The Public Utilities Board

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MANITOBA	Order No. 146/99
THE PUBLIC UTILITIES BOARD ACT	July 30, 1999

Before: G. D. Forrest, Chairman
D. L. Barrett-Hrominchuk, Member
E. Edmondson, Member
J. A. MacDonald, Member
M. Rodrigue, Member

AN APPLICATION BY WESTCOAST ENERGY INC. REQUESTING APPROVAL OF THE ACQUISITION OF ALL OF THE ISSUED AND OUTSTANDING SHARES OF CENTRA GAS MANITOBA INC. BY THE MANITOBA HYDRO-ELECTRIC BOARD

The Public Utilities Board

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Executive Summary

Background

The Public Utilities Board ("the Board") issued a Public Notice on April 30, 1999 wherein it advised of The Manitoba Hydro-Electric Board's ("Hydro") decision to pursue the acquisition ("the Transaction") of Centra Gas Manitoba Inc. ("Centra") and invited interested parties to assist in establishing the scope of the Board's review of the Transaction.

On May 14, 1999 Westcoast Energy Inc. ("WEI") and Hydro executed an Agreement for the Purchase of all of the Shares of Centra ("the Agreement") which confirmed the $245 million purchase price, subject to certain adjustments, and provided for closing of the Transaction concurrent with the approval of the Board. Centra would become a tax exempt entity immediately following closing, and as a result, be liable for a one-time tax payment of approximately $78 million.

The Board issued Order No. 90/99, dated May 28, 1999 wherein the Board identified the following four issues that should be addressed at a public hearing.

The impact of the proposed Transaction on:

1. the provision of safe and reliable utility services;
2. competition in both the electric and natural gas industries in Manitoba;
3. rates charged to ratepayers of both utilities, and
4. the future regulation of each of the utilities.

The Public Utilities Board

Application

On June 4, 1999, WEI on behalf of itself and certain of its direct and indirect wholly-owned subsidiaries, submitted an application to the Board for an Order pursuant to *The Public Utilities Board Act* authorizing and approving the transfer of all issued and outstanding shares of Centra to Hydro in accordance with the terms and conditions of the Agreement dated May 14, 1999.

Pre-Closing Transactions

It was a requirement of WEI that the sale be structured in the most tax efficient manner to WEI. To accomplish that objective, WEI must be able to carry out certain pre-closing transactions. As none of the corporations in the WEI group involved in these transactions are subject to tax in Manitoba, such transactions would have no impact on Centra ratepayers, Hydro ratepayers or Manitoba taxpayers.

Both WEI and Hydro requested two days notice of issuance of a time dated Order so that the pre-closing transactions and the Agreement could be executed properly and the Advanced Tax Ruling obtained by WEI from Revenue Canada could be validated.

Transaction Overview

WEI testified that its presence in the Manitoba market no longer fits within its strategic plan. Therefore, WEI decided that Centra should be sold and Hydro, having been identified as a potential purchaser, was first approached by WEI in October of 1998.

Hydro submitted that the Transaction should provide numerous benefits to energy consumers in Manitoba including:

- synergistic cost savings of over $12 million per year;

- a one-stop energy company to meet customers' total energy requirements in the most effective and efficient manner;

- a "made in Manitoba" approach to providing comprehensive energy service with the profits and benefits staying in Manitoba;

- more efficient use of energy resources;

- a strategically stronger energy company to better confront competitive and other market risks and opportunities, and

- a broader range of employment opportunities in an expanded and diversified energy company.

Hydro strongly believes that adding the gas distribution facilities of Centra to the operations of Hydro will result in a stronger organization, better equipped to meet the energy needs of Manitobans and the competitive challenges of the future.

Impact of the Transaction on the Provision of Safe and Reliable Service

WEI submitted that both Centra and Hydro enjoyed excellent reputations for providing safe and reliable service to Manitobans, and the Transaction would not change in the continuation of this enviable level of service.

To satisfy itself of the condition of Centra's assets and its ability to provide safe and reliable service, Hydro carried out extensive due diligence of Centra's system and operations with the assistance of external consultants. Hydro and its external consultants did not identify any significant problems regarding unsafe conditions or operations. Hydro was satisfied that Centra staff were generally well trained and understood their responsibilities. Therefore the operations would be unaffected by the Transaction.

Impact of the Transaction on Competition in both the Electric and Natural Gas Industries in Manitoba

WEI testified that competition will not be impeded as a result of the Transaction. There is currently, and will continue to be, significant competition in the gas commodity market provided by aggregators, brokers and marketers ("ABMs"). WEI and Hydro also noted that Centra's monopoly position related to gas distribution would not change as a result of the Transaction. The Competition Bureau was not prepared to issue a formal ruling on the Transaction, but acknowledge that rates for both Hydro and Centra will continue to be subject to regulatory oversight by the Board.

Impact of the Transaction on Rates Charged to Ratepayers of Both Utilities

The purchase price is within the fair market value range determined by WEI, Hydro and Hydro's external consultants Nesbitt Burns Inc. ("Nesbitt Burns"). KPMG Corporate Finance Inc. ("KPMG") also concluded that the Transaction is fair from a financial point of view to Hydro. The incremental costs to affect the Transaction would be offset by Hydro's ability to realize synergies and cost savings. All of the parties agreed that the appropriateness of the price depends on the ability of Hydro to realize the projected synergies and cost savings.

Rates in Manitoba for both electricity and natural gas markets are regulated by the Board. Therefore, Hydro will not have the ability to unilaterally increase rates once the Transaction is completed. Hydro has further testified that rates charged to both the electric and gas customers will not increase as a result of the Transaction. Once the financial targets have been achieved, decisions can be made regarding the allocation of financial benefits resulting from the combined ownership of the two utilities.

Impact of the Transaction on the Future Regulation of each of the Utilities

Hydro has not yet determined whether it prefers that future rate hearings for gas and electricity should be combined or separate, but stated that the most efficient process and structure should be the goal.

Intervenor Positions

All of the intervenors either spoke in support of the transaction or did not oppose the transaction in principle. There was a strong message from the intervenors, however, that their support of the Transaction was predicated on the Board maintaining a very strong oversight role in the integration process. Further, the Intervenors recommended that the Board retain an active regulatory role over both the gas and electric operations of Hydro to ensure that the expected synergies and cost savings are achieved, and the resulting benefits are shared appropriately by customers in both utilities.

Board Findings

The Board has approved the Transaction and the related pre-closing transactions, agreeing with Hydro that adding the gas distribution facilities to the operations of Hydro could potentially result in a stronger organization, better equipped to meet the energy needs of Manitobans and the competitive challenges of the future.

Given the professional opinions of WEI, Nesbitt Burns, KPMG, Dr. Booth, and Mr. Todd, the Board feels that the price was negotiated as an open market transaction. The Board has directed Hydro to achieve cost savings and synergies in excess of the $12 million estimated by Hydro. In so doing, Hydro should reduce the risk to the ratepayers of the amalgamation costs exceeding those previously estimated, and accelerate the realization of benefits to the ratepayers. The Board also set out several specific recommendations and directives regarding the future integration process and possible regulatory changes.

The Transaction will have no immediate impact on the current method of regulation of both the gas utility and the electric utility. Board approval will be required for any major change to the operation or regulation of each entity in the future. The Board will monitor Hydro's commitment to its customers that rates for natural gas service and electricity service will not increase as a direct result of the Transaction.

1.0 Appearances

D. Abra, Q.C.	Counsel for The Public Utilities Board of Manitoba ("the Board")
J. Foran, Q.C. C. Peters	Counsel for Westcoast Energy Inc. ("WEI")
P. Ramage R. Bettner	Counsel for The Manitoba Hydro-Electric Board ("Hydro")
B. Meronek, Q.C. K. Saxberg	Counsel for the Consumers' Association of Canada (Manitoba) Inc. and the Manitoba Society of Seniors Inc. ("CAC/MSOS")
T. McCaffrey	Counsel for Manitoba Industrial Power Users Group ("MIPUG")
D. Buhr	Counsel for Winnipeg Hydro/City of Winnipeg ("Winnipeg Hydro")

2.0 Witnesses for Westcoast Energy Inc.

A. H. Willms	Chief Operating Officer
R. C. Price	Vice-President, Financial Services
G. L. Ebel	Vice-President, Strategic Development

3.0 Witnesses for The Manitoba Hydro - Electric Board

R. B. Brennan, CA	President and CEO
T. W. Gouldsborough	Division Manager, Corporate Planning and Development
V. H. Warden	Vice-President, Finance and Administration
C. E. Wray	Division Manager, Finance and Administration
G. W. Rose	Vice-President, Customer Service and Marketing
P. A. Miller, CA, CBV	Senior Vice-President and Director, KPMG Corporate Finance Inc. ("KPMG")
R. J. Owen, CA	Assurance Partner, KPMG LLP ("KPMG")
J. A. Tower	Vice-President and Director, Power and Utilities Group, Nesbitt Burns Inc. ("Nesbitt Burns")
B. J. Hardie	Vice-President, Government Investment, Banking Group, Nesbitt Burns
K. D. Campbell	Chief Executive Officer, Campbell-Ryder Engineering Limited ("CRE")

4.0 Witnesses for the Consumers' Association of Canada (Manitoba) Inc. and the Manitoba Society of Seniors

J. D. Todd	President, Ecoanalysis Consulting Services Inc.
L. D. Booth	Professor of Finance, J. L. Rutman School of Management, University of Toronto

5.0 Intervenors

S. Boyd	Communications, Energy and Paperworkers Union, Local 681 ("CEPU")
B. J. Meronek, Q.C. K. Saxberg	CAC/MSOS
D. Foreman	Heating Ventilating and Air Conditioning Coalition of Manitoba ("HVAC")
T. McCaffrey C. Osler	MIPUG
K. Melnychuk	Municipal Gas ("Municipal")
E. Fleming	Provincial Council of Women of Manitoba Inc. ("PCWM")
D. Buhr R. Bamburak J. Linton	Winnipeg Hydro

6.0 Presenters

R. Bauer, President	Association of Manitoba Hydro Staff and Supervisory Employees, Bargaining Unit ("AMHSSE")
M. Dolin	Citizen
D. Kelly, Vice President	The Canadian Federation of Independent Business (Prairie Region) ("CFIB")
B. Maes, President V. Bond, Vice-President	Canadian Union of Public Employees, Local 998 ("CUPE")
J. Mauws, Executive Director	Association of Manitoba Municipalities ("AMM")
R. McLean, Business Manager	International Brotherhood of Electrical Workers, Local 2034 ("IBEW")
H. Mehrle, Chairperson	The Heartland Gas Initiative ("HGI")
V. Vrsnik, Provincial Director	The Canadian Taxpayers Federation ("CTF")

7.0 Background

In October 1998, WEI approached Hydro to inquire if Hydro had any interest in acquiring Centra. After discussions with its Board of Directors and the Government of Manitoba, Hydro decided to pursue negotiations with WEI regarding the potential acquisition of Centra ("the Transaction"), provided that favorable terms and conditions could be negotiated.

On October 15, 1998, WEI and Hydro entered into a Confidentiality Agreement that provided for the disclosure of certain information by WEI to Hydro with respect to the proposed acquisition of Centra. At that time, WEI engaged Scotia Capital Markets as its financial advisor for this matter. Nesbitt Burns and KPMG were retained by Hydro to assist in the valuation of Centra, to develop transaction strategies, to conduct due diligence reviews and to provide general advice regarding the Transaction. On January 12, 1999, a data room was established by WEI to provide an opportunity for Hydro and its advisors to conduct a due diligence review.

Hydro and WEI signed a Letter of Intent ("the Letter") dated March 9, 1999 which confirmed the material intentions of each of the parties, and provided that if the proposed Transaction closed, Hydro would purchase all of the issued and outstanding shares of Centra for a purchase price of $245 million. The Letter provided that Centra would become a tax exempt entity immediately following closing, and as a result, would pay a one-time tax estimated at $78 million. The Letter further provided that the closing would be subject to the execution and delivery of a definitive agreement of purchase and sale and other mutually satisfactory legal documents, covenants, representations, warranties, indemnities, terms and conditions. The Letter also included other matters such as completion of a due diligence review and receipt of all necessary regulatory and other approvals. It was the intent of both parties to work diligently and in good faith to settle all legal documentation with a view to executing the Agreement for the Purchase of all the Shares of Centra ("the Agreement") on or before March 31, 1999, with closing to occur on or about April 23, 1999.

On April 12, 1999, WEI Counsel, on behalf of WEI and Hydro, advised the Board of the Transaction and further advised that an application would be made to the Board for all requisite approvals as soon as the Agreement was executed.

The Hydro Board of Directors approved the Transaction on March 10, 1999, and the WEI Board of Directors approved the Transaction on May 14, 1999. The Government of Manitoba issued Orders in Council 212/1999 and 213/1999, both dated May 5, 1999 that allowed the Transaction to proceed.

The Board issued a Public Notice on April 30, 1999 wherein it notified the public of the Transaction and invited interested parties to assist in establishing the scope of the Board's review. The Board solicited comments from interested parties regarding the issues which should be included in the Board's review of the Transaction, and the minimum filing requirements that should be included with the request for approval of the Transaction.

On May 14, 1999 the parties executed the Agreement which confirmed the $245 million purchase price, subject to certain adjustments, and provided for closing of the Transaction concurrent with the approval of the Board.

The Board issued Order No. 90/99, dated May 28, 1999 wherein the Board identified the following four issues to be addressed at a public hearing:

The impact of the Transaction on:

1. the provision of safe and reliable utility services;
2. competition in both the electric and natural gas industries in Manitoba;
3. rates charged to ratepayers of both utilities; and
4. the future regulation of each of the utilities.

In addition to identifying the scope of the proceedings, Order No. 90/99 set out 24 minimum filing requirements that WEI would be obligated to file with the Board in seeking approval of the Transaction.

