Manitoba Hydro Proposal to Purchase Winnipeg Hydro
File H (Vol. 10) [c/r HG (Vol. 4)]

5. On March 20, 1997, City Council adopted the Reshaping Our Civic Government report that described a series of initiatives aimed at addressing City Council's priority - Improving our local government. Significant among those initiatives was a directive to the administration to examine the options and issues related to the future of Winnipeg Hydro.

Ernst & Young and CIBC/Wood Gundy were engaged to prepare a written report providing "an analysis of the strategic options available to the City in regards to its ownership of Winnipeg Hydro." Among the options to consider were:

i) the status quo;
ii) a re-capitalization of Winnipeg Hydro;
iii) a merger or sale of all or a part interest of Winnipeg Hydro;
iv) a sale of a component business (generation, transmission or distribution);
v) a public offering.

An Administrative Review Team undertook a preliminary examination of the consultant's first draft.

On March 24, 1999, Council approved a request from the Administration to update the original study to reflect the current hydroelectric environment and to look at and report on recent developments in the industry.

Subsequent to the receipt of the above mentioned update the Administration prepared a report for consideration by Council that concluded:

"There are no pressing reasons why the City should look at selling Winnipeg Hydro at this time. There is a steady stream of dividends available and upgrading of the Pointe du Bois facility will render the utility more valuable in the future. Should the outcome of the current Power Agreement negotiations turn out to be similar as what exists today, then an accelerated approach to upgrading Point du Bois should be taken. If the outcome of negotiations is not favorable to the City then a less aggressive upgrading schedule should be adopted."

Consideration of the report of the Administration resulted in Clause 2 of the Report of the Executive Policy Committee dated April 12, 2000, which was adopted by Council at its meeting held on April 26, 2000, and reads as follows:

"The Executive Policy Committee recommends:

1. *That the City continue to own and operate Winnipeg Hydro.*
2. *That the dividend stream to the City from Winnipeg Hydro be stabilized at current levels.*
3. *That no decision be made on the pace of the Straflo upgrade until the Power Agreement with Manitoba Hydro is concluded.*
4. *That the Proper Officers of the City be authorized to do all things necessary to effect the intent of the foregoing."*

This direction has served to guide the Administration since its adoption. In the interim, from time to time and informally, Manitoba Hydro has expressed interest in acquiring Winnipeg Hydro but no official offer was tendered nor, until very recently, was any form of negotiation undertaken.

Manitoba Hydro has forwarded to the Chief Administrative Officer a proposal for the purchase of Winnipeg Hydro, hereinafter sometimes referred to as the Utility. A copy of the proposal dated February 7, 2002, as outlined on Appendix "A". Further to the proposal dated February 7, 2002, Manitoba Hydro has also forwarded a letter dated February 19, 2002, outlined in Appendix "B" addressing concerns expressed by Councillors and staff with respect to the future prospects of Winnipeg Hydro employees, particularly the matter of employees pensions.

It is the responsibility of the Chief Administrative Officer to consider any proposal to purchase City-owned assets and, where it is judged appropriate, to make recommendations to Council with respect to how the City's interests might best be served.

Accordingly, the following assessment of the merits of the Manitoba Hydro proposal and an examination of the implications of the contemplated sale for the customers of Winnipeg Hydro, the taxpayers of the City of Winnipeg and of Manitoba, and the affected City employees has been prepared.

Manitoba Hydro has proposed to acquire the whole of the assets, business and undertakings of Winnipeg Hydro, in consideration of which Manitoba Hydro will:

- Pay to the City annual amounts as follows: $25 million in years 1 through 5, $20 million in years 6 through 9, and $16 million annually thereafter in perpetuity.

- Assume all assets and liabilities of the Utility including outstanding net debenture and other debt.

- At no cost to the City, guarantee annual energy cost savings in the amount of $1 million through a combination of savings from participation in the Manitoba Hydro Power Smart programs and the provision of free Christmas lighting.

- Additionally, Manitoba Hydro undertakes to occupy 400,000 square feet of new Class A office space to be constructed somewhere in the Downtown area.

This proposal has substantial merit inasmuch as:

1. The annual payments would stabilize and guarantee the City's historical Winnipeg Hydro-generated dividend stream in perpetuity. Moreover, in the first nine years, the payments proposed are in excess of dividends that could be reasonably expected if the City were to continue to operate the Utility. Furthermore, the Utility's aging generating and transmission facilities in particular are in need of replacement and or refitting. The cost to service debt that would have to be incurred to complete this work would result in significant reductions to the annual dividends the City currently uses to hold down property and other taxes.

2. The benefits outlined above may be sufficient in themselves to recommend finalization of a sale agreement with Manitoba Hydro. However, two other consequences of such a sale represent significant benefit to the City. First, our credit raters will no doubt favorably regard the elimination of debt guarantees. Second, the development of 400,000 square feet of office space in Downtown will produce additional property tax revenues. Perhaps just as important is the fact

such a development would directly contribute to achieving Council's stated policy objective to re-vitalize Downtown.

This proposal provides a premium price for Winnipeg Hydro and eliminates significant business risk going forward.

