

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

**AND IN THE MATTER OF a generic proceeding on the Board's
motion to hear submissions on the Directive of the Minister of
Energy, Science and Technology dated June 7, 2000**

SUBMISSION OF THE INTERVENORS

BOREALIS ENERGY CORPORATION

AND THE

CITY OF MISSISSAUGA

Introduction

Borealis Energy Corporation ("Borealis") and the City of Mississauga ("Mississauga" or the "City") (individually, the "Party", collectively, the "Parties") have intervened in this proceeding arranged by the Ontario Energy Board (the "OEB" or the "Board") to present the views of Enersource Corporation ("Enersource") a corporation incorporated by the Parties to undertake a consolidation of municipally owned electric utilities in the 905 area code (the "905 MEU's").

The Enersource Partners

Mississauga is the owner of Hydro Mississauga Corporation ("HMC") which distributes electricity to residential, commercial and industrial customers within Mississauga. Borealis is a subsidiary of the Ontario Municipal Employees Retirement System ("OMERS") which was established in 1962 by the Province of Ontario (the "Province") as a multi-employer pension plan for employees of local governments in Ontario. OMERS is financed by equal contributions from participating employers and employees and by investment earnings of the fund. As of March 31, 2000, a total of 1,169 municipalities, boards and commissions participate in the plan which has approximately 300,000 members who are or will be eligible for pension benefits.

OMERS has traditionally been an investor in public infrastructure projects through the purchase of federal, provincial and municipal securities. OMERS formed Borealis in 1998 to make direct investments in public infrastructure assets and services because governments were moving to a process where they would regulate but not own traditional infrastructure assets and as such sought alternative means of sponsoring, developing and financing them.

After reviewing and analysing Bill 35, which legislated the proposed de-regulation of the electricity industry, Borealis concluded that its involvement in the electricity distribution business would meet its investment mandate. In addition, the Province's expressed goals of encouraging consolidation of municipal electric utilities (MEUs) and the reluctance of many public officials to immediately offer their MEUs for sale, were positive signals to Borealis to participate in the electricity distribution business. Borealis began to develop creative financing solutions to accommodate the financial and political objectives of the cities within the 905 area (individually the "905 City", collectively, the "905 Cities"). with respect to the long-term goals of their 905 MEUs.

On Mississauga's part, it commenced extensive public discussions and a costly twelve-month investigation into the alternatives facing its MEU and concluded that it should retain HMC in public hands. In April 2000, the City announced that it would enter into a strategic partnership with Borealis with the object of consolidating the 905 MEU's under a single corporate umbrella, Enersource. A target date of November, 2000 was set for the consolidation of the 905 MEUs (the "Amalgamation") in order to take advantage of the provincial deadline for the introduction of the transfer tax.

The Enersource Offer: Structure and Advantages

The Enersource offer (the "offer") provides for the re-capitalization of each new 905 MEU participant in the Amalgamation in accordance with its regulated rate base and its debt/equity ratio approved by the OEB. In the process, the Offer provides each participating 905 City with cash amounting to the approved debt component of its utility plus shares in Enersource equal to the 905 MEU's approved equity component. A cash investment in Enersource is then made by Borealis equivalent to 10% of the

value of the equity of the merged utility which is intended to provide capital to support growth and investment in state-of-the-art systems, as well as the development of additional retail opportunities.

In order to provide the participating 905 City with the assurance of a minimum sale price for its utility, Borealis provides a put option exercisable in 2004 at the option of the 905 City. In addition to the put option, each participating 905 City is permitted by the shareholders' agreement to sell its shares in Enersource to other 905 City shareholders until 2004. After 2004 the shares can be sold to third parties with customary rights of first refusal by the remaining shareholders.

Enersource provides opportunities for economies of scale and scope that are not found in a smaller stand-alone municipal utility. The cash investment by Borealis can support capital investment for growth and new investments including the development of a substantial retail business. In addition, the larger entity provides a critical mass to create efficiencies in the 905 MEUs and to develop new businesses such as telecommunication and fibre optics. A larger customer base and additional rights-of-way, hydro poles and ducts can also provide untapped advantages to a well-financed and aggressive company like Enersource.

The formation of Enersource was not designed as an opportunity for a quick sale. The Enersource Offer protects the public interest by retaining the municipal utility in public hands and offering a real opportunity for electricity customers in their capacity as taxpayers to benefit from a return on new business opportunities. In addition, the electricity consumer will continue to experience high system reliability and quality customer service.