On June 10, 1999 the Board issued Order No. 106/99 which granted intervenor status to a number of interested parties, and established a timetable for the orderly exchange of information by the participating parties.

WEI filed an application with the Board on June 4, 1999. A public hearing to consider the application was held at the Radisson Hotel in Winnipeg, Manitoba on June 28 to 30, July 5 to 9, and July 12 and 13, and closing arguments were heard on July 15, 1999.

8.0 Application

8.1 General

On June 4, 1999, WEI, on behalf of itself and certain of its direct and indirect wholly-owned subsidiaries, submitted an application to the Board for an Order pursuant to *The Public Utilities Board Act* authorizing and approving the transfer of all issued and outstanding shares of Centra to Hydro in accordance with the terms and conditions of the Agreement.

8.2 The Agreement

The Agreement provided that all of the issued and outstanding shares of Centra be purchased by Hydro from WEI for $244,695,000, and all of the issued and outstanding shares of Minell Pipelines Ltd. ("Minell") be purchased by Hydro for $305,000. The purchase price is to be reduced by:

1. any cash dividends that are declared by Centra from January 1, 1999 to the date of closing;
2. any severance costs paid to specific senior executives of Centra named in the Agreement estimated to be $2.5 million;
3. any amount paid by Centra relating to the settlement of a matter indemnified by the Agreement that is settled prior to closing;

The terms and conditions of the Agreement include the following:

- Centra will be a tax-exempt entity immediately following closing and as a result will pay an estimated $78 million tax under Section 149 of the *Income Tax Act (Canada) ("ITA")*.
- closing is subject to the completion of a due diligence review, receipt of all necessary regulatory approvals required by law, the consents of third parties under material contracts, and necessary indemnification given by WEI as requested by Hydro.

- the Enlogix CIS contract has been amended to provide that Centra may, upon six months notice, terminate such contract without penalty or any early termination fee at any time after the second anniversary date of the closing.

- the employment of up to seven senior executives of Centra may be terminated immediately prior to closing at Hydro's discretion. The cost of the related severance packages and all other termination liabilities and change of control bonuses will be paid directly by Centra. This payment will occur by WEI advancing to Centra the amount required prior to the Transaction closing as a non-interest bearing loan. Centra will repay such loan immediately following the Transaction closing. That amount will be deducted from the purchase price to be paid by Hydro. Any pension or other retirement benefit arrangements that are provided to such executives shall continue to be the obligation of Centra. WEI shall notify Hydro in writing on or before July 30, 1999 as to which of the terminated executives, identified by Hydro, shall be re-employed by WEI.

- all inter-company agreements and arrangements between Centra and WEI and its affiliates will terminate without cost to Hydro, except for a specific list provided in the Agreement which included Centra's 10.625% Senior Debenture maturing on July 14, 2006 held by Union Gas Limited, the Pension and Benefits Agreement and the Enlogix contract.

- WEI or any of its affiliates, except for Engage Energy Canada L.P. ("Engage"), are not permitted to distribute gas in the Province of Manitoba for a period of ten years, nor market gas in the Province of Manitoba for a period of five years following closing.

- there is no restriction on WEI or any of its affiliates regarding carrying on its existing heating, ventilation and air conditioning businesses in Manitoba.

- any existing contract between Centra and any third party will continue to be honored.

- Hydro will own 100% of the Centra Hydro Energy Services ("CHES").

- an appendix to the Agreement entitled "WEI Disclosures" which contains representations and warranties regarding outstanding liabilities of Centra. At the date of close, these liabilities become the responsibility of Centra and Hydro. However, if any undisclosed liabilities are discovered that exceed $1 million in aggregate, WEI will be liable for the total amount of undisclosed liabilities.

- each party is responsible for its own legal and other expenses incurred in connection with negotiation, preparation, execution, delivery and performance of the Agreement.

- WEI and Hydro are each responsible for 50% of auditor's fees with respect to the post closing adjustments.

- approval of the Board must be obtained.

- approval under the *Competition Act* is a condition of the Agreement but can be waived by agreement of both WEI and Hydro.

8.3 Publication in The Manitoba Gazette

Section 92 of *The Public Utilities Board Act* requires that where, by any general or special Act, a public utility or its owner is authorized to unite with any other public utility or its owner, the union is subject to the consent of the Board, and has no effect until the Order of the Board authorizing the union is published in one issue of *The Manitoba Gazette.*

By letter to the Board dated June 15, 1999, counsel for WEI advised the Board that:

> "For the reasons discussed below, the closing of the Transaction must occur on the same date as the Order is made. Because Section 92 of the Public Utilities Board Act states that a union of Public Utilities has no effect until the Order approving the Transaction is published in *The Manitoba Gazette,* the Transaction cannot be closed until the Order is published in *The Manitoba Gazette.* Therefore, the issuance of the Order and the publication of the Order in *The Manitoba Gazette* must occur on the same date."

8.4 The Pre-Closing Transactions

In negotiating the sale of the shares of Centra, it was a requirement of WEI that the sale be structured in the most tax efficient manner to WEI. To accomplish that objective, WEI made it a condition precedent that WEI be permitted to carry out certain pre-closing transactions. WEI testified that these pre-closing transactions will have no impact on the ratepayers of

Hydro, the ratepayers, Centra, or the taxpayers of the Province of Manitoba, as none of the WEI corporations involved in the pre-closing transactions are subject to tax in Manitoba.

The pre-closing transactions reduce WEI's taxable gain on the sale of shares of Centra in two ways.

(i) the taxable gain is reduced by utilizing available non-capital losses in certain of WEI direct and indirect subsidiaries as well as capital cost allowance in WEI.

(ii) accessing the safe income attributable to shares of Centra. This is done through the capitalization of Centra's retained earnings and contributed surplus and by making an election under paragraph 111(4)(e) of the *ITA*. The result of these transactions is to increase the adjusted cost base of the shares of Centra, and thus reduce the tax cost to WEI related to the sale.

WEI received an Advanced Tax Ruling from Revenue Canada on May 28, 1999 that approved the pre-closing transactions, provided that these pre-closing transactions are executed as proposed. The Advanced Tax Ruling is subject to certain limitations, but is binding provided that the pre-closing transactions are completed before November 30, 1999.

Board approval is required for the pre-closing transactions contained in items 3 to 7 below to allow WEI to transfer the shares of Centra to Hydro in accordance with the Agreement.

The pre-closing transactions are as follows:

1. Centra will increase the stated capital of its shares by an amount equal to its retained earnings and contributed surplus as at the closing date to be effective at the time of issuance of a favorable order by the Board

2. Centra will make an election under Section 111(4)(e) of the *ITA* in its income tax return for the period ending immediately before the change of control in respect of its capital property.

3. Centra Gas Utilities Inc., the current owner of the shares of Centra, will transfer all of the shares of Centra to NGX Financial Inc. ("NGX"), an indirect wholly-owned subsidiary of WEI, pursuant to Section 85 of the *ITA*.

4. NGX will transfer all of the shares of Centra to Westcoast Power Holdings Inc. ("WPHI"), a direct wholly-owned subsidiary of WEI, pursuant to Section 85 of the *ITA*.

5. WPHI will transfer all of the shares of Centra to Westcoast Energy International Inc. ("WEII"), a direct wholly-owned subsidiary of WEI, pursuant to Section 85 of the *ITA*.

6. WEII will transfer all of the shares of Centra to 3536971 Canada Inc. ("3536971"), a wholly-owned direct subsidiary of WEI, pursuant to Section 85 of the *ITA*.

7. WEI will cause 3536971 (which at the time will be a wholly-owned subsidiary of WEI) to be wound up on a tax deferral basis under the *ITA*.

Both WEI and Hydro requested two days advance notice of when the Order is to be issued so that the pre-closing transactions could be arranged and closing could be executed properly. Both WEI and Hydro testified that they were not requesting to be advised of the content of the Order, but simply the timing of its issuance by the Board. The parties requested that the Order be time dated so that the Advance Tax Ruling will be valid.

9.0 Overview

9.1 WEI's Position

WEI is currently involved in certain significant development projects that have considerable capital requirements. WEI's presence in the Manitoba market does not fit within its strategic plan. Therefore, WEI decided that Centra should be sold and Hydro, identified as a special purchaser, was first approached by WEI in October of 1998. During the previous two years, WEI did not attempt to market Centra to any additional parties other than to explore expressions of interest. WEI testified that none of these expressions of interest ever reached a formal negotiation stage.

During the hearing, WEI testified that it had no intention of extending the closing date of the Agreement beyond July 31, 1999 for two reasons:

1. the negative effect on the morale of employees, and
2. the fact that the economic factors and the value of the Transaction change for both Hydro and WEI if approval is not received by July 31, 1999.

9.2 Hydro's Position

Hydro submitted that the Transaction would provide numerous benefits to energy consumers in Manitoba including:

- synergistic cost savings of over $12 million per year;
- a one-stop energy company to meet customers' total energy requirements in the most effective and efficient manner;
- a "made in Manitoba" approach to providing comprehensive energy service with the profits and benefits staying in Manitoba;

- more economic use of energy resources;

- a strategically stronger energy company to better confront competitive and other market risks and opportunities, and

- a broader range of employment opportunities in an expanded and diversified energy company.

Hydro believes that adding the gas distribution facilities to the operations of Hydro will result in a stronger organization, better equipped to meet the energy needs of Manitobans and the competitive challenges of the future.

It is Hydro's intent to fully integrate the operations of Centra with those of Hydro as soon as possible. Integration teams have been established under the direction of an Integration Policy Group that will handle overall direction, co-ordination and the final recommendations. The teams will consist of both Hydro and Centra employees. To date, integration planning has consisted of:

- the establishment of the Integration Policy Group and the policy decision process;

- the development of a preliminary communication strategy for staff;

- meetings between Hydro and Centra management;

- the issuance of a Request for Proposal for advisory services regarding integration;

- the identification of issues;

- the formation of a space planning team and the development and approval of terms of reference for that team;

- the development of human resource and accounting guidelines;

- the defining of the integration team requirements and the team's terms of reference, and the selection of team members, and
- the development of orientation material for the development teams.

9.3 Intervenors' Positions

9.3.1 CEPU

CEPU was in favor of the Transaction, stating that the reassurance by Hydro that it will not impose layoffs on its staff, and Hydro's commitment that there will be no reduction in service in either utility, gave its members comfort. CEPU has a long history of dedicated service and is prepared to work with Hydro to make the Transaction a success.

9.3.2 CAC/MSOS

CAC/MSOS was not opposed in principle to the Transaction. It noted that there was not sufficient evidence on the record to recommend that the Board disallow the Transaction. CAC/MSOS suggested that the Board must maintain constant oversight and monitoring to ensure that Hydro's commitments are fulfilled.

9.3.3 HVAC

HVAC did not oppose the Transaction. HVAC currently enjoys a good working relationship with Hydro, but urged the Board to proceed with caution so that no issue is overlooked.

9.3.4 MIPUG

MIPUG has not seen any evidence to indicate that the Transaction is contrary to the public interest. Therefore, MIPUG recommended that the Board approve the Transaction. MIPUG is of the view that the Transaction represents a good deal for Manitoba, provided the synergies are achieved and the costs to implement the synergies are not greater than expected. However, MIPUG expressed certain concerns and urged the Board to ensure that it maintains a high level of involvement with both Centra and Hydro in the future to ensure that the synergies are achieved and no customer classes are negatively impacted.

9.3.5 Municipal

Municipal neither opposed nor endorsed the Transaction. However, it urged the Board to ensure that the Transaction will not impede competition and to use its authority to maintain the current competitive situation. Municipal suggested that the Board must maintain its current oversight in the gas utility market.

9.3.6 PCWM

PCWM neither opposed nor endorsed the Transaction. PCWM requested that the Board attach certain conditions to the approval in order for the Board to maintain its involvement in the gas utility market to ensure accountability and transparency.

9.3.7 Winnipeg Hydro

Winnipeg Hydro did not oppose the Transaction. However, Winnipeg Hydro suggested that Hydro needs direction from the Board and that Hydro should be tested in the future to ensure that it fulfills its commitments.

9.4 Board Findings

Following the format identified in Order 90/99, the Board Findings have been segregated into each of the four issues and are set out in subsequent sections of this Order. In summary, the Board has concluded that the proposed transaction will, on balance, have no serious consequences with regard to the provision of safe and reliable service, competition in both the electric and gas industries in Manitoba, rates charged to ratepayers of both utilities, and future regulation of each of the utilities.

The Board accepts the arguments put forward by Hydro that adding the gas distribution facilities to the operations of Hydro could result in a stronger organization, better equipped to meet the energy needs of Manitobans and the competitive challenges of the future. Accordingly, the Board has concluded that the proposed transfer of all of the issued and outstanding shares of Centra to Hydro, pursuant to the Agreement, is in the public interest and should be approved. However, the Board also agrees with the arguments of MIPUG, CAC/MSOS and others that the Board must maintain a strong regulatory oversight over both the gas and the electric utilities.

There were a number of issues discussed during the hearing that were not directly related to the Transaction but exist as a consequence of the Transaction. The Board has therefore made a number of recommendations and directives arising from Board Findings, many of which require immediate attention while others may be dealt with at future general rate and other public hearings. These recommendations and directives are set out in a subsequent section of this Order.

10.0 The Impact of the Transaction on the Provision of Safe and Reliable Utility Services

10.1 WEI's Position

WEI stated that it had no concerns regarding the sale of Centra to Hydro, which it regarded as a very large, respected utility with good management. In WEI's view, the management of Centra is capable of running the utility. WEI added that although it had provided services to Centra regarding financing, insurance, audit, tax, and information technology service, the day-to-day operations of Centra are relatively independent of WEI. Therefore, the Transaction should not impact the provision of safe and reliable service.

WEI testified that, of the seven senior executives noted in the Agreement, the Vice-President of Operations would have the most involvement with the provision of safe and reliable service. WEI added that, although Hydro inquired about the responsibilities of the executives, WEI was not consulted, nor had it received notice of who, if any, of the seven senior executives may be terminated. WEI submitted that the other levels of management currently in place are capable of operating the utility.

