are leaders in efficiency in the Ontario Energy Board's efficiency rankings, opportunities for further cost efficiencies will exist.

Operating Regions

The merger will initially have three distinct operating regions. These will be reflected in the organizational design at the operational structure at the operating level. The operating regions are detailed in Table 2.

Table 2: Merger Operating Regions

Western Region:	Horizon service territories – Hamilton and St. Catharines
Central Region:	Enersource and Hydro One Brampton service territories
Eastern Region:	PowerStream service territories – Aurora, Markham, Vaughan and Richmond Hill and Barrie and a number of smaller satellite communities

Centralized and Decentralized Services

In developing its operational organizational structure, the merger's primary considerations will be efficiency, effectiveness and service levels. Not all job functions within the utility are directly tied to the regions they serve. In fact, several services can be performed centrally for efficiency purposes, rather than in the service region, without any degradation of efficiency, effectiveness, and service levels. Centralizing appropriate functions contributes to creating scale and lowering costs, which is a fundamental objective of the merger. A necessary step is to identify what functions can be centralized and what functions are best left decentralized.

Asset Related Services

For the merger, regional functions would be categorized as those focused on the delivery of service at the asset or infrastructure level in the field. Opportunities exist for reduction and rationalization of Asset Related Services. This comes with the adoption of best practices in job planning, resource planning/allocation methodologies and task productivity improvements. However, the overall optimization function recognizes the inherent regional aspect of these tasks, and the benefit of delivering them in a decentralized manner. They are intrinsically linked to geographic assets and trade-off of commuting costs, response time and overall productivity that would be lost to centralization.

Transactional / Informational Services

Transactional/informational services, by contrast, are technology focused. The definition of technology includes business processes. These functions utilize technology as leverage for productivity.

The focus is typically on standardization and repeatability and is not tied to the field and thus these functions are prone to be more centralized.

In certain areas, a hybrid approach between centralized and decentralized functions is desirable, and therefore will be employed, such as in Human Resources and Information Technology.

Community Operational Presence – Service Centres

The merger will utilize the six existing service centres located within the three regions:

- Western Region – Hamilton and St. Catharines
- Central Region – Mississauga and Brampton
- Eastern Region – Markham and Barrie

From a service standpoint, very little, if anything, would change with regard to Horizon service centres. The implication is that no reduction or alteration of service levels will result from the merger.

Transaction Overview

In this section a quick overview of the transaction is provided, touching on the following areas to outline the financial framework of the merger.

- Corporate Structure
- Valuation
- Tax Environment
- Corporate Finance
- Merger Synergy Savings
- Due Diligence

The merger transaction being proposed comprises the following:

- A merger of the regulated and non-regulated business activities of: PowerStream Holdings Inc., Enersource, and Horizon Holdings Inc. (individually, “a merger partner” and collectively, the “merger partners”)
- An acquisition of the regulated electricity distribution business of Hydro One Brampton Networks Inc. for gross proceeds of $607 million net of any purchase price adjustments as defined in the corresponding Share Purchase Agreement.

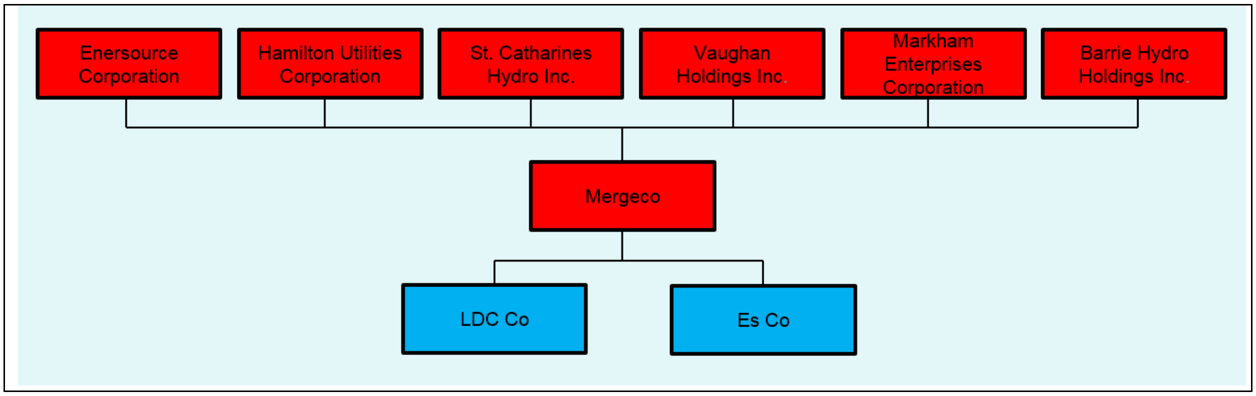
Corporate Structure

The corporate structure has been designed with the following objectives:

- Financial flexibility to support ongoing sustainment-based investment in electricity distribution and business growth
- Tax efficiency

The proposed final merger structure is shown in Figure 3.