Enersource is an Ontario-made solution. It combines homegrown capital with the expertise of the 905 MEU's current employees to create a real opportunity for local taxpayers to share in the new electricity marketplace. Borealis, OMERS and Mississauga have taken the long-view in their investment decisions. Enersource offers employees expanded career opportunities. It offers participating 905 MEUs a familiar partner and its long-term objective is to provide customers with fair and competitive electricity distribution rates and real opportunities for taxpayer benefits.

Current status of Enersource

Since April 2000, Mississauga and Borealis have spent considerable time and money presenting the advantages of joining Enersource to almost all the 905 Cities. Both Mississauga and Borealis have spent large amounts of money on lawyers, accountants, consultants and investment bankers on structuring the amalgamation, preparing alliance and shareholders' agreements and preparing business plans of the 905 MEU's. Enersource had also prepared all the necessary legal documents and was about to enter the capital markets with a bond offering when the Minister of Energy's directive was issued and Bill 100 was introduced.

This bond offering is no longer a marketable product in the capital markets as Bill 100, although not yet law, has removed its ability to cover the interest costs from cash flow that would otherwise be available from hydro rates.

Also with the uncertainty generated by Bill 100 and the window for tax-free amalgamations rapidly closing, Enersource is concerned that if Bill 100 is not withdrawn this summer then this window of opportunity for consolidating the 905 MEUs will be closed.

Enersource and its founding partners, Mississauga and Borealis, understand that Bill 100 is not the responsibility or the creature of the OEB. They also understand that amending Bill 100 is beyond the authority of the Board. In any event, there needs to be a solution to the current impasse and Borealis and Mississauga are convinced that this Board forms an integral part of that solution and they are therefore prepared to work with all the parties to find an acceptable resolution to the concerns which gave rise to the tabling of Bill 100.

Impact of Bill 100 on Valuations and Amalgamations

Bill 100 raises serious concerns about the value of all MEU's which are generally determined by earnings and cashflows. There is now no reasonable way to accurately predict future distribution rates and earnings to which an MEU will be entitled. Moreover, Bill 100 could be interpreted to permit returns on only new capital invested in the business which may be insufficient to permit 905 MEU's to meet any unusual demands for cash outlay which may arise from time to time to ensure the reliability and safety of the system. Further, Bill 100 raises the potential issue of a write-down of the 905 MEU assets in accordance with generally accepted accounting principles.

Bill 100 also raises new concerns about the benefits of municipal mergers if no returns on equity can be earned. Municipal shareholders will not be prepared to accept the public reaction and the difficult issues of governance inherent in rationalization of their hydro utilities without certainty of returns.

Bill 100 also presents private sector investors with significant uncertainties. The legislation sends a negative signal to prospective private sector investors that the Province is prepared to retroactively change legislation regardless of the financial consequences to private investors. Moreover, the legislation discourages investors such as Borealis to use its financial resources to act as a catalyst to facilitate the merger of MEU's if there is significant uncertainty as to their future revenue streams.

The commercial marketplace is not comfortable with an ever-changing landscape that seems to be driven by political exigencies rather than sound business judgment. Not only is the investment community concerned but the bond markets have sent strong signals to the marketplace that they too are not willing to invest in distribution utilities until the uncertainty is removed.

For these reasons, Mississauga and Borealis cannot pretend that Bill 100 has had no effect on the Amalgamation of the 905 MEUs. The Enersource Offer would allow

participating 905 Cities to convert a substantial portion of their hydro assets into cash, share in potential new retail businesses and still keep their hydro in public hands. Bill 100 has effectively removed the cash component from the plan by disallowing the cost of this debt in hydro rates and thereby indirectly reducing the value of each 905 MEU.

The effect is that Bill 100 has altered the parameters of Enersource's plan and destabilized its Amalgamation program. CBRS, which rates the debt of most municipalities and follows the electricity re-structuring in Ontario, recently reported that:

... implementation of this legislation (Bill 100) may exacerbate regulatory uncertainty in the re-structuring of the Ontario electricity industry. (CBRS Inc. Special Report, July 2000, Volume 1)

and

This is the second time in three years that Ontario municipalities have seen legislation that dramatically alters the terms of earlier provincial legislation. ...Bill 100 ... prevents re-capitalization and utility rate increases that earlier legislation clearly permitted ...

Whatever message the Province intended by introducing Bill 100, one thing is clear: electricity re-structuring just got more uncertain not less.

Part of this uncertainty results from the fact that Bill 100 seems to illustrate an intention on the part of the Province to favour the sale rather than the amalgamation of municipally owned utilities. Bill 100 will have the unintended result of municipal shareholders and private sector investors abandoning the field to the Province's own utility: Hydro One.