WEI is not aware of any impact that the Transaction will have on Year 2000 readiness of Centra's Information Technology Infrastructure.

In WEI's view both Centra and Hydro enjoy excellent reputations for providing safe and reliable service to Manitobans, and thus the Transaction should result in the continuation of this high level of service. WEI took comfort in the fact that Hydro was among the industry leaders in providing safe and reliable service, and stated that Hydro's number one priority was safety. WEI stated that, while there are clear differences between the operation of a natural gas and electric utility, the Board should take comfort in the fact the two utilities will learn from each other.

10.2 Hydro's Position

Hydro admitted that while it does not have any experience in operating a natural gas utility, Centra employees will form a key part of the operations of the integrated utility. Hydro added that it does have extensive experience in the safe, efficient management and operation of an integrated energy utility responsible for supply, storage, transmission, distribution, metering and customer service and billing.

Under the Agreement, the employment of up to seven senior executives of Centra may be terminated by Centra immediately prior to closing the Transaction. In connection with such terminations, if any, Hydro must notify WEI in writing on or before July 15, 1999 as to which executives may be re-employed by WEI following the Transaction closing. The decision must be kept confidential until July 30, 1999.

Hydro expressed the view that even if all seven of Centra's top executives are terminated, the remaining operating staff can ensure that operations were unaffected, as Centra's top executives are not directly involved in the day-to-day operations of the utility. Hydro estimated that the combined workforce in the two utilities could be reduced by 100-150 employees through attrition. There should, however, be no adverse affects on safe and reliable service in the gas or electric operations as a result of these staff reductions

Hydro submitted that CRE had reviewed Centra's systems and procedures and had favorably commented on system integrity, cathodic protection and leakage surveys. Hydro further stated that CRE did not identify any significant problems by way of unsafe conditions or operations, and was satisfied that Centra staff were generally well trained and understood their responsibilities. Hydro submitted that certain improvements in Centra's procedures suggested by CRE may lead to efficiency gains, but were really not safety concerns.

10.2.1 The Capital Expenditure Plan

Hydro's assessment of Centra's capital plan focused on a review of Centra's proposed rural expansion plan and historical expenditures in other areas. In order to evaluate the financial impact of the purchase, the capital expenditure plan was adjusted to reflect lower expenditure levels for rural expansion projects. The revised plan provides for the completion of existing rural expansion projects and additional funding for system betterment.

Centra's original forecast of capital expenditures and the revised forecast are as follows:

Centra's Original Forecast of Capital Expenditures for 1999 - 2002 (000's)

	1999	2000	2001	2002
New Business				
System growth	$ 7,487	$ 7,534	$ 7,349	$ 7,522
Expansion less contributions	29,176	15,733	14,305	14,825
	36,663	23,267	21,654	22,347
System betterment	3,392	2,423	2,682	2,745
General plant	7,291	5,307	4,666	4,775
Total net capital expenditures before overheads and capitalized interest	$47,346	$30,997	$29,002	$29,867

Revised Forecast for Centra's Capital Expenditures for 1999 - 2003 (000's)

	1999	2000	2001	2002	2003
New Business					
System growth	$ 8,436	$ 8,762	$ 9,518	$ 9,731	$10,181
Expansion less contributions	2,064	4,914	7,123	7,178	7,205
	10,500	13,676	16,641	16,909	17,386
System betterment	4,117	5,353	4,312	4,273	5,250
General plant	6,461	8,459	4,698	3,413	3,306
Total net capital expenditures before overheads and capitalized interest	$21,078	$27,488	$25,651	$24,595	$25,942

10.2.2 Due Diligence

As a part of its due diligence process, Hydro investigated the safety and reliability of Centra's operations. The process began in November 1998 through a review of publicly available information regarding the assets and operations of Centra. Hydro's personnel and advisors were given access to a data room at the offices of Centra's auditors. This data room contained a significant volume of information on Centra's finances, human resource matters, benefit plans, commodity purchase and transportation, facilities, operations, property holdings, franchise agreements, information technology matters, service contracts and inter-corporate or affiliate transaction or service arrangements. The information was reviewed by a multi-disciplinary taskforce augmented by external specialists. Numerous information requests were made by Hydro to supplement the data room material. The materials in the data room were further supplemented by briefings from senior staff at Centra. Through CRE, Hydro also consulted with the technical advisors to the Board on the system integrity and operations.

Hydro conducted a detailed examination of corporate records and financial matters. This examination included a review of audit files and working papers, environmental matters, information technology systems, (including Y2K readiness), collective agreements and all employee benefit plans, claims against Centra, commodity supply contracts, records concerning the maintenance and integrity of the distribution system and regulatory matters. A report on the condition of the physical assets was prepared by CRE. KPMG assisted Hydro in completing its due diligence investigations with respect to the financial aspects of the Transaction, and a draft report of the findings of KPMG was filed as an exhibit to these proceedings. All of the foregoing formed the basis for the negotiation of the Agreement.

Hydro reviewed best practices material on the combination of other organizations to gain an understanding of the key issues and potential problems involved in the integration of the two entities. Hydro also met with Centra employees, who had experienced the Greater Winnipeg Gas/ICG Utilities Manitoba Ltd. merger in 1990, to gain an understanding of its impact on Centra and to obtain a further appreciation for the processes in Centra. A Request for Proposal has been issued for integration advisory services to ensure industry integration experience is considered in Hydro's approach.

10.2.2.1 CRE Report

CRE was retained by Hydro to review risk and liability issues specifically related to operations, public safety and reliability of assets. CRE also reviewed Centra's gas supply and storage contracts and transportation arrangements.

Originally CRE had suggested that Centra's gas supply and transportation arrangements were onerous. However, further review and discussion with Centra personnel led CRE to conclude that gas supply and transportation pricing represented fair market value. The premiums payable and other terms and conditions represent a fair trade-off for purchase load factor seasonal flexibility provisions. CRE stated that there were no extraordinary risks in these arrangements, and given the current market volatility, the arrangements appeared to be fair. CRE indicated that the future of the gas supply markets is uncertain, but since the present arrangements expire in 2003, alternate supply portfolios can be evaluated at that time.

The second aspect of the CRE engagement was a review of Centra's capital assets and system integrity policies and procedures primarily related to transmission and distribution assets. Upon review of Centra's leak survey procedures, CRE concluded that the frequency of surveys, either once every two years or once every three years, was much higher than any other Canadian utility.

CRE was concerned that Centra did not reconcile gas receipts with deliveries on an individual take-off basis. The fact that Centra has a vigorous leak survey process alleviated CRE's concerns. CRE submitted that a range of 2% for unaccounted for gas was an acceptable industry standard. Historically, Centra was within a range of 0.73% to 1.66%. However, CRE was concerned that there were several different divisions within Centra, as well as independent contractors, conducting leak surveys and there was little co-ordination during the survey process.

CRE commended the Board's proactive approach to ensuring that public safety is maintained. CRE suggested that such involvement provided a high degree of comfort as to the quality of assets and the integrity of the system.

CRE submitted that the useful service life of Centra's assets, as determined for depreciation purposes, appeared to be shorter than those of other utilities, but conceded that depreciation studies and rates contained therein were utility specific. CRE noted that a new depreciation study is scheduled to be completed in the fall of 1999, which could result in either a risk to the owner for accumulated depreciation in excess of that which the study may find to be appropriate, or an increase in revenue requirement to recover any unbooked depreciation expense.

CRE reviewed Centra's cathodic protection program and concluded that the repair of shorts on an "as found" basis is being accomplished in a reasonable period of time. CRE further stated that the program is well supervised and plant facilities are being properly maintained.

Although, the operation of Centra's accredited meter shop met Measurement Canada standards, CRE suggested that the methods of keeping records were not consistent with those used by Electricity and Gas Canada, and could be improved.

CRE suggested that because Centra has been legislated to inspect all installations of new appliances, and must ensure that its structures and facilities are in compliance with all requirements of the Department of Labour with regard to downstream piping, there is a potential for legal action against the utility, in the event of an equipment malfunction.

CRE identified a rural expansion project that may not achieve the estimated revenues projected in the feasibility test. CRE suggested that Hydro may be at risk if the Board declared some portion of this project to be imprudent, which would require refunding customers' contributions if certain revenue targets are not met in subsequent years.

CRE reviewed the Board's oversight role of Centra pursuant to *The Gas Pipe Line Act* and concluded that the Board's role in matters such as spot checks, testing of plant installations and records inspections provided added assurance that the public interest is being protected.

CRE submitted that safety was of paramount importance, with costs being less important. CRE suggested that the required level of oversight may be reduced if Centra was better managed.

CRE was satisfied that the Centra staff are capable, and concluded that with the Board's continued supervision, examination and direction, there is little risk with regard to the operation of Centra's system. However, there may be more efficient, effective ways to provide an increased level of service.

10.3 Intervenors' Positions

10.3.1 CEPU

CEPU submitted that safe and reliable distribution of natural gas is of paramount importance to its membership. CEPU stated that they have worked with the staff of Hydro in many circumstances, such as the 1997 flood, and are convinced that Hydro is committed to safety and reliability of service. CEPU stated that its membership had experienced three changes in ownership, and although management styles were different, all employees retained the commitment to continue to provide a high level of service. CEPU contended that with the continued oversight of the Board and the commitment of employees, the Transaction would have no impact on the continued provision of safe and reliable utility service.

10.3.2 CAC/MSOS

CAC/MSOS indicated that safe and reliable utility services should not be compromised by the Transaction. CAC/MSOS submitted that the vigilance of the Board, through constant communication with Centra personnel and day-to-day general supervision, provided significant comfort. CAC/MSOS noted that in the past, the Board had not disallowed any significant safety or system integrity related expenditures. CAC/MSOS suggested that the report of CRE was positive with respect to the condition of Centra's assets and Centra's ability to operate the system. CAC/MSOS stated that with Hydro's history of safe service and reliability, the system should continue to operate safely.

CAC/MSOS did raise concerns that CRE expressed certain views on matters in which CRE did not have expertise. CRE did not fully understand or appreciate the nature of the terms and conditions underlying Centra's gas supply and transportation arrangements.

CAC/MSOS recommended the Board ignore CRE's comments with respect to the proprietary of the Trans Canada Gas Service ("TCGS") contract and franchise agreements.

10.3.3 HVAC

HVAC stated that the major reason for the excellent safety record which the Manitoba HVAC industry enjoys is due to the current system of controls in place for gas-fired equipment installations. This system requires Centra to conduct a safety inspection prior to turn-on for every registered gas-fired equipment installation. HVAC contended that this inspection process is a vital part of the utility's job, and the utility is compensated for the activity in its rates. HVAC noted that Centra had applied for approval of random testing, rather than full inspection. The evidence at this proceeding suggested that this was not a preferred option. HVAC is concerned that the current system might be at risk, and suggested that a cutback of the inspections would compromise safety, and should not be viewed as a cost-cutting exercise.

10.3.4 MIPUG

MIPUG stated that provided Centra continues under the jurisdiction of the Board, Centra would continue to provide safe and reliable service. MIPUG was not concerned with the potential severance of the seven executives of Centra. MIPUG contended that the Agreement allowed Hydro to retain these people, and felt that Hydro would make a decision that would not compromise safe and reliable service.

10.3.5 Municipal

Municipal was silent with respect to safe and reliable service.

10.3.6 PCWM

PCWM was silent with respect to safe and reliable service.

10.3.7 Winnipeg Hydro

Winnipeg Hydro considered that the Transaction should improve the co-ordination of underground design, construction and maintenance records thereby enhancing safety. Winnipeg Hydro supported the one-call system for underground plant clearances, but suggested that Centra's historical records of gas line locations are problematic. To ensure safety, Winnipeg Hydro suggested that steps be taken to improve records, and emphasized the need for the implementation of a fully integrated geographic information system.

10.4 Board Findings

Although WEI is the applicant, the responsibility with regard to the continuation of safe and reliable utility service rests with Hydro. To this end, the Board has some concerns with the provision of service during the transition period, as Hydro assumes the daily operations of Centra and implements its integration and operation merger plans. The Board fully agrees with CAC/MSOS that there is a distinct and clear difference in the relative corporate cultures and employee attitudes of a private utility and that of a Crown corporation. Considerable and dedicated effort by all concerned is needed in order to ensure that there will be no adverse impact on service delivery in the short term. The Board encourages the quick amalgamation of all collective agreements to ensure a dedicated, knowledgeable and loyal workforce which will continue to provide safe and reliable service. The Board is not convinced that Hydro fully appreciates the differences in the day-to-day operations of a gas utility and that of an electric utility. Hydro must retain personnel within Centra with the appropriate training and experience to understand the complex operations of a natural gas utility so that a smooth transition can occur and public safety will not be compromised.

The Board acknowledges the strong management history of Hydro and its commitment to safe and reliable service. The Board expects that efficient and effective operations across both utilities should be created, without adversely impacting the delivery of safe and reliable services.

The Board accepts the conclusions of CRE that the condition of Centra's assets is adequate. However the Board notes CRE's comments respecting the potential for improved management and controls, communication, maintenance of records, depreciation rates and more precise reconciliation of gas receipts and deliveries. These provide suggestions to Hydro for future improvement to the system. The Board expects Hydro to investigate these matters with a view to preparing a summary report of its findings, and proposed solutions, and to file such a report with the Board by no later than July 31, 2000.

The Board has commented many times on the fact that it will not allow the safety or integrity of the natural gas system to be compromised. Board oversight is required pursuant to *The Gas Pipe Line Act*, and the Board expects that such mandated responsibilities will continue to be carried out. In the future, through efficient and effective management, and a track record of consistent safe and reliable system operations, the level of oversight may be reviewed. This review will occur if the Board is convinced that safety will not be sacrificed and the general public interest will be protected.