Figure 3: Proposed Corporate Structure



In Figure 3, the Holdco shown is a new holding company for all of the businesses of the merger, both on the regulated and competitive business sides.

The new Local Distribution Company (shown in Figure 3 as "LDC Co") will be the company that combines all the regulated businesses and their assets as well as the solar generation assets.

The Energy Services Company (shown in Figure 3 as "ES Co") holds all other competitive services and other non-regulated business interests.

The existing businesses of Enersource Corporation, Horizon Holdings Inc. and PowerStream Inc. would be effectively merged in the new LDC Co and new ES Co. Hydro One Brampton Inc. would be directly acquired into the new LDC Co.

With one exception, the merger would be held directly by municipal holding companies that, in turn, are held directly by respective municipalities as follows:

- Hamilton Utilities Corporation – City of Hamilton
- St. Catharines Hydro Inc. – City of St. Catharines
- Barrie Hydro Holdings Inc. – Town of Barrie
- Markham Enterprises Corporation – City of Markham
- Vaughan Holdings Inc. – City of Vaughan

The exception is Enersource. The City of Mississauga and BPC Energy Corporation ("Borealis", a wholly owned subsidiary of OMERS, or Ontario Municipal Employees Retirement System) are the current owners of Enersource. Mississauga owns 90% and Borealis owns 10% of Enersource's shares. They would continue to hold their respective shareholder interests in the merger through Enersource Corporation.

The merger will require financial flexibility, including outside investment, to support its growth objectives or it would effectively be limited to issuing debt. In order to provide this financial flexibility, the merger proposes to adopt a partnership structure for each of its electricity distribution business (the "LDC Co") and electricity generation in its energy services businesses. The use of a partnership is expected to permit additional private investment in a tax efficient manner not available to more traditional corporate structures. The partnership structure would not affect shareholdings.

The partnership structure is expected to be adopted subject to:

- Receipt of appropriate and favourable tax rulings and interpretations, and
- Regulatory acceptability by the Ontario Energy Board

Assuming the partnership structure is adopted, the LDC Co assets of the merger would be transferred to the LDC LP on a tax deferred basis. The solar generating assets of the merger could be similarly transferred to a separate LP to provide similar financial flexibility benefits.

Valuation

The merger partners engaged Deloitte LLP to perform a relative (as opposed to absolute) valuation of each merger partners to the transaction for purposes of allocating the merger shareholdings to the respective shareholders of each merger partner.

The merger partners requested a relative valuation of income generating assets on the basis that each would contribute a common capital structure (i.e., debt and equity) to the merger. The common capital structure adopted for purposes of valuation is comprised of 60% debt and 40% equity relative to contributed assets.

The principal business of each merger partner is regulated electricity distribution. The asset value or “Rate Base” of the regulated and total business (regulated and non-regulated) of each merger partner is shown in Figure 4 based on 2014 financial statements.

Figure 4: Rate Base Valuation of Regulated and Non-Regulated Businesses

Rate Base - Regulated Business ($M)		
	2014	**%**
PowerStream	$929.5	45.1%
Enersource	$654.1	31.7%
Horizon Utilities	$477.6	23.2%
	$2,061.2	
Rate Base - Regulated and Non- Regulted Business ($M)		
	2014	**%**
PowerStream	$952.6	45.5%
Enersource	$657.2	31.4%
Horizon Utilities	$483.8	23.1%
	$2,093.6	

Note: The calculation of Rate Base is based on the information from 2014 Financial Statements only and does not include any adjustments for non-distribution assets.

Each merger partner has non-regulated businesses as follows:

- Horizon Holdings Inc. – solar generation, meter servicing, and water billing
- Enersource Hydro Mississauga – streetlight maintenance, high voltage design and maintenance
- PowerStream – PSSolar, sub-metering, and other energy businesses

The PSSolar business is not included in the relative valuation of the merger partners. PowerStream shareholders will continue to benefit directly from the economics of the underlying solar assets and contracts existing as of the merger date. The contracts, however, will remain in the merger and will be managed by the merger under a management services agreement.