The CBRS report states:

In our opinion, the 33% transfer tax and Bill 100 amendments effectively render Hydro One as the prime candidate to acquire MEUs such that the

company may be able to achieve significant consolidation within the distribution sector. (CBRS Report page 4, column 1)

In the same report CBRS states:

The transfer tax effectively crowds out private sector interest in any prospective MEU sale, (Bill 100 disallows) ... rate setting to re-capture debt service for re-capitalization purposes (which) may motivate municipalities to divest their interest in the local distribution company. Furthermore, there may be limited financial incentive for municipalities to merge and consolidate their local distribution interest with each other following Bill 100 rate setting restrictions. (CBRS Report column 2 page 3)

Mississauga and Borealis agree with the comments by the rating agencies that Bill 100 is seen as a serious impediment to amalgamating municipal utilities and an unwarranted intrusion into the commercial marketplace. In fact, Bill 100 by having the unintended result of favouring Hydro One, has created the very distinct possibility of the complete monopolization of the Province's electricity distribution system.

In addition, the legislation makes no mention of squeezing efficiencies from the major component of the customers' monthly bill: the commodity charge.

In fact, the Province's generating company, Ontario Power Generation Inc. ("OPG") is selling power to Hydro One at rates which are cheaper than those it charges municipal utilities. The effect of this pricing scheme is that OPG is giving a subsidy to Hydro One which means that on market opening, Hydro One customers will experience a rapid increase in the energy component of their overall rates.

Furthermore, the OPG subsidy also disguises Hydro One's true cost of distributing power which is excessive even after accounting for the rural rate assistance. The lower cost of power or "subsidy" has allowed Hydro One to maintain its old rates and increase its distribution costs resulting in a skewed comparison with other utilities.. For this reason Enersource cautions the Province against using Hydro One as the basis for comparing distribution rates.

Finally, Bill 100 raises serious doubts about the role and independence of this Board. The Board has developed its Electricity Rate Handbook through a process that is consistent with the governing legislation and it has maintained a strict principle of not distinguishing between municipal, government and privately owned MEUs. Bill 100 has now compromised this fairness. The Rate Handbook is an excellent tool that should be allowed to guide the rate setting process as it was developed with the input from the users. Bill 100 is unnecessary if the Rate Handbook is used as originally designed.

Suggested Solutions

Borealis, OMERS and Mississauga are of the opinion that a solution to resolve the differences between the Minister's Directive to protect hydro consumers and the commercialization of the MEUs (which, by definition, requires the MEUs to adopt for-profit commercial practices) must be based on the following principles:

- the restoration by the Province of the independence of the Ontario Energy board as an independent adjudicator;
- the acceptance by all participants in the electricity distribution business that the operating financial parameters of the MEUs will be governed by the Electricity Rate Handbook; and
- the acceptance by all participants in the electricity distribution business that rate shock to the consumer must be mitigated, subject to the MEUs being adequately compensated for the transition costs of corporatizing their entities and any unusual expenditures to ensure safety and reliability of the electricity distribution system.

As a solution, Borealis and Mississauga propose that the full Market Based Rate of Return (MBRR) be phased in over the first generation PBR.

Enersource has included below one example of a phase-in approach which meets the Minister’s Directive. In order to illustrate this methodology, Enersource has applied the solution to HMC. The table below is intended to be just one example of an acceptable phase-in solution. There are other rate setting options which will generate similar results.

The example selected by Enersource shows no rate increase before market opening and average increases of 2.5% for each of the next two years and 3.0% for the third year. These increases will approximate forecasted inflation rates for the projected period 2000 – 2003 and represent a reasonable approach to moving the rate structure to the allowable levels set by the Rate Handbook. More importantly, this approach will satisfy the Directive from the Minister with respect to the concerns for the impact of the proposed rates on the consumer.

In the case of HMC the MBRR will not be reached until the final year of the first generation PBR. The average customer of HMC would then experience rate increases, assuming energy costs do not decrease, which will be close to forecasted inflation rates. Enersource is of the opinion that a similar procedure with other MEUs will result in comparable phased-in increases. As PBR takes hold in the second generation of rate applications along with the introduction of competition in generation, rates will begin to fall. The short-term impact of rate increases will be more than offset by the longer-term rate reductions.

	2000	2001	2002	2003
Average All - Customer Rate Increase	0	2.5%	2.5%	3%

Conclusion

Borealis and Mississauga respectfully recommend the above solution to the Board as it meets the terms of the Directive, satisfies the concerns of the commercial

marketplace and can be implemented without a change to the Electricity Rate Handbook.

Mississauga and Borealis are confident that the solution proposed, satisfies the Minister's concerns expressed in the Directive and, therefore, Bill 100 should be withdrawn, and by doing so, the independence of the Board and the fairness of the rate adjudication process can be maintained.