Until it can be demonstrated that safety and reliability will not be compromised, the Board will expect Hydro to continue performing full inspections on the installation of gas-fired appliances. These inspections have contributed to the excellent safety record in Manitoba.

The Board is of the opinion that it has an active role to play in overseeing the integration process, and will expect that Hydro will provide the Board with regular updates on the progress of the integration process, and any potential problems which may impact public safety.

The Board believes that the due diligence process identified all relevant contracts that should continue, as well as those that should be terminated. It has concluded that these contracts will not impact on the level of service provided. The Board wishes to remind Hydro that the Board has previously directed Centra to review the possibility of outsourcing the management of its entire gas supply portfolio and associated assets. The Board will expect the report required pursuant to Order 118/99 in a timely fashion. The Board does not expect that the amendments to the terms of the Enlogix contract will have any negiative impact on the provision of safe and reliable service.

The environmental concerns appear to be well documented, but the related costs have not been identified. The Board acknowledges that these measures and costs are difficult to assess in a short time frame, and may not be known for years. The Board notes the clause in the Agreement that limits Hydro's exposure for any undisclosed liabilities.

The Board expects to be kept informed of any proposed consumer information packages, bill inserts, media advertising and other consumer awareness materials in advance of these materials being issued to the public. On balance, the Board is confident that the Transaction will not unduly impact the continued delivery of safe and reliable service.

11.0 The Impact of the Transaction on Competition in Both the Electric and Natural Gas Industries in Manitoba

11.1 WEI's Position

WEI testified that competition will not be impeded as a result of the Transaction. There is currently, and will continue to be, significant competition in the gas commodity market provided by aggregators, brokers and marketers ("ABMs"). This will not change as a result of the Transaction. WEI also noted that Centra has a monopoly position in the Manitoba market at the present time related to gas distribution and that it will be difficult for a competitor to enter the market in any event.

WEI testified that the only HVAC business carried on by WEI and its affiliates in Manitoba is by Union Energy Inc. ("Union"). Union carries on a program to finance and rent natural gas appliances and water heaters in Manitoba under the name Centra Energy Services. WEI stated that it intends to continue operating its HVAC business in Manitoba under the name Union Energy.

The only WEI affiliate which is an ABM is Engage. WEI indirectly holds a 50% ownership interest, and the remaining 50% is held indirectly by The Coastal Corporation. As WEI does not hold a controlling interest in Engage, WEI cannot control any action taken by Engage including whether or not it carries on business in Manitoba. However, WEI has agreed to use its best efforts to keep Engage out of the Manitoba market.

WEI applied for a ruling on the Transaction from the Competition Bureau of Canada, pursuant to the *Competition Act*. Although the Competition Bureau response was not available before the conclusion of the hearing, a copy of a letter dated July 16, 1999 was provided to the Board on July 27, 1999. The Competition Bureau was not prepared to issue a formal ruling on the Transaction, but acknowledged that rates for both Hydro and Centra will continue to be subject to regulatory oversight by the Board.

11.2 Hydro's Position

Hydro is of the view that the Transaction will not result in a lessening of competition in either the electric or natural gas industries in Manitoba. Hydro must apply to the Board for any proposed change in rates. This process will not change as a result of the Transaction. Similarly, Centra has a monopoly to distribute natural gas in its franchise areas and its natural gas sales rates are regulated by the Board. The natural gas sales rates include the costs of transmission and distribution, which are monopoly functions, and the cost of the commodity, which is competitive. Some gas customers exercise the right to arrange for their own gas commodity purchases either directly or through ABMs. The Transaction will not change this situation.

Given that rates for both electricity and natural gas are regulated by the Board, Hydro will not have the ability to unilaterally increase rates as a consequence of the Transaction. Hydro believes that, as a one-stop energy provider, customer service will improve with the new capability of offering the most cost-effective energy option for specific uses by offering expert advice and assistance to customers to help them select the energy product that best satisfies their individual needs.

With respect to future gas expansion plans, Hydro will review proposed projects based on their economic viability, and will decide what is best overall for customers. Projects will be reviewed individually, and will require a sound business case in order to proceed.

11.3 Intervenors' Positions

11.3.1 CEPU

CEPU's position is that there will be no impact on competition. As a result of the Transaction, CEPU noted that customers will be able to make more informed decisions.

11.3.2 CAC/MSOS

CAC/MSOS does not believe that there will be a decrease in competition as a result of the Transaction. Except for the retail sale of gas as a commodity, the two monopolies are now merging into one monopoly. It is unlikely that competition in the form of gas distribution or electric distribution will ever take root in the Province. CAC/MSOS is confident that the degree of intervention and supervision by the Board will help to maintain the current competitive situation.

CAC/MSOS argued that if the Board determines the Transaction does not adversely affect competition, or that the effect on competition is not sufficient to disallow the application, then the Competition Bureau has no jurisdiction to reverse that decision.

CAC/MSOS is of the view that significant subsidies will be needed to make any future rural expansion work feasible. Therefore, CAC/MSOS agreed with Hydro's strategy to evaluate further rural expansion in light of the economic effect on both utilities.

11.3.3 HVAC

HVAC has always operated in a monopolistic market and has enjoyed a friendly relationship with Hydro. As Hydro will now be larger and stronger, HVAC recognizes that a friendly relationship needs to be maintained. HVAC submitted that Hydro's commitment to ensure that confidential customer information is not used, to the benefit of either Centra or Hydro, provides some assurance.

11.3.4 MIPUG

Gas distribution and electric services are currently provided on a monopolistic basis in Manitoba. MIPUG does not believe that competition will be lessened in any material way as a result of Hydro owning both natural monopolies. However, MIPUG believes that the Board has an important role to play to ensure that a level playing field is maintained.

MIPUG's primary concern related to competition, and the interactions between the two utilities, is whether the electric utility customers will find themselves subsidizing expensive and risky gas expansion projects. However, MIPUG added that it looks forward to exploring opportunities that will arise from the combination.

11.3.5 Municipal

Municipal believes that the Board must ensure that competition within the natural gas market is maintained now that Hydro will be a stronger and more diverse utility. Municipal welcomes competition, but on a level playing field. Municipal encouraged the Board to take steps to ensure that the sale of natural gas will continue to be subject to strong regulation and to establish a code of conduct to ensure that Centra and Hydro do not utilize confidential customer information to impede competition.

11.3.6 PCWM

PCWM was silent with respect to competition.

11.3.7 Winnipeg Hydro

It is Winnipeg Hydro's view that more supervision will be required for this larger monopoly utility. It pointed out that efficiency does not equal competition and fewer participants means less likelihood of different approaches being considered or tried. Winnipeg Hydro recommended that any new ventures into areas where sufficient private competition already exists should require Board approval to ensure that competition remains intact.

11.4 Board Findings

The Board now has the letter from the Competition Bureau wherein it was not prepared to issue a formal ruling on the Transaction, but acknowledged the Board's continued regulatory oversight of the sales rates charged by both Hydro and Centra.

The Board is of the view that as a result of the Transaction, rural expansion may proceed at a slower pace than it might otherwise have done. Hydro testified that it will complete all rural expansion projects currently underway, but will reassess all future expansion plans for economic viability. The Board concurs with this approach.

The Board believes that there may be reduced competition between the two energy sources, particularly for industrial customers. Hydro's efforts to promote the most economic use of alternate energy sources should have an offsetting positive impact on the risk of reduced competition. If there are major synergies that could occur as a result of the Transaction, which could give greater opportunities to export power, the Board believes that Hydro should consider the potential sharing of these benefits.

One large dominant utility could lessen the opportunity for competition, particularly if there is not a level playing field for other market participants. For this reason, strong regulatory oversight is critical. The Board agrees with the evidence put forward by WEI and Hydro, that there is currently a monopoly arrangement for the transmission and distribution of both electricity and natural gas. That arrangement will not change as a result of the Transaction. Hydro and Winnipeg Hydro are the only entities that can sell electricity in Manitoba at the retail level. This arrangement will not change as a result of the Transaction. The current competitive situation relating to the sale of the natural gas commodity will also not change as a result of the Transaction. Most if not all of the intervenors concur with these views. It is the Board's conclusion that the Transaction will have little or no effect on competition in both the electric and natural gas industries in Manitoba, provided that strong regulatory oversight remains in place. The matter of regulatory oversight is discussed in more detail in Section 13 of this Order.

12.0 The Impact of the Transaction on Rates Charged to Ratepayers of Both Utilities

12.1 WEI's Position

WEI testified that the Transaction should not have a negative impact on rates. WEI performed a valuation of Centra. The purchase price is within the range that WEI determined to be the fair market value of the entity. In addition, incremental costs to effect the Transaction should be offset by Hydro's ability to realize synergies and cost savings. WEI further testified that the $78 million tax liability, which results on closing when Centra becomes tax-exempt, is a liability of Centra. There should be no reduction of the purchase price because the tax liability results from Hydro's decision to acquire 100% of Centra.

12.1.2 The WEI Valuation

The WEI Strategic Development Group prepared an internal valuation of Centra as at December 31, 1998. The team consisted of valuation and corporate finance professionals including Chartered Accountants and Masters of Business Administration. There were no Chartered Business Valuators ("CBVs") involved in preparation of the valuation. WEI's analyses suggested a fair market value of the common shares of Centra in the range of $233 million to $263 million, with a midpoint of $243 million. WEI did not disclose its valuation to Hydro during the negotiation process.

The WEI valuation assumed that Centra would remain a taxable entity and the fair market value was determined on a stand-alone basis. The valuation was conducted on a high-level basis and did not take into account perceived synergies or a premium for control to the purchaser.

WEI used the discounted cash flow method ("DCF") as its primary valuation technique whereby a discount factor, which measures the risks related to the company, is applied to the projected normalized cash flow. WEI used the comparable transactions method and the comparable trades method to provide support for its valuation range. The comparable transactions method uses certain ratios such as the price to book ratio ("PBR") and the price to earning ratio ("PER") that were achieved during recent comparable purchases and sales of utility companies. These ratios were then applied to determine a valuation range. The comparable trades method compares these same ratios of comparable companies currently trading on a public exchange. The result of the WEI internal valuation is compared to the Nesbitt Burns' valuation on the following table.

Comparison of WEI Valuation to Nesbitt Burns Valuation

Valuation Method	WEI Valuation Date: Dec. 31, 1998		NESBITT BURNS Valuation Date: March 29, 1999	
	Range	Midpoint	Range	Midpoint
Comparable Transactions				
Value Range (millions)	$219 – $237	$228	$235 – $285	$260
*PBR	1.7 – 1.84	1.77	2.0 – 2.4	2.2
Comparable Trades P/E				
Value Range (millions)	$211 - $228	$220	$215 – $280	$248
*PBR	1.7 – 1.9	1.8	1.5 – 2.0	1.75
Discounted Cash Flow				
Value Range (millions)	$253 – $263	$258	$200 – $250	$225
Average of above methods (millions)	$225 - $244	$234	$216 - $272	$244
Conclusion				
Valuation Range (millions)	$223 – $263	$243	$230 – $270	$250

*PBR is calculated by dividing the value range by Centra's estimated shareholders' equity as at the valuation date.

WEI's DCF was based on the following:

- Centra's forecasted financial statements dated December 31, 1997 for the years 1998-2000 used to determine the expected cash flow of the company;

- Centra's price management trading losses resulting from a recent Board decision which were excluded from the forecast as they are considered a one-time, non-recurring cost;

- the original capital expenditure forecast for 1998 to 2002 was used to determine annual capital requirements. The valuation was not revised when the new capital expenditure forecast was developed for 1999 to 2003 which reduced the amount of rural expansion and increased the amount of funding allocated to system betterment;

- a discount factor of 6.8% based on the weight average cost of capital ("WACC") of Centra; and

- a 69:31 debt-equity ratio, although Centra is regulated on a debt-equity ratio of 60:40. This was done because the purchase of Centra was originally financed through debt which existed both in Centra and in WEI. When taken together, the debt-equity ratio is 69:31.

WEI testified that $2.7 million of unbooked accrued vacation pay would not affect the value and did not affect the price as the amount is immaterial to the total purchase price. This amount was subsequently booked by Centra. In addition, WEI stated that the $2.2 million liability for unfunded post-retirement benefits did not need to be recorded for accounting purposes, and would not affect the value of Centra or the price paid by Hydro.

12.1.3 WEI Analysis of the Potential Synergies Resulting from the Transaction

In January 1999, Scotia Capital Markets, in consultation with WEI, estimated that a strategic buyer would be able to realize $19 million in annual cost saving synergies in the areas of engineering, distribution, customer service, customer accounting and information services, finance and administration, gas supply and regulation, marketing and sales, human resources and educational services, and executive costs.

After this initial analysis, Centra prepared an overview of the synergies that might be achieved by Hydro. Assuming full integration, Centra estimated that Hydro could realize synergies of $13 million to $19 million in operations, customer accounting service, administration, human resources, marketing, regulation, and executive functions. Centra also suggested that additional synergies would be available in the call centre, billing, joint utility services, and business development functions. The value to Hydro of gas powered turbine generation, power system upgrading deferral, and international business opportunities that involve gas or gas/electric may also result in additional savings. The synergy calculations were determined by taking a percentage of total cost or were estimated by applying some degree of judgment. Where synergies would result in staffing redundancies, an estimate of staff saving was used to derive a dollar estimate.

WEI testified that there is a good expectation that Hydro will be able to achieve these synergies, but added that some of the synergies, such as regulatory savings, likely will not be achieved without a full corporate merger.

12.2 Hydro's Position

Hydro testified that rates for both gas and electricity customers would be lower than they would otherwise be if the Transaction was not completed. Hydro also committed that rates charged to both the electric and natural gas customers would not increase as a direct result of the Transaction.