Deloitte employed leading valuation principles in its determination of relative value as follows:

- Enterprise Value – uses discounted cash flow analysis to arrive at the value of each merger partner
- Market Multiple – multiple of the asset value determined that a prospective purchaser might be willing to pay on the basis that it continues to earn a regulated rate of return on the regulated assets of each merger partner after consideration for merger costs and savings.

The Enterprise Value approach was used exclusively to value the non-regulated business investments of each merger partner. The high-level results of the relative valuation by merger partner are shown in Figure 5:

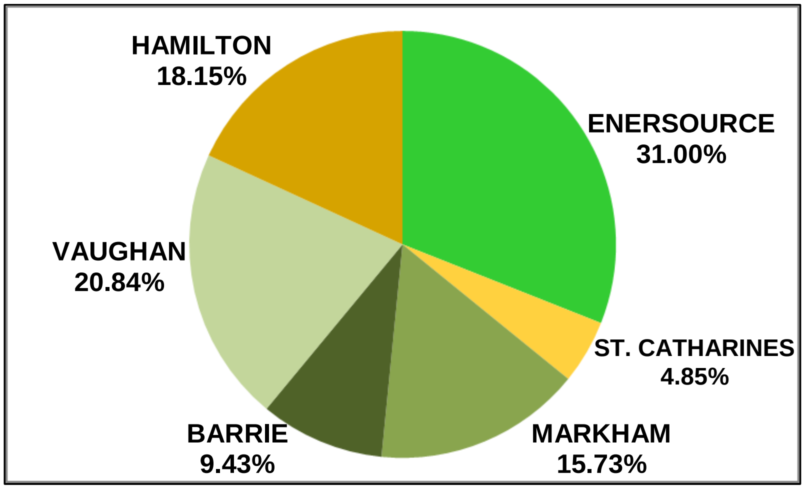
Figure 5: Enterprise and Market Value of the Merger Comparison

	Enterprise Value	Market Value	Difference (MM-EV)
PowerStream	46.0%	45.2%	-0.7%
Enersource	31.0%	31.5%	0.5%
Horizon	23.0%	23.3%	0.3%

It is evident from the above that both approaches yield very similar results. The merger partners anticipate using the Enterprise Value approach as the primary approach to value on the basis that this is a more pure analytical approach for purposes of relative valuation. A valuation based on market multiples is a relevant test of the reasonability of the relative values reached through the Enterprise Value approach.

The allocation of shareholdings under the Enterprise Value approach is shown in Figure 6:

Figure 6: Shareholder Allocations of the Merger based on Enterprise Value



NB: Enersource would be the actual shareholder rather than Mississauga and Borealis, since Borealis (a division of OMERS) cannot be a direct shareholder for tax efficiency reasons.

The valuation results indicate that there is no single controlling interest in the merger. The shareholdings are well distributed among shareholders, with Enersource having the largest interest at 31.0% (with the City of Mississauga and Borealis respectively having interests therein of 27.9% and 3.1%).

Tax Environment

Under the *Income Tax Act (Canada)*, the merged company is tax exempt. It will make payments in lieu of taxes (PILs) to the Ontario Government, but from an Income Tax Act perspective it is a tax exempt entity. PILs paid to the Ontario Government are credited towards the province's Provincial Transfer Tax.

The Transfer Tax is applied on the sale of municipal electric utility assets. (It is set at 33% of Fair Market Value of property transferred. Recently, the Ontario Government has communicated a reduction of Transfer Tax that will take effect between January 1, 2016 and December 31, 2018. It has reduced the Transfer Tax from 33% to 22%. Former PILs payments can be accumulated since incorporation and can be used as a credit to shield the amount of Transfer Tax to be paid on a transfer of interest to a non-exempt person under the Income Tax Act person.

In order for the merger to remain tax-exempt under the Income Tax Act:

- Each municipal holding company which owns shares in the merger must remain at least 90% owned by a municipality, and
- The merger must remain 100% owned by one or a combination of municipalities or municipal holding companies

Corporate Finance

The merger will require ongoing access to financial capital to address the following investment objectives:

- Ongoing sustainment of the electricity distribution business through re-investment in aged infrastructure, new investment in customer connections growth, and corresponding working capital
- Acquisition of Hydro One Brampton
- Growth through mergers and acquisitions or logical extensions of the existing business
- Shareholder preferences for monetizing their respective investment interests in the merger

The regulated utility sector in Canada and much of the United States is generally in an A-range for utilities that do not have significant commodity-based exposures. In Canada, 20 of 33 rated utilities are in the Standard and Poor's A-range. Consequently, a long-term A-range outlook is an appropriate target for the merger at this time and considering the nature of its combined business.

