



ONTARIO ENERGY BOARD

STAFF SUBMISSION

Application by Town of Essex for leave to acquire shares of
E.L.K. Energy Inc. pursuant to subsection 86(2) of the Ontario
Energy Board Act
Board File Number EB-2008-0310

November 13, 2008

The Town of Essex ("Essex") is requesting approval to become the sole shareholder of E.L.K. Energy Inc. ("ELK"), a licensed electricity distributor. ELK is the result of a voluntary amalgamation of the hydro-electric commissions Essex HEC, Kingsville HEC and Lakeshore HEC) effective January 1, 2000.

When ELK was created, Essex held (and continues to hold) 38% of the issued and outstanding common shares in ELK.

Essex has entered into a Share Purchase Agreement with the other two shareholders of ELK, namely the Town of Kingsville ("Kingsville"), a 38% shareholder, and the Town of Lakeshore ("Lakeshore"), a 24% shareholder, whereby Essex intends to purchase all of the common shares of ELK held by Kingsville and Lakeshore, thereby becoming the sole shareholder of ELK.

Section 86(2) of the *Ontario Energy Board Act, 1998* states:

Acquisition of Share Control

(2) No person, without first obtaining an order from the Board granting leave, shall,

(a) acquire such number of voting securities of a transmitter or distributor that together with voting securities already held by such person and one or more affiliates or associates of that person, will in the aggregate exceed 20 per cent of the voting securities of the transmitter or distributor; or

(b) acquire control of any corporation that holds, directly or indirectly, more than 20 per cent of the voting securities of a transmitter or distributor if such voting securities constitute a significant asset of that corporation. 1998, c. 15, Sched. B, s. 86(2).

Essex has submitted that subsection 86(2) of the Act does not apply to the proposed transaction on the basis that Essex already owns more than 20% of ELK and has therefore passed the 'threshold'. Essex submits that section 86(2) is intended to allow the Board to scrutinize the financial viability of an entity that is proposing to become a significant shareholder and that this should only occur *once*, that is at the time when such an entity first proposes to become a significant shareholder and not on subsequent acquisitions, regardless of the size of subsequent acquisitions.

Board staff respectfully disagrees with Essex' submissions.

Firstly, there is no Board policy, guideline or decision indicating that s.86(2) applies only to an initial acquisition over 20% and not to any subsequent acquisitions, regardless of the size of such subsequent acquisitions.

In any event, Essex had not applied for leave of the Board for its initial acquisition of a 38% shareholding of ELK. Essex acquired its original and current shareholding of 38% through the voluntary amalgamation of the hydro-electric commissions of Essex, Lakeshore and Kingsville and transfer by-laws passed by each of the respective municipalities. Leave of the Board was not sought (nor required) when Essex acquired its shareholding. Hence the Board did not have an opportunity to scrutinize the transaction in fulfillment of responsibility to maintain a financially viable electricity industry, as set out in the section 1 of the *OEB Act*.

Secondly, the proposed transaction is not an acquisition of a trivial shareholding in ELK but rather all of the remaining shares of ELK. A transaction of this magnitude which would result in ELK becoming the sole shareholder of ELK is of concern to and should be scrutinized by the Board. This is especially the case when the proposed transaction may affect a distributor's capital structure. In its application material, Essex indicates that ELK proposes to obtain bank financing to cover a dividend payment to Essex and future smart meter capital expenditures. The proposed financing will result in ELK's capital structure moving from a 40/60 Debt / Equity split (pre-transaction) to a 78/22 Debt / Equity split (post-transaction). Essex has stated that the Essex shareholder loan can be entirely converted to equity, which would result in the post-transaction capital structure of ELK being 54/46. However, the application does not confirm that this post-transaction conversion will be carried out. ELK is scheduled to rebase in 2010.

Thirdly, the proposed transaction represents a significant change from Essex being a major shareholder to becoming the sole, controlling shareholder of E.L.K.'s operations and management.

While the *OEB Act* does not specify the shareholding that constitutes 'control' of a body corporate, reference may be made to the Ontario *Business Corporations Act, R.S.O. 1990, Chapter B.16 ("OBBCA")* which indicates that a corporation is controlled by another person if such a person holds more than 50% of the voting securities of the corporation.

The *OBBCA* states:

- (5) For the purposes of this Act, a body corporate shall be deemed to be controlled by another person or by two or more bodies corporate if, but only if,
 - (a) voting securities of the first-mentioned body corporate carrying more than 50 per cent of the votes for the election of directors are held, other than by way of security only, by or for the benefit of such other person or by or for the benefit of such other bodies corporate; and
 - (b) the votes carried by such securities are sufficient, if exercised, to elect a majority of the board of directors of the first-mentioned body corporate. R.S.O. 1990, c. B.16, s. 1 (5).

In the present case, Essex clearly intends to acquire more than 50% of the shares of ELK thereby becoming the sole, controlling shareholder of ELK. In the circumstances, Board staff respectfully submits that Board review is warranted to ensure the financial viability of the distributor and that consumers are held harmless.

All of which is respectfully submitted