12.2.1 Due Diligence

Hydro, assisted by KMPG and Nesbitt Burns, conducted a due diligence review of Centra over a number of months whereby a detailed review of documentation and discussions with management and key personnel at Centra were conducted in the following areas:

- Auditors working papers;
- Income taxes;
- Commitments, contingencies, and liabilities;
- Environmental considerations;
- Prospective financial information;
- Cost of goods sold;
- Operating expenses;
- Employee benefit plans;
- Internal control structure;
- Accounting policies and procedures;
- Cash, cash flow and banking relationships;
- Accounts receivable;

- Inventory;
- Prepaid expenses and other assets;
- Accounts payable and accrued liabilities;
- Debt;
- Related party transactions, and
- Capital assets.

During the process it was discovered that one of Centra's pension plans has an unfunded liability of approximately $788,000. In addition, a provincial tax liability, as a result of a reassessment, that had originally been estimated at $20,000, was determined to be in the range of $400,000 to $750,000. KPMG testified these and other minor issues were identified during their investigation. However, each issue was dealt with appropriately during the negotiation process and no major issues were outstanding as at the date of the hearing that would have a material effect on the Transaction.

As part of the Transaction, KMPG must update its due diligence to the date of close. In addition, KPMG has been engaged to determine the fair market value of all of the assets and liabilities of Centra. The process is ongoing, and the information will be used in accounting for the Transaction on Centra's and Hydro's financial statements as well as in the calculation of all tax liabilities resulting from the Transaction. KPMG is in the process of preparing a report with respect to the due diligence process that will be finalized once the Transaction closes.

12.2.2 Purchase Price

Hydro wanted independent objective input on whether the Transaction was fair from a financial perspective. Therefore, Hydro used a model that is quite often used by public companies whereby it engaged Nesbitt Burns to assist in negotiations and preparation of a primary valuation, and it also engaged KMPG to provide an opinion regarding the fairness of the Transaction from a financial point of view.

Nesbitt Burns

Nesbitt Burns' analysis suggested a fair market value of the common shares of Centra to be in the range of $230 million to $270 million with a midpoint of $250 million. Hydro did not share this valuation assessment with WEI during the negotiation process.

Nesbitt Burns employed two primary valuation methods: the comparable transactions method and the comparable trades method. A third method, DCF, was used to check the valuation developed using the primary methods. The results of these calculations are summarized in the table in Section 12.1.2. Although the three methods generated different value ranges, Nesbitt Burns did not attempt to reconcile the results. Nesbitt Burns testified that it used its professional judgment to determine the final value range.

Nesbitt Burns' work did not focus on an assessment of the impact on customer services and rates that might arise from the Transaction, nor did it assess the potential impact of synergies or the incremental tax liability. Nesbitt Burns did not calculate the fair market value of the assets and liabilities of Centra.

The Board was unable to examine Nesbitt Burns' working papers that supported the final report issued on May 26, 1999 due to their proprietary nature. However, Nesbitt Burns advised that it utilized the following assumptions and information in the analysis:

- financial statements of Centra for the years ended December 31, 1993 to December 31, 1998;
- Centra's financial forecast for the five years ending December 31, 2002;
- 1998 cash flow adjusted for the following non-recurring items:

- a weather adjustment;
- the disallowed price management costs after tax;
- the recovery of overpayment from brokers regarding disallowed price management costs.

- an allowed return on equity of 9.4%;
- a weighted-average cost of capital of 5.25 to 5.75%;
- a terminal growth rate of 2.00% to 2.50%;
- 1998 equity adjusted to 40% due to the temporary nature of gas price hedging losses;
- seven comparable Canadian transactions which occurred over the period of March 1990 to March 1998;
- ten comparable U.S. transactions which occurred over the period of April 1996 to October 1998;
- comparable Canadian trading multiples for the pipeline, electrical utilities, and gas distribution groups of public companies; and
- a 20% control premium applied to the comparable trading multiples.

KPMG Fairness Opinion

KPMG was retained by Hydro to express an independent professional opinion whether the proposed Transaction was fair from a financial point of view. Fairness opinions are fundamentally different from valuation reports. A valuation report details how a valuator arrived at a conclusion on value. A fairness opinion is a professional opinion as to the fairness of a proposed transaction from a financial point of view. Generally, a fairness opinion has a much broader mandate than a valuation report. It usually requires consideration not only of a valuation analysis but other relevant financial factors.

In providing its fairness opinion to Hydro, KPMG performed several calculations and analyses in arriving at its conclusion. KPMG selected a DCF method to determine the post-acquisition value of Centra. KPMG separately identified synergies and the implications of the synergies in terms of cash flow to Centra. KPMG then discounted the synergies at a weighted-average cost of capital that was 3% higher than that applied to existing cash flows to reflect the additional risk. It also performed its own independent research regarding precedent comparable transactions, public stock market trading statistics, general economic statistics, and natural gas and transmission industry statistics.

KPMG also performed sensitivity analysis that considered fluctuations in weighted-average cost of capital, growth rates and capital expenditures. When KPMG assumed that no synergies would be realized, the value range of Centra fell below the purchase price of $245 million. However, when a 50% realization of the synergies was assumed, the value range was above the purchase price.

The Board was unable to examine the working papers that supported the final report issued by KPMG on May 10, 1999 due to the proprietary nature. However, KPMG did provide the Board with the major assumptions used in its model. They were as follows:

- a 10 year time horizon (1999-2008);
- estimated earnings before interest, tax and depreciation ranging from $57 million to $69 million over the 10-year projected period;
- annual cost savings to be achieved from the acquisition of Centra estimated to reach approximately $12 million by 2001;
- estimated ongoing capital expenditures ranging from $14 million to $15 million over the 10-year period excluding 1999;
- estimated capital expenditures for 1999 of approximately $26 million;

- estimated amalgamation costs of approximately $20 million over a two-year period ending in 2000, as opposed to Hydro's estimate of $17.5 million over three years;

- estimated pre and post acquisition capital structures of 40% equity and 60% debt for regulatory purposes;

- estimated weighted average cost of capital ranging from 4.8% to 5.6%;

- growth in earnings before interest, taxes, depreciation and amortization ("EBITDA") from 2008 and into the future, estimated to range from 1.0% to 1.5%;

- marginal corporate income tax rate of 46%.

The following items were not included in the analysis:

- diseconomies of scale;

- benefits from the termination of the Enlogix contract;

- transfer tax savings;

- new growth due to expansion projects; and

- the document entitled "WEI Disclosure" because it was not available when the analysis was done.

KMPG is of the opinion that the value of a company cannot be determined by one single ratio. In the overall picture, the amount of cash that a company can generate over a period of time is the most important factor. However, a number of factors must be examined. KPMG concluded that the Transaction is fair from a financial point of view to Hydro.

12.2.3 Accounting for the Transaction

Hydro's investment in Centra will be recorded at the amount paid, plus costs directly associated with completing the Transaction. The financial statements of Centra and Minell will be consolidated with those of Hydro. On consolidation, the purchase price in excess of Centra's book value will be allocated to the assets, liabilities, and goodwill.

Hydro suggested that goodwill and amalgamation costs will be amortized by Hydro over 40 years, while the assets of Centra will be amortized on a straight-line basis over their estimated future economic service life. Any amounts paid to refinance existing debt will be amortized over the term of the replacement debt. The one-time tax of approximately $78 million will be recorded as an asset and amortized at a rate approximating the amount of tax that would have been paid if Centra had remained taxable.

12.2.4 Financing

The Transaction will require immediate financing of the acquisition price of $245 million, the transfer-tax liability estimated to be $78 million, and the short-term obligations estimated to be $15 million. In addition, Hydro will assume the existing $148 million long-term debt obligations of Centra. Hydro will finance these expenditures through a long-term debt issue at market rates with terms ranging from 10-30 years. The short-term debt will be financed with short-term notes at market rates. Hydro estimated that it could finance the purchase price at a rate of 6.68% including the provincial guarantee fee.

12.2.5 Income Tax Issues

An election will be made under Section 111(4)(e) of the *ITA* to revalue the assets of Centra. At closing, the tax status of Centra will change from taxable to non-taxable. In accordance with section 149(10) of the *ITA*, the change in tax status triggers a deemed disposition of the assets at fair market value. The total tax payable resulting from the application of Sections 111(4)(e) and 149(10) is estimated at $78 million.

In order for Centra to remain as a taxable entity following the close of the Transaction, more than 10% of the shares would have to be owned by a party other than Hydro. This option was rejected by Hydro.

The one-time tax payment will be recorded by Centra as a deferred asset and amortized at a rate approximately equivalent to the amount of taxes that would have been paid had Centra remained taxable.

Centra currently pays the Government of Manitoba about $4.4 million and the Government of Canada approximately $6.6 million annually in income taxes. After the Transaction closes, the Government of Manitoba will receive approximately $29.5 million and the Government of Canada will receive approximately $48.5 million, as a one-time tax payment in 1999. Hydro has estimated that gas rates will continue to include approximately $11 million annually related to income taxes. That amount will be set aside each year to pay down the $78 million debt related to the one-time tax payment. Once the debt has been retired, 37% of the $11 million will be allocated to the Government of Manitoba as a grant in lieu of taxes, and the balance will be used to pay down accumulated interest on the debt. Once the accumulated interest has been retired, the full $11 million will be paid annually to the Government of Manitoba as a grant in lieu of taxes. Hydro testified that there should be no impact on the ratepayer as a result of the change in tax status.

12.2.6 Hydro's Analysis of Synergies

Hydro stated that its synergy estimates were established based on discussions among Hydro's team members, review of documents from the 1998 general rate application, and information reviewed in the data room during the due diligence process. Value judgments were made to determine the total payroll and other synergies that could be achieved.

Hydro has identified cost savings that are estimated to grow to $12 million per year over a three-year period. Hydro is of the view that this estimate is low and further savings can be achieved. It is expected that the expenses to implement these synergies will be $17.6 million that will be incurred over a three-year period. Details of the potential synergies are included in the following table:

Potential Synergies

$000

Function	1998 O & M Budget 1998 GRA	1998 O & M Budget Payroll Costs 1998 GRA	1998 O & M Budget Other Costs 1998 GRA	Potential Payroll Synergy*	Potential Percentage Reduction in Payroll Costs	Potential Other Synergies	Potential Total Synergies	Potential Total Synergy: % of Total O & M	Examples of Potential Savings in Other Costs
Engineering & Distribution Operations	$11,569	$ 8,477	$ 3,092	$ 137	1.6%	$ 225	$ 362	3.1%	Construction Fleet purchase/maintenance Weather Forecasting Services
Customer Service	10,484	8,484	2,000	2,039	24.0%	500	2,539	24.2%	Rural office space Trenching Meter Shop
Finance & Administration	6,188	2,294	3,894	1,092	47.6%	600	1,692	27.3%	Westcoast charges Purchasing/materials management
Customer Accounting & Information Services less positions added to perform work of ISM-BC Contract	11,875	5,366	6,509	2,029	37.8%	3,600 (2,000)	3,629	30.6%	Elimination of ISM-BC contract Combined Postage JD Edwards License Fee Cancellation
Marketing & Business Development	3,171	1,604	1,567	172	10.7%	100	272	8.6%	Combined sponsorships/advertising
Human Resources & Educational Services	6,802	6,731	71	1,228	18.2%	0	1,228	18.0%	
Gas Supply, Legal & Regulatory	2,471	1,310	1,162	327	25.0%	1,000	1,327	53.7%	Regulatory Costs
Executive	2,552	1,305	1,247	1,100	84.3%	600	1,700	66.6%	Cars Travel Club Memberships
Totals	$55,111	$35,570	$19,541	$8,124		$4,625	$12,750	23.1%	
Offset by: Partial Wage Equalization				($750)			($750)		
Totals	$55,111	$35,570	$19,541	$7,374	20.7%	$4,625	$12,000	21.8%	

* The payroll synergies are from a combined Manitoba Hydro/Centra Gas Manitoba workforce.

As approximately 60% of the anticipated cost savings is related to wages, Hydro estimates that it will be able to reduce the combined workforce by 100-150 employees through attrition.

Overall, the Transaction is projected to begin making a positive contribution to consolidated net income of $4.3 million in 2001/02, rising to over $14.1 million in additional net income by 2009/10. Detail regarding the impact of the Transaction on the consolidated net income of Hydro and Centra is included in the following table:

Centra Acquisition

Impact on Consolidated Net Income
Summary

	Aug. 1 - Mar. 31	($ millions) January - December									
	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09	2009/10
Projected Status Quo Net Income											
Revenues	272.8	347.0	358.2	368.5	377.1	387.7	398.5	409.7	420.2	431.9	443.8
Cost of Gas	180.7	225.7	232.5	239.5	246.7	254.2	261.9	269.8	277.9	286.3	294.9
Operating revenue	92.1	121.3	125.7	129.0	130.4	133.5	136.6	139.9	142.3	145.6	148.9
Operating expenses	54.7	84.3	86.5	88.8	91.1	93.4	95.9	98.4	100.9	103.5	106.2
Finance expense	9.8	14.8	15.5	15.9	14.5	14.6	14.6	14.8	14.2	14.4	14.5
Tax expense	13.4	10.9	11.6	11.9	12.1	12.4	12.7	13.0	13.2	13.4	13.6
Net Income After Tax for Status Quo	14.2	11.3	12.1	12.4	12.7	13.1	13.4	13.7	14.0	14.3	14.6
Hydro Adjustments											
Synergies	1.5	9.2	12.6	12.9	13.1	13.4	13.6	13.9	14.2	14.5	14.8
Incremental amortization costs	(5.1)	(7.8)	(8.4)	(8.4)	(8.4)	(8.4)	(8.4)	(8.0)	(8.0)	(8.0)	(8.0)
Enlogix replacement	0.0	0.0	2.2	2.2	2.3	2.3	2.4	2.4	2.5	2.5	2.6
Additional interest expense	(9.5)	(14.6)	(14.8)	(14.5)	(15.6)	(15.1)	(14.6)	(13.8)	(14.0)	(13.2)	(12.5)
Income taxes saved	13.4	10.9	11.6	11.9	12.1	12.4	12.7	13.0	13.2	13.4	13.6
Transfer tax recovery	(7.5)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)	(8.6)	(6.9)	(6.9)	(6.9)
Payments to Province	0.0	0.0	0.0	0.0	0.0	0.0	0.0	(2.4)	(4.1)	(4.1)	(4.1)
Total adjustments	(7.2)	(13.3)	(7.8)	(6.9)	(7.5)	(6.4)	(5.3)	(3.5)	(3.1)	(1.8)	(0.5)
Impact on Consolidated Net Income	7.0	(2.0)	4.3	5.5	5.2	6.7	8.1	10.2	10.9	12.5	14.1

Once Hydro's financial targets have been achieved, decisions can be made on the allocations of the financial benefits resulting from the combined ownership of the two utilities. Hydro will implement procedures whereby staff, providing shared services, will properly allocate their time between electric and gas operations. Hydro testified that the cost savings would first be allocated to Centra in order pay off the debt and the amalgamation costs. Then, the costs will be tracked separately and an allocation will be considered at that time. Hydro noted that it currently performs this type of analysis to allocate costs among different customer rate classes.