Sustainment-Based Investment

The financial plan has been modelled on the basis that the ongoing sustainment and growth requirements of the electricity distribution system in the merger are provided for in a manner consistent with the long-term forecasts of the entities on a stand-alone basis. In other words, the merger will not alter the capital requirements for the renewal of assets and meeting the natural growth within each community, as each merger partner had planned for prior to entering into these merger discussions.

Each entity has long-term capital plans based on detailed asset condition assessments, growth estimates, and sound engineering principles. These plans will be maintained under the merger.

Rate-making policy effectively establishes an appropriate capital structure for Ontario local distribution companies. This "deemed" structure comprises 60% debt and 40% equity in support of the regulated assets or "Rate Base" of a local distribution company. At these levels of debt and equity and corresponding rate-recovery of financial capital, rate-making policy effectively supports an A-range credit rating.

The merger anticipates maintaining a financial capital structure around 60% debt as a result of the acquisition of Hydro One Brampton. The merger will manage its business to continue to support an A-range rating.

Acquisition of Hydro One Brampton

Acquisition Financing

Hydro One Brampton Networks Inc. is effectively being acquired by the merger without the assumption of any debt, other than debt-like obligations not severable from the business.

These debt-like obligations include customer deposits, regulatory liabilities, and employee benefit liabilities.

On this basis, the acquisition of Hydro One Brampton is to be financed by:

- Borrowing against Hydro One Brampton's Rate Base to the extent such borrowing supports an A-range rating overall for the merger
- Contributions of borrowing capacity and / or new equity capital by each Party in proportion to its relative shareholding in the merger

The level of borrowing to support the transaction will be set at between 70% and 75% of the Hydro One Brampton purchase price to optimize the cost of financial capital for the merger, while also providing sufficient ongoing liquidity to support its sustainment-based investment requirements at a target A-range credit rating.

The amount of borrowing and capital contribution by source is summarized in the Table 3, assuming an overall 70% level of debt financing to finance the Hydro One Brampton purchase price. While Enersource and PowerStream will need to contribute new capital to acquire Hydro One Brampton, Horizon Holdings has sufficient debt room to pay for its portion of the acquisition.

Table 3: Borrowing and Capital Contribution Requirements by local distribution company

($ millions)	**Debt Capacity**	**New Equity**	**Total**
Hydro One Brampton Networks Inc.	201.6	-	201.6
PowerStream Inc.	61.6	124.7	186.3
Enersource Corporation	61.1	64.6	125.7
Horizon Holdings Inc.	100.6	($7.2)	93.4
Total	424.9	182.1	607.0

The acquisition of Hydro One Brampton represents a long-term investment by the merger. Such investment is properly financed by corresponding long-term financial instruments such as long-term debt and / or new shareholder equity.

Growth Investment

As a result of the tax regimes within which local distribution companies operate, growth capital has been substantially limited to an ability to raise new debt capital. The tax status of local distribution companies and their investment interests was described earlier.

Following the acquisition of Hydro One Brampton and with consideration for its ongoing sustainment investment requirements, the merger will not have sufficient borrowing capacity to achieve its strategic growth objectives. Consequently, a structured approach is required to manage PILs and Transfer Tax to allow new capital to enter the merger for future growth opportunities.

The structure provided for within the Corporate Structure summary section represents such a structured approach to managing these taxes. Specifically, the structure contemplates the use of partnerships to permit the issuance of treasury units for cash to private interests in a manner that is not expected to result in either Transfer Tax or Departure Tax. The structure also permits some level of Transfer Tax paid on monetization of shareholder interests without the risk of triggering Departure Tax.

The contemplated use of the partnership structure is consistent with the existing tax regimes imposed on local distribution companies and does not result in any tax leakage to the taxing authorities with respect to the tax basis of the merger investment interests. Consequently, the merger partners expect that the structure should be acceptable to the tax authorities.

Other options to financing growth are limited within the context of the current tax regimes governing municipally-owned local distribution companies. Such options are either significantly less cost effective or significantly limit the amount of private financial growth capital that can be accessed without resulting in material tax consequences.