The confidence of the Administration with respect to the merits of the Manitoba Hydro proposal is strongly underpinned by the findings contained in the recent and extensive study of alternatives for Winnipeg Hydro ordered by the previous Council and conducted by Ernst & Young and CIBC World Markets. CIBC World Markets has examined the Manitoba Hydro proposal against the backdrop of the earlier findings and have advised that the proposal represents a fair price for the whole of the assets, business and undertakings of Winnipeg Hydro.

Council has a general obligation to protect the interests of the citizens it represents as well as additional obligations to those of its citizens who are customers of Winnipeg Hydro. The particular and specific interests of Winnipeg Hydro customers must not be compromised as a consequence of a change in ownership. Broadly, these interests can be grouped in the categories - Service Quality and Reliability and Rates.

A. Service Quality and Reliability

Winnipeg Hydro has an excellent record in respect of service quality and reliability. Manitoba Hydro also has a good record in this regard. With respect to service reliability in particular there are no grounds for concern. Service reliability is a function of energy supply, 50 per cent of which is already supplied by Manitoba Hydro, and the design parameters and maintenance standards of the distribution system, none of which are likely to change as a result of this sale. Similarly, there is no reason to expect that the quality of service in general is likely to be negatively affected by the sale.

B. Rates

Winnipeggers, including the customers of both Winnipeg and Manitoba Hydro, enjoy some of the lowest rates in North America. Presently, by law, Winnipeg Hydro rates must be identical to those charged by Manitoba Hydro. For many years Manitoba Hydro has taken the lead in making application to the Public Utilities Board of Manitoba with respect to the setting of rates. This procedure and requirement would remain unchanged and rates, therefore, should not be a concern.

The sale of Winnipeg Hydro to Manitoba Hydro would benefit both Winnipeg property taxpayers and Manitobans in general. Winnipeggers would benefit in terms of the financial stability provided by the guaranteed revenue stream plus the incremental property taxes and guaranteed energy cost savings. The anticipated favorable view of this transaction by our credit raters is also deemed a significant benefit.

Manitobans generally will also benefit from the transaction. It is likely that Manitoba Hydro will replace and refit Winnipeg Hydro infrastructure, which will generate economic activity in the construction industry. More importantly, a larger and strengthened Manitoba Hydro will be better positioned to capitalize on opportunities for the export sale of power. Operating synergies will allow

Manitoba Hydro to continue to provide the low domestic rates for electric power presently enjoyed by all Manitobans.

The City of Winnipeg prides itself on its record of fair and respectful treatment of its employees. In the event of a sale and transfer of Winnipeg Hydro, Council will undoubtedly want to ensure that Winnipeg Hydro employees represented by CUPE Local 500 and those represented by WAPSO, or that are WAPSO Exempt, will not be disadvantaged.

The Manitoba Hydro proposal undertakes to comply with the laws of the Province of Manitoba regarding successor rights and to comply with all associated obligations to honor the collective agreements of Winnipeg Hydro employees. For greater certainty and specificity around the critical matter of employee's pensions, the Manitoba Hydro proposal states that the parties will structure the sale agreement so as to ensure the pensions of all Winnipeg Hydro employees are duly protected. Furthermore, Premier Doer is on record as stating that Winnipeg Hydro employees will be protected by legislation.

In 1906, with great foresight, City Council and the voters of the day seized an opportunity and established what was to become Winnipeg Hydro. From that time to this, the Utility has served Winnipeggers well. Citizen customers in the area of the former City of Winnipeg have benefited from a high quality hydroelectric service supplied at rates that have been, and continue to be, among the lowest in North America. Winnipeggers in general have benefited from the financial stability and reduced reliance on property taxes made possible by the transfer of Winnipeg Hydro profits to general revenue.

Today, opportunity with respect to Winnipeg Hydro arises once again. By taking up the Manitoba Hydro proposal, Council can secure and stabilize the City's finances into the future and at the same time eliminate significant future business risk and ensure the fair and respectful treatment of its employees. Furthermore, the resulting strengthening of Manitoba Hydro will allow continued low domestic rates for hydroelectric power and will position Manitoba Hydro to increase export sales enhancing its ability to be an "economic engine" providing benefit for all Manitobans.

For the information of Council, as part of the pre-closing due diligence process, a full examination of current and capital budget implications of the proposed sale will be conducted.

The Executive Policy Committee recommends:

I. That Council direct the Chief Administrative Officer to finalize terms and conditions of an agreement, together with any and all collateral or ancillary agreements, for the sale of the whole of the assets, business and undertakings of the City of Winnipeg with respect to its Winnipeg Hydro operations pursuant to the proposals made by Manitoba Hydro dated February 7 and 19, 2002 and outlined on Appendix "A" and "B" which, in the opinion of the Chief Administrative Officer, together with any and all collateral or ancillary agreements, will satisfy the intent of Council.

II. That Council declare surplus those lands and buildings incorporated within the financial statements for Winnipeg Hydro.

III. That the Proper Officers of the City be authorized do all things necessary to implement the foregoing and execute such documents as required.