Hydro testified that once the debt has been paid, there may be a reduced rate burden on both electricity and gas customers.

12.3 Intervenors' Positions

12.3.1 CEPU

CEPU submitted that, as a result of the proposed Transaction, there will be benefits to ratepayers.

12.3.2 CAC/MSOS

CAC/MSOS expressed the view that the major and overriding business risks of the Transaction are the potential for increased amalgamation costs and the potential for failure to achieve the cost savings.

CAC/MSOS pointed out that there is no evidence that unequivocally points to a conclusion that the proposed Transaction should not be approved. However, the risk of an excessive purchase price is no longer on the shareholders of Centra. The risk would rest with ratepayers.

CAC/MSOS urged the Board to consider the fact that Nesbitt Burns had a significant financial interest in the outcome of the Transaction. In addition, the analysis of Nesbitt Burns was largely based on professional judgment. CAC/MSOS suggested that the samples that were used were sparse and somewhat outdated, and that three out of seven comparable transactions related to one company. CAC/MSOS suggested that the comparable transactions and trades were useful only in an overall qualitative sense. Further, as the Transaction was a vendor initiated purchase, a premium for control should not have been applied to the comparable trades.

CAC/MSOS noted that the discounted cash flow was an appropriate valuation model. However, it was impossible to extract the underlying assumptions from the witnesses produced on behalf of Nesbitt Burns. CAC/MSOS disagreed with Nesbitt Burns and stated that the price management disallowance results may not be a one-time occurrence.

CAC/MSOS was of the view that the fair market value is more appropriately at 1.5 times book value, resulting in a value range $60 million lower than the purchase price. The direct implication is that Hydro will have to achieve greater synergies to cover the higher purchase price.

CAC/MSOS stated that there is no guarantee that lower costs will result in lower rates. CAC/MSOS noted that Hydro was unable to identify any competitive risks, opportunities, or service quality objectives that would enhance the service that gas consumers are already getting. Thus, the only tangible benefit is the projected cost savings.

CAC/MSOS noted that Hydro stated that the amalgamation cost estimates are high. However, KMPG used even higher figures and assumed a shorter time frame over which they were to be incurred.

CAC/MSOS was also of the view that Hydro has underestimated the impact of the Enlogix contract and the cost consequences. CAC/MSOS believes that the contract is too rich and the costs to Hydro could be as much as $2 million if it continues with the contract over the next two years. Any disallowance of any costs that are deemed to be excessive by the Board will impact the net savings that Hydro expects to achieve. In addition, CAC/MSOS stated that there is a substantial risk of incremental costs not being considered by Hydro with respect to the CIS system.

CAC/MSOS fears that although Hydro expects to achieve cost neutrality with respect to wages and benefits, costs could increase in an attempt to achieve parity. Further, as 60% of the cost savings are in the form of payroll costs, there is increased risk in achieving savings. In addition, CAC/MSOS disagreed with Hydro's assumption that it can reduce regulatory costs by $1 million each year.

In summary, CAC/MSOS submitted that the net impact of the Transaction is potentially only favorable to WEI and to the Government of Manitoba. There is no guarantee that the ratepayers, for whom the Transaction is being consummated, will receive any benefit.

12.3.2.1 The Evidence of John Todd

John Todd was retained by CAC/MSOS. He reviewed the proposed acquisition of the shares of Centra by Hydro, the impact of the transaction on ratepayers in Manitoba, and commented on the Board's regulatory role in this matter.

Mr. Todd expressed concern about the additional debt level of $486 million that Hydro will assume as a result of this Transaction. Interest charges on this debt will roughly equal Centra's net income of $35 million to $45 million, leaving little, if any, room for contribution to reserves.

It was Mr. Todd's contention that the write-up of assets and amortization of goodwill may lead to future rate increases if financial targets of Hydro are to be maintained. Therefore, from a ratepayer perspective, it is essential that synergy cost savings exceed all the incremental costs of the amalgamation process.

Mr. Todd agrees with Hydro that the major business risks relate to the magnitude of the synergies and amalgamation costs that ultimately result from this purchase. He is concerned that Hydro has made little effort to fully quantify the relative risks to customers of a failure to achieve these synergies or to control the amalgamation costs.

The proposed movement of Centra to a non-taxable status is, in his view, a minor factor. He sees the benefits flowing to the Manitoba taxpayer rather than the ratepayers. This is a significant departure from past practices where the ratepayers have been the primary beneficiary of the preferential tax status of Crown Corporations.

Mr. Todd suggested that under a Rate Base, Rate of Return regulatory regime, the rate payers would not be required to pay for the cost of increased capital resulting from the Transaction. In his view, a shift to Cost of Service regulation will permit this cost and incremental amortization costs to be passed on to the ratepayer.

The level of cost savings relative to synergies and the termination of the Enlogix contract are essential to the success of the Transaction. Without these, Hydro will either have to raise rates or sacrifice its financial targets.

Mr. Todd is of the view that Hydro is overly optimistic in its assessment of cost savings in the areas of customer information systems, future employee compensation levels, staffing level reduction, and reduced capital requirements. He believes that they have overlooked potential diseconomies that will result from the merger of two culturally and technologically different operations. He also believes that an immediate movement to Cost of Service regulation would reduce the transparency of the utility operation and limit the accountability of Hydro for future synergies and cost control. It is possible and desirable for Centra to remain under a Rate Base, Rate of Return regulation in the short-term, and be subject to greater scrutiny by the Board.

Mr. Todd recommended that Centra remain a separate entity regulated on a Rate Base, Rate of Return basis until such time as all potential synergies are achieved. In these circumstances Centra would only be allowed a return on the pre-transaction assets and Hydro would have to rely heavily on the net synergy cost savings to cover the acquisition costs and to achieve its financial targets. Only after this has been achieved should Hydro be permitted to roll Centra into its Cost of Service regulation. A generic hearing was suggested as an appropriate forum for the Board to address the merits of possible changes in the future.

12.3.2.2 The Evidence of Lawrence D. Booth

Dr. Lawrence D. Booth was retained by CAC/MSOS to assess the impact of the Transaction on ratepayers in Manitoba.

Dr. Booth suggested that the valuation procedures employed by Nesbitt Burns and KPMG are consistent with conventional practices for business valuations. His view is that the DCF methodology is more appropriate for non-utility acquisitions and that the PBR value are more appropriate for the acquisition of regulated utilities.

Dr. Booth does not agree with the PBR of 2.0 suggested in the Nesbitt Burns valuation. In his opinion, the multiple should be much lower for a regulated utility, probably in the 1.4 - 1.5 range. Consequently, the fair market value of Centra might have been lower than the purchase price by $60 million. Dr. Booth also suggested that there should not have been a premium paid for this vendor initiated sale.

Despite his concerns with the valuation multiples, Dr. Booth is not opposed to the Transaction. He believes that given the right conditions, sufficient synergies and cost savings can be achieved to support the purchase price without rate increases. Dr. Booth cautioned, however, that there have been more unsuccessful mergers or acquisitions than successful ones. In his view, successful acquisitions require unequal corporate size, culturally compatible operating units, and significant overlap of operating technology. A quick integration of operations is also required to achieve the essential synergies necessary to justify the Transaction.

While Dr. Booth is not opposed to the integration of Centra's operations into Hydro, he is concerned that, without specific incentives, the projected cost savings will not materialize. In his view, Centra's operations should continue to be regulated on a Rate Base, Rate of Return basis for a three-year transition period in order that synergies and cost savings can be specifically tracked and reported.

Dr. Booth is of the opinion that Rate Base, Rate of Return regulation is more open and transparent. Cost of Service regulation does remove the incentive to increase the rate base, but typically provides less information to the public. Therefore, he believes that the gas and electric ratepayers, would be better served by maintaining the existing regulation in the initial years.

12.3.3 HVAC

HVAC stated that it would like to see the synergies realized in order to provide a benefit to Manitobans.

12.3.4 MIPUG

MIPUG submitted that it is not clear to what extent ratepayers, and particularly electricity ratepayers, will benefit. However, MIPUG feels that the Board should manage the risks involved with the Transaction rather than reject it.

With regard to the purchase price, MIPUG submitted that all of the parties could have benefited from additional information on valuation matters. MIPUG noted that there was nothing in Hydro's evidence that suggested that the rates will go down for the electricity customers, other than Hydro's commitment. MIPUG is relying on that commitment.

MIPUG believes that at least some cost savings will be achieved. However, synergies will need to be tracked separately. MIPUG expressed concern that tracking of savings will be difficult.
MIPUG noted that there is no plan at present to allocate cost savings. MIPUG is relying on Hydro's commitment to appear before the Board to determine allocation methodology in the future.

MIPUG submitted that the evidence clearly establishes that the Government of Manitoba is the winner in the Transaction, as there are gains for the Province and no material risks. The Government of Manitoba will benefit with a lump sum tax payment of $29 million. In addition, there will be interest and guarantee fee revenue arising from the purchase price and income tax liability of $78 million. There will also be payments in lieu of taxes as soon as the transfer tax principal and interest has been repaid. MIPUG submitted that Hydro should reconsider this arrangement.

12.3.5 Municipal

Municipal was silent on the issue of the impact of the Transaction on utility rates.

12.3.6 PCWM

PCWM agreed with CAC/MSOS's position that a PBR of 1.5 to arrive at a purchase price seems fair and reasonable. Using a PBR of 2.0 increases the risk of an adverse impact on rates. Given the compensation structure of Nesbitt Burns, PCWM questioned the ability of that firm to remain independent. PCWM pointed out that the difficulty in merging the two corporate cultures of Hydro and Centra increases the risk of the Transaction.

12.3.7 Winnipeg Hydro

Winnipeg Hydro would like to see a Board hearing with respect to the Cost of Service methodology held prior to any general rate application hearing for either gas or electricity rates. Such a hearing should be exclusive of pass-through applications noting issues such as cross subsidization and postage stamp rates vs. zone rates. In addition a separate cost of service study hearing must be held. Winnipeg Hydro urged the Board to use actual rather than prospective costs, as forecasts are often inaccurate.

12.4 Board Findings

The Board has heard independent evidence from Nesbitt Burns supporting a fair market value range that is consistent with the fair market value range determined internally by WEI. The price negotiated between Hydro and WEI is also near the mid-point of the fair market value range determined by Nesbitt Burns and WEI. Although Dr. Booth has suggested that the fair market value should be approximately $60 million lower, the Board has also heard evidence from KPMG concluding that the Transaction, including the price paid, is fair from a financial point of view to Hydro. It is the Board's view that the $245 million purchase price was determined by the particular market circumstances. It is apparent that WEI's assessment of market value and asking price was largely supported by the valuation of Nesbitt Burns, and by the subsequent independent fairness opinion issued by KPMG. Consequently, the Board is satisfied that the price reflects Hydro's estimate of potential synergies and the price negotiated between Hydro and WEI for the acquisition of all of the issued shares of Centra is market based.

While the Board acknowledges the concern expressed by CAC/MSOS regarding the independence of Nesbitt Burns because it has a financial interest in the Transaction, the

Board is satisfied that the valuation prepared by Nesbitt Burns is consistent with the internal valuation prepared by WEI, and is further supported by the independent fairness opinion prepared by KPMG.

The Board recognizes that the key business risk attached to the Transaction is the ability of Hydro to achieve synergies and cost savings that exceed the incremental costs of the Transaction. The Transaction is significant. Hydro is taking on $486 million of additional debt at a time when most organizations are implementing debt reduction strategies. Many of the expected synergies and cost savings cannot be precisely determined or estimated. In addition, there are a significant number of unknowns, one or more of which could have an negative impact on Hydro's ability to achieve synergies and cost saving that exceed the incremental costs of the transaction. Costs associated with the Enlogix contract and possible alternatives to replace the Enlogix contract, uncertainties regarding employee contracts and related labour issues, and the uncertainty in Hydro's ability to identify sufficient redundancies are a few of the areas that will affect the risk of achieving cost savings.

The ratepayers must take on this risk. Nevertheless, the Board is confident that there is an opportunity for Hydro to achieve increased efficiencies as a result of the Transaction. The Board accepts Hydro's position that the identified synergies and cost savings of $12 million are a conservative estimate, and the Board expects that greater cost savings are achievable and will be targeted by Hydro, once it becomes more familiar with the operations of Centra.

The Board notes that the synergies and cost savings should be achievable over a relatively short period, perhaps 2-3 years, as will some of the service related benefits. However, some of the financial benefits to customers will accrue over a longer period, perhaps 10 years or more. The Board further notes the commitment of Hydro that existing rates paid by both the electricity and gas customers will not increase as a direct result of this Transaction. The

Board cautions the ratepayers that this commitment from Hydro does not equate to a moratorium on rate increases. A major component of the gas sales rate is the commodity cost of gas, which is driven by market forces that at times can be unpredictable and volatile, and are outside of Hydro's control. Gas sales rates could increase in the future as a result of increases in the commodity cost of gas, or other non-gas Cost of Service items not directly related to the acquisition costs of the Transaction.

The Board also notes the significant benefits accruing to the Government of Manitoba as a result of the transaction. The benefits include an immediate up-front tax payment that is substantial, and payments of grants in lieu of taxes in the future that are far greater than the tax payment to which the Province would otherwise be entitled. In addition, the Province benefits in the form of higher guarantee fees related to the debt incurred by Hydro to consummate the Transaction. All of these benefits to the Province will not affect ratepayers only if Hydro is successful in achieving its expected cost savings and synergies. The Board agrees with the position put forward by several intervenors that the risk to the ratepayers would be substantially reduced if the annual grant-in-lieu of taxes of $11 million was not required, once the $78 million tax liability and related interest costs are paid.

Because of all of the uncertainties discussed above, and in particular, the significant risks assumed by the ratepayers, the Board is of the view that a comprehensive regulatory process must remain in place, with significant regulatory oversight to ensure that the interests of the ratepayers are protected. In addition, there is a need for a detailed tracking process to be implemented so that the synergies and cost savings realized from the transaction can be identified, and shared with the appropriate customer groups.

The Board looks to the strong management and leadership of Hydro to achieve cost savings and synergies in excess of those estimated. The Board will also exercise strong oversight of the process to ensure that the expected benefits are achieved, and that customers of both utilities will benefit from the Transaction. The Board has concluded that, while there are risks, the Transaction, if well managed, should have no significant detrimental impact on the rates charged to ratepayers of both the gas and the electric utilities.

13.0 The Impact of the Transaction on the Future Regulation of each of the Utilities

13.1 WEI's Position

WEI was silent on the issues of future regulation. However, it was WEI's opinion that the realization of the synergies would be negatively affected if Centra is not allowed to fully integrate its operations with Hydro. In addition, WEI noted that the number of hearings may be reduced under a Cost of Service approach in setting rates, as opposed to the present Rate Base, Rate of Return approach.

13.2 Hydro's Position

Hydro envisions a change from the current Rate Base, Rate of Return regulation of Centra to a Cost of Service model. Unlike the Rate of Return model now used for Centra, the Cost of Service approach does not encourage the expansion of the rate base. Hydro has not yet determined if it prefers that future rate hearings for gas and electricity be combined or separated. The goal should be to achieve the most efficient structure.

Part IV of *The Public Utilities Board Act* appears to be based on the historic structure of the natural gas industry in Manitoba wherein gas companies have traditionally been privately owned entities. Part IV of the statute requires the Board to determine rates, the rate base and rate of return, but does not explicitly contemplate rate setting using a Cost of Service regime.

In order to provide certainty and clarity, amendments to *The Public Utilities Board Act*, permitting cost of service rates based on revenue requirements, would be Hydro's preferred option.

Hydro hopes that, in the interim, the Board may determine that there exists sufficient latitude in the current regulatory regime to accommodate Hydro's Cost of Service method. It is Hydro's position that continued regulation of the gas utility will be status quo subject to any determination by the Board, and that Board approval will be required prior to a merger of Centra into Hydro. However, a definitive opinion in this regard has not been obtained.

13.3 Intervenors' Positions

13.3.1 CEPU

CEPU stated that it is unfamiliar with the Cost of Service regulatory model and could not put forth an opinion as to its appropriateness for a gas utility. However, CEPU felt that any contemplated changes to either the terms and conditions of service or changes to future regulation with respect to Centra should be subject to examination and approval by the Board.

13.3.2 CAC/MSOS

In the view of CAC/MSOS, the Board's jurisdiction pursuant to *The Gas Pipe Line Act* will remain intact after the Transaction is closed. There is nothing in any other legislation which supersedes this authority. CAC/MSOS added that Hydro has made a commitment to assist in restoring the Board's jurisdiction if any legal impediments arise.

CAC/MSOS stated that there is no principle in law which would give a statutory tribunal authority that it does not otherwise have. Jurisdiction cannot be conferred by consent. It is CAC/MSOS's position that Sections 82 and 92 of *The Public Utilities Board Act* will continue to apply to Hydro and there can be no merger, consolidation or union of Centra into Hydro without approval of the Board.

It is clear to CAC/MSOS that vigilance must be maintained. It noted that generally companies are "in the leap of faith business" when it comes to mergers and acquisitions. However, "the graveyard is full of failed ventures which were once couched in optimistic and effervescent terms." The potential problem for Hydro is one of underestimating the diseconomies, underestimating the cultural difficulties and underestimating the standardization costs that inevitably occur when dealing with a merger of this magnitude. CAC/MSOS submitted that the risk of allowing complete integration is that the savings will never be able to be identified and the parties will never be able to determine whether any of these savings may have been obtained in any event.

CAC/MSOS indicated that transparency is the key. In the absence of maintaining regulatory separation and the status quo for Centra, there will be no possible measurement available to the Board to determine whether Hydro has fulfilled its commitments. CAC/MSOS urged that a transition or probation period be maintained during which Hydro is given a chance to demonstrate its abilities to achieve its goals.

CAC/MSOS requested that the Board order Hydro to:

- seek approval, under either Sections 82 or 92 of *The Public Utilities Board Act*, to integrate;
- keep Centra separate and apart from Hydro, from a regulatory point of view;

- keep separate accounting records;
- continue to operate on a Rate Base, Rate of Return regulatory environment in the transition period with a notional capital structure as is presently in place, that is a 60/40 ratio;
- come before the Board at an early opportunity to deal with issues such as the Enlogix cost, the price management plan, and a general rate application;
- track the cost savings from Centra, after having developed a baseline;
- ensure that the rates to ratepayers remain unaffected by the integration;
- apply any cost savings against incremental cost of acquisition;
- apply a Cost of Service methodology only after Hydro can demonstrate that there are cost savings in excess of incremental costs to be achieved;
- apply to the Board for a hearing with respect to recommendations for amendments to existing legislation to accord with the appropriate method of regulation, and
- deal with the allocation of the net benefits to ratepayers after all of these other matters are taken care of.

CAC/MSOS did not take a position that Rate Base, Rate of Return regulation be maintained for any other period of time other than the transition period.

CAC/MSOS is of the opinion that the operative portion of the Board's Order is appropriate for publication in *The Manitoba Gazette.*

13.3.3 HVAC

HVAC would like assurance that Centra is held accountable if it goes beyond its mandate in a manner that impacts the HVAC community. HVAC emphasized the importance of maintaining Centra's requirement for an annual general rate application. Although Hydro is accountable through the Manitoba Legislature, HVAC is of the view that this level of accountability is not as great as that provided by the Board.

In addition, HVAC expressed concern with regard to the fact that Hydro may now be able to overrule previous Board orders.

In HVAC's opinion, the current system of regulation with respect to Centra should be preserved until Hydro is in a position to work with the HVAC industry instead of competing with it. HVAC stated that current inspections of natural gas installations are important and should not be viewed as a cost saving opportunity. HVAC would like to see the Board continue the Enlogix hearing.

HVAC expressed the opinion that Hydro should be allowed to amalgamate the two utilities in the near future in order to realize the full amount of synergies.

13.3.4 MIPUG

MIPUG's opinion is that the Transaction will not affect the Board's jurisdiction over Centra with respect to *The Public Utilities Board Act* or *The Gas Pipe Line Act*. If MIPUG believed that the Transaction would result in the Board losing jurisdiction over Centra, MIPUG could not recommend that the Board approve the Transaction, as it would be contrary to the public interest. MIPUG is relying on Hydro's repeated assurances that Centra will be regulated on a "status quo" basis unless there is legislative change to provide otherwise.

MIPUG expressed the view that legislative change is required before Centra can be regulated with a Cost of Service model, and Hydro may need Board approval to integrate functions.

MIPUG stated that the Legislature did not intend for the gas utility to become unregulated as a result of the Transaction. It is clearly in the public interest to ensure that the gas utility continues to be regulated by the Board. MIPUG submitted that the legislative trend with respect to Hydro has been to increase the regulatory role of the Board.

Given the short period of time available to evaluate many complex issues, MIPUG strongly believes that further Board hearings are necessary to ensure that future decisions are made wisely and that the public interests are protected. MIPUG strongly recommended that the Board describe in its decision certain guidelines, recommendations and directions with respect to the transition period.

13.3.5 Municipal

Municipal submitted that the Board must maintain its supervisory role over Centra in order to ensure that Centra's power, as a monopoly, is not abused. Municipal would like to see Hydro formalize its commitment that there will be no change in the current regulation as a result of the Transaction.

13.3.6 PCWM

PWCM submitted that the Board is the appropriate agency to help ensure the accountability of Hydro. PCWM sees merit in keeping Hydro and Centra separate, at least for the transition period. Integration could proceed while separate financial statements and accounting for the two operations would allow progress to be monitored in a transparent and accountable way.

PWCM is concerned that there will be considerable political pressure to proceed with rural gas expansion. Using a feasibility model for future expansion will ensure accountability.

PWCM believes that the current rate of return model appears to be working and any change to a Cost of Service regulatory model should be subject to a different Board hearing.

13.3.7 Winnipeg Hydro

Winnipeg Hydro does not question the intent of Hydro to make the Transaction work. However, more Board supervision is required. Winnipeg Hydro would like to see a post-Transaction hearing so that the Board and the public can evaluate the actual results of the Transaction. It expressed concern regarding Hydro's ability to identify and segregate operational savings that will occur in any event from savings that will occur as a direct result of the Transaction.

Winnipeg Hydro recommended that Hydro be allowed to integrate quickly in order to realize the full extent of the synergies, and urged the Board to use the opportunity to commence framing its regulatory role.

13.4 Board Findings

The Board notes the evidence put forward by MIPUG, CAC/MSOS and other intervenors in strong support of the continuing and perhaps expanded regulatory oversight required from the Board. This continuing regulatory oversight of the Board is also referred to by the Competition Bureau in its letter of July 16, 1999.

The Board finds that the proposed Transaction does not impact on any of the Board's current jurisdiction over Hydro or over Centra. Simply put, the Transaction is to facilitate a sharing of common services and functions between two utilities, with costs being properly allocated. The Transaction will not change any existing statutory requirements which include:

(a) Centra being regulated on a Rate Base, Rate of Return basis;

(b) Hydro continuing to set rates on a Cost of Service basis;

(c) *The Gas Pipe Line Act* continuing to apply to Centra regardless of ownership;

(d) Hydro and Centra remaining separate entities for purposes of regulation; and

(e) all existing Board Orders, directives, requirements and practices continuing to apply to Centra unless and until Hydro obtains Board approval to vary them.

While parties raised serious concerns about possible changes to the method of regulation of each of Hydro and Centra in the future, there was unanimity on the issue that what is presently being requested of the Board is simply approval of the proposed Transaction. There is no request or application before the Board to merge, unite or consolidate Centra with

Hydro. The Board finds there are legislative requirements in Sections 82 and 92 of *The Public Utilities Board Act* that, should Hydro intend to merge, unite or consolidate Centra with Hydro, the prior approval of the Board must be obtained. Approval of the Transaction does not confer any approval for Hydro to functionally integrate or corporately merge Centra's operations into Hydro's operations.

There was further concern that if Centra was merged, united, or consolidated with Hydro, then the gas utility would be subject to a lower level of regulation than now exists over the operation of the gas utility. For example, and for reasons unknown, section 2(5) of *The Public Utilities Board Act* provides that, with limited exceptions, *The Public Utilities Board Act* does not apply to Hydro and the Board has no jurisdiction or authority over Hydro. Conversely, *The Public Utilities Board Act* does apply, in full, to the regulation of Centra. That this dichotomy would continue to exist, after the Transaction, is difficult to explain or understand. Hydro has stated that one of the significant benefits to be realized from the Transaction is an efficiency in energy resource planning. In other words, a common ownership of the energy utilities would facilitate the co-ordinated and cost efficient planning of major capital expenditures required to meet the energy needs of Manitobans.

The current state of Hydro regulation precludes the requirement for Board approval of capital expenditures. That existing legislation does not provide regulatory oversight of Hydro's capital expenditures was a matter confirmed in the stated case of *The Public Utilities Board (Man.)* v. *Manitoba Hydro et al* (1989) 61 Man. R. (2d) 164 (Man. C.A.).

Even in light of the restrictive legislation and Court ruling, the Province of Manitoba has, through Order-in-Council, sought Board review of Hydro's capital expenditure plans when the Conawapa Generating Station was being considered in conjunction with the sale of electricity to Ontario Hydro.

Because of the Transaction and the capital expenditures that may have a resultant potential impact on rates, it now appears reasonable and prudent for the Government of Manitoba to remove the statutory restriction on the Board's regulation of Hydro in Section 2(5) of *The Public Utilities Board Act*. Removal of the statutory restriction on the Board's jurisdiction and authority over Hydro is further warranted when one examines the impact of the Board's disallowing, and not including in consumer rates, certain expenses of Centra. Prior to the Transaction, any disallowance of expenses meant such costs were not passed on to ratepayers, and it was Centra's shareholders that had to bear the cost. A recent example is the Board's disallowance of $27.25 million of gas costs in Order 79/98.

With Hydro as the new shareholder of Centra, any disallowance of the gas utility's expenses has the perverse possibility of having to be borne by the electric utility and its customers either through rates or retained earnings. Because the Board has enabled the gas utility to use a "future test year" for determining what expenses will be included in future rates, sound management can avoid disallowances that financially impact the utility's shareholder by applying for Board approval prior to the utility undertaking significant expenses - including capital expenditures. This relatively recent pronouncement of the Board, to enable the gas utility to be regulated on a future test year basis, provides additional reasons why the Board's jurisdiction and authority over Hydro should no longer be statutorily limited.

Assuming Hydro will in future apply to the Board to merge, unite, or consolidate the two utilities, there will be an issue as to the type of regulatory regime that should be utilized.

The Board finds that it is premature and unnecessary to determine, at this time, whether a "Cost of Service" regulatory regime for a merged utility provides better accountability and transparency than some other form of regulation. This issue is for another day.

14.0 Presenters' Positions

14.1 AMHSSE

AMHSSE consists of approximately 430 staff specialists and supervisors. Mr. R. Bauer, representing AMHSSE, submitted that the Transaction is in the best interest of the Province of Manitoba and the customers of Centra.

AMHSSE noted that the two utilities are similar with regard to serving both commercial and residential customers, distributing their product along a network, metering and billing on a monthly basis, maintaining an underground system component, and providing call centres for the public. AMHSSE sees many opportunities to consolidate functions and ultimately realize savings that in turn would benefit the customer.

AMHSSE stated that Hydro's solid and dependable management style should help the economic growth of the province and benefit all Manitoba. AMHSSE concluded by stating that the community-minded spirit of Hydro is something that will be even further cultivated in a new organization that encompasses the gas utility.

14.2 Mr. M. Dolin

Mr. Dolin, representing himself and his grandson, supported the Transaction. He stated that governments are collectives of people that provide services that individuals cannot provide for themselves. He pointed out that the assumption that everything in the private sector is good, everything in the public sector is evil and the only management that is effective management is in the private sector is incorrect. There is good and bad management in both the public sector and the private sector.

Mr. Dolin believes that Centra was not accountable under WEI control and that Centra will be more accountable to the people of this province under the control of Hydro.

The only way the rural areas in Manitoba will be served, as was with rural electrification, is if the profit motive is removed and the public service becomes part of the interest of this corporation. The proposed ownership structure for Centra is a more effective and efficient way of gas distribution and is in the public interest.

14.3 CFIB

CFIB is a national non-profit, non-partisan organization representing the interests of 95,000 small and medium-sized companies across Canada and 4,000 members in Manitoba. Its mission is to promote and protect a system of free competitive enterprise. Mr. Kelly, representing the CFIB, stated that the Transaction is not in the best interest of gas customers, electrical customers, or the Province, and he urged the Board to reject the Transaction.

CFIB stated that this purchase would reduce consumers' choices when it comes to energy service providers. CFIB is concerned that the new company may choose to enter other unregulated businesses, using the advantages conferred by being a government Crown corporation. Small private agents, brokers or marketers will have difficulty competing with a firm such as Hydro with its size, reputation and relationship with government.

In addition to the risk of assuming the new debt, CFIB is troubled that there does not appear to be any independent analysis of the synergistic savings. If the synergistic savings are not achieved, or if Hydro ends up not being an appropriate fit to run a gas distribution business, both electricity and natural gas ratepayers will suffer. In the future, expansion of service to uneconomic regions will come at the expense of ratepayers across the Province.

CFIB submitted that there are a variety of public policy tools at the Government of Manitoba's disposal that would allow the inexpensive provision of natural gas. In addition, many of the synergistic savings could be achieved through closer co-operation of the two utilities on billing and other administrative options. CFIB is concerned about the considerable risk of cross-subsidization between electricity and natural gas and that there may be a diminishing of the regulatory requirements with respect to the provision of natural gas. While CFIB supports reduced regulations on business, it is important to make the distinction between firms operating in a competitive marketplace and those operating in a monopolistic one.

In conclusion CFIB stated that eliminating the only significant competitor in the provision of energy services in Manitoba would reduce the number of options of service providers that are presently available.

14.4 CUPE

CUPE represents approximately 900 Hydro employees who perform a wide variety of clerical and administrative, analytical and technical functions. Mr. Maes and Mr. Bond, representing CUPE, submitted that the purchase and integration of Centra will be beneficial for the ratepayers and consumers of Manitoba.

CUPE stated that the ratepayers and consumers would no longer pay Federal taxes and this will translate into savings for ratepayers and consumers. The Government of Manitoba will gain in grants what it may lose in taxes. In addition, combining the billing and payroll functions in an integrated utility will produce savings of approximately $12 million per year, which is the equivalent of a 4% rate reduction.

CUPE believes that the Transaction will create new jobs and secure existing jobs in Manitoba. The purchase will create new opportunities for all Manitobans by ensuring that the utility continues to enhance its ability to become a major player in the North American market. Hydro will be able to encourage consumers to switch to natural gas, thus preserving electricity for export and achieve savings that can be used to expand gas service.

CUPE stated that the purchase will give Hydro added market strength and flexibility and will protect the province from the potential of a foreign take-over of the Manitoba energy market. CUPE concluded that Hydro would be in a better position to increase security of production and to increase exports of lucrative firm power by building gas-fired generators or converting it to coal-fuel generators.

14.5 IBEW

IBEW represents 2,415 of Hydro's employees who operate and maintain generating stations, the converter and transmission systems, and the distribution system. Mr. McLean, representing IBEW, supported the Transaction.

IBEW stated that Hydro is considered to be an excellent employer within the Province of Manitoba and beyond Manitoba's borders and IBEW is prepared to welcome the new employees into the corporation.

IBEW referred to the benefits of the amalgamation of the Manitoba Power Commission and the Winnipeg Electric Company into Hydro in 1963, and other smaller mergers, such as the integration of the generating transmission and distribution system at Lynn Lake and Laurie

River and the distribution system in Flin Flon, acquired from Hudson Bay Mining and Smelting.

IBEW is firmly convinced that the operation of the combined gas and electric utility as a provincially-owned public utility will provide the best service available at the lowest cost possible. IBEW stated that the notion that competition will protect the consumer is not valid in this case because the monopolies for gas and electric will be held by an organization whose driving motivation is not profit but system reliability and customer service. As long as Hydro remains a Crown corporation, and both gas and electric rates are monitored by the Board, the consumer will be protected.

14.6 HGI

HGI is an association of eight rural municipalities, nine towns and villages, two economic development associations and the Association of Bilingual Municipalities, all located in South Central Manitoba. Mr. Mehrle, representing HGI, supports the Transaction.

As a result of the removal of transportation subsidies, HGI wants to expand opportunities in value-added agriculture, keep farmers and manufacturers competitive and viable, protect the environment, preserve and build communities and families, farms and businesses in the onslaught of rapid change. Each of these goals will be advanced with the availability of natural gas. As an example, HGI estimates that hog producers in the HGI area can save over $1.6 million annually with natural gas. Alberta and Saskatchewan competitors already have access to natural gas.

Given the current regulation in the energy field, HGI is confident that Hydro will maintain its record as a safe and reliable supplier of energy. Savings will be realized and the profits will stay in Manitoba to benefit Manitobans, not WEI.

By combining electricity and gas under one utility, HGI argued that it is logical that Hydro will promote the cheapest form of energy to its clients where appropriate. The impact on competition will only be positive as there has never been any real competition in gas or electricity in any event.

HGI noted that a Crown corporation could take a long-term view in terms of recouping capital costs in expanding to under serviced areas and thereby increasing the prospect of an economic expansion to rural Manitoba.

HGI's argued that the Transaction is as important to Manitobans now as was the case in the late 1940s with rural electrification.

14.7 CTF

The CTF, represented by Mr. Vrsnik is opposed to the acquisition of Centra by Hydro and recommended that the Board deny the Transaction.

CTF noted that the lack of information available to the public prior to the Application is cause for alarm. However, CTF is pleased with the decision to hold public hearings. CTF argued that the Government of Manitoba has put itself on the path of debt retirement and the Government and Hydro should not now reverse this direction by accumulating a $486 million liability as a result of the Transaction.

CTF proposed that the viability of the Transaction hinges on realization of the operating synergies. However, the information provided on operational synergies is insufficient to arrive at an opinion as to whether the cost saving estimates are realistic. Moreover, Hydro has not sufficiently considered potential rate impacts, or how to respond to a scenario where some operational synergies collapse or unanticipated costs surface.

CTF noted that governments of the 1990's have learned how ill-positioned they are to efficiently operate large corporations and are taking leave of power utilities if they can find buyers. CTF pointed out that when Centra lost $45 million hedging commodities in 1998, the Board shielded ratepayers by requiring shareholders to share in the loss. In contrast, errors in judgment by a nationalized gas utility would be borne by Manitoba taxpayers alone. CTF cited the foreign investments made by Manitoba Telephone System and risky re-insurance plans made by Manitoba Public Insurance as examples of poor management decisions under government control.

CTF argued that abandoning the competitive model between gas and electricity distributors in favour of a virtual power monopoly may diminish competition and, consequently, erode financial targets. CTF concluded that taxpayers and consumers are on the hook for any errors in judgment by the nationalized utility management. No shareholders will be available to absorb any losses.

14.8 AMM

By way of letter to the Board dated June 8, 1999, AMM stated that they had a good working relationship with both Centra and Hydro, and many of the member municipalities support the purchase of Centra by Hydro. AMM believes that the efforts to expand rural gasification and promote economic development throughout Manitoba will be assisted with Centra as part of a Crown Corporation.

15.0 Recommendations and Directives Arising from Board Findings

Both Hydro and Centra are energy utilities and both operate monopoly utility services for the provision of their energy source to consumers. Because of their monopoly status, provincial legislation has recognized that regulation must be provided, as a proxy for competition. However, the legislation that establishes the regulatory framework for these two utilities contains significant differences that now need to be examined in light of the Transaction and the evolution of de-regulation in both the natural gas and electric energy sectors. Additionally, the regulation of the two utilities both in the short term and in the long term needs to be carefully considered and planned to ensure that the public interest is being protected.

To various parties at this public hearing, and particularly to intervenors representing residential and industrial consumers, the issue of the future regulation of Hydro and Centra was the key consideration as to whether the proposed Transaction should be approved by the Board. Both MIPUG's and CAC/MSOS' support for approval of the Transaction was predicated on strong and continuing regulation by the Board to ensure that the forecasted benefits of the Transaction are ultimately realized by customers of both utilities.

While the specifics of the Transaction are detailed elsewhere in this Order, it can be said, in general terms, that the Transaction has been structured such that in the short term, there are no financial costs to utility ratepayers. There are also no financial benefits for the ratepayers. Because most of the costs of the Transaction are known, the largest unknown becomes whether amalgamation cost can be controlled and whether the cost savings will be achieved. There is not a large margin for error. There exists significant and real risk for both utilities' consumers should the forecasted savings and synergies not materialize.

The risk to consumers is that the forecasted savings and synergies will never be identified, monitored or achieved in any conclusive way. The risk also extends to not being able to determine whether savings might have been experienced in any event because of efficiencies by the utilities or by regulatory process.

To protect customers from these risks, there needs to be continued strong regulatory oversight. Failing such regulatory oversight, there would be no accountability for Hydro's representations that the savings expected to be realized will make utility ratepayers the ultimate beneficiaries of the Transaction. The Board therefore has the following directives and recommendations:

Recommendations and Directives to Hydro

1. Hydro submit, for Board approval, at the earliest possible time, a functional integration plan including an annual monitoring process.
2. Hydro record all gas costs and revenues separate from electric costs and revenues for regulatory purposes.
3. Hydro record separately all direct acquisition costs for review by the Board on an annual basis.
4. Hydro record separately all direct integration costs for subsequent review by the Board.
5. Hydro record separately all cost savings directly related to the Transaction for subsequent review by the Board.
6. Within twelve months of the date of closing, Hydro report to the Board on the revised estimate of acquisition costs, integration costs, expected cost saving, and a proposed plan as to how the net benefits arising from the Transaction are to be shared between the customers of the gas and electric utilities.
7. Hydro make applications to the Board at the earliest possible date for confirmation of rates for the year 2000 for both the gas and electric utilities.

8. Hydro consider a shorter amortization period for all costs of the Transaction, including integration costs and goodwill.

9. Hydro not cross-subsidize the operations of one utility using the operations of the other utility.

10. Hydro consider the need for a new code of conduct which addresses how customer information and business transactions should be shared between the two utilities.

Recommendation to the Government of Manitoba

1. *The Public Utilities Board Act* be amended to remove Hydro's exemption under Section 2(5).

16.0 IT IS THEREFORE ORDERED THAT:

1. The transfer of all issued and outstanding shares of Centra Gas Manitoba Inc. ("Centra Manitoba") to The Manitoba Hydro-Electric Board in accordance with the terms and conditions of an Agreement for the Purchase of all the Shares of Centra Manitoba dated May 14, 1999 BE AND IS HEREBY APPROVED.

2. The following pre-closing Transactions BE AND ARE HEREBY APPROVED:

   (a) Centra Gas Utilities Inc., the current owner of the shares of Centra Manitoba, prior to closing, will transfer all of the shares of Centra Manitoba to NGX Financial Inc. ("NGX"), an indirect wholly-owned subsidiary of Westcoast Energy Inc. ("WEI"), pursuant to Section 85 of the Income Tax Act (Canada).

   (b) NGX will transfer all of the shares of Centra Manitoba to Westcoast Power Holdings Inc. ("WPHI"), a direct wholly-owned subsidiary of WEI, pursuant to Section 85 of the Income Tax Act (Canada).

   (c) WPHI will transfer all of the shares of Centra Manitoba to Westcoast Energy International Inc. ("WEII"), a direct wholly-owned subsidiary of WEI, pursuant to Section 85 of the Income Tax Act (Canada).

   (d) WEII will transfer all of the shares of Centra Manitoba to 3536971 Canada Inc. ("3536971"), a wholly-owned direct subsidiary of WEI, pursuant to Section 85 of the Income Tax Act (Canada).

   (e) WEI will cause 3536971 (which at the time will be a wholly-owned subsidiary of WEI) to be wound up on a tax deferred basis under the Income Tax Act (Canada).

THE PUBLIC UTILITIES BOARD

"G. D. Forrest"
Chairman
Signed in Winnipeg
July 30, 1999 at 1.50 p.m

"Hollis Singh"
Acting Secretary

Certified a true copy of
Order No. 146/99 issued by
The Public Utilities Board
Hollis Singh
Acting Secretary