

Ontario Electricity Coalition

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Enersource Keep It Public for the People of Mississauga

Mississauga residents were surprised recently by a City Council decision to investigate the sale of Enersource, the former Mississauga Hydro. After all, when the idea was raised in the past, the vast majority of residents opposed it.

Most people understand the value of a publicly owned, local electrical utility. But the pressure on Mississauga to sell Enersource comes from those who are hoping to grab a valuable asset at bargain prices.

Advocates of selling the utility claim that Enersource provides only a minimal return to its shareholders – the major shareholder being the City of Mississauga with 90% ownership on behalf of the people. Advocates of privatization also claim that the value of the utility will decrease in the future as more changes are made to the way electricity is managed in Ontario.

Both of those arguments are wrong and both, in the long run, mislead Mississauga residents.

The economic and financial information in this brief has been developed by Jim Stanford, a respected economist for the Canadian Auto Workers and a member of the blue-ribbon fiscal review panel convened last year in Toronto by Mayor David Miller. The broader arguments regarding the value of public ownership are widely accepted by advocates of public power, particularly the Mississauga Electricity Coalition and its Ontario counterpart.

Enersource Financial Performanceⁱ

Enersource Generates a Healthy Financial Return for Mississauga

Over the fiscal years 2005 through 2007, Enersource earned a total of \$45 million in net income for its owners -- an average annual profit of about \$15 million per year.ⁱⁱ That represents a return on average equity of 7.25% for the City's investment in the companyⁱⁱⁱ (which is now worth, on the books, just over \$190 million^{iv}). That is a good rate of return – especially these days.

Over these three years, Enersource also paid more than \$25 million in dividends to the City, or an average of \$8.4 million per year.^v That represents a dividend payout ratio (on average equity) of 4.5 percent.^{vi} That is higher than the dividend payout rates of most commercial investments.

Last year alone, Enersource paid a \$9.3 million dividend to the City.^{vii} On top of the dividend payout, the City also receives a 90% share of Enersource's retained earnings and a 90% share of any increase in the company's equity.

The "2.3%" Return Estimate is Wrong

A misleading argument has been made that the return to the City equals a supposed \$7 million annual dividend divided by \$300 million.^{viii} Neither the numerator nor the denominator of this calculation is valid.

The City's total return from its investment in Enersource is not limited to the annual dividend, which was \$9.3 million last year, not \$7 million. The owners of any company also profit from a company's retained earnings and any increase in its equity base. It is highly misleading to describe an investment return solely by the dividend payout.

To take an extreme example, one of Canada's most successful private companies is Research in Motion. This company does not pay any dividend to shareholders. According to the above methodology, therefore, the return to RIM shareholders is precisely zero. But RIM shareholders also benefit from their investment in other ways, just like the City of Mississauga does from its investment in Enersource. In fact, RIM shareholders have enjoyed a 168% appreciation in share prices over the last year – not zero!^{ix}

Furthermore, the City of Mississauga's investment in Enersource is not "approximately \$300 million," as indicated in Councillor Parrish's opinion article in the *Toronto Star*. The City's stake is valued in both the City's own financial statements, and Enersource's financial statements at 90% of the company's total equity. This is equal to \$192 million at present.

Dividing the total return, including a 90% share of retained earnings as well as the dividend, by the true book value of the City's investment, gives an annual return over the past three fiscal years of 7.25% – three times as high as estimated in Councillor Parrish's article.

The Enersource Investment Pays a Higher Return Than Would be Paid for Debt

The City of Mississauga currently has no debt, and a AAA bond rating. If it undertook new debt, it would pay an interest rate in the neighbourhood of 5% and possibly even less.

It is clear that the City is earning more from its continuing investment in Enersource than it could save either by selling the company and investing in other financial investments or by foregoing new debt to pay for capital infrastructure.

When a private company sees an opportunity to borrow money at a low interest rate, and invest it to earn a higher rate of profit, especially in a relatively risk-free investment, it does so. No corporate CEO would ever argue to sell off a money-making investment, in order to pay off debt that carries a lower rate of interest. That would reduce profits.

Municipal financing decisions should be guided by similar cost-benefit comparisons.

Enersource Value to the Community

The value that Enersource brings to the Mississauga community goes far beyond what it returns in dividends and other monetary benefits.

While some councilors have stated publicly that the City does not really have control because it does not have control over electricity rates, it is important to recognize that municipalities have not controlled the price of electricity. However, any municipality *does* control the strategic direction of its local utility. That is one of the reasons council decided not to merge with PowerStream – because control of Mississauga’s hydro would lie with Vaughan city council.

Keep control local

Mississauga City Council can use its local utility to implement important policies like energy conservation and environmental protection. And, there is benefit to electricity ratepayers from having a publicly owned utility. With an uncertain future that could include further deregulation of the electricity market, this could be worst time to sell. Private corporations that purchase municipal electrical utilities will be lobbying the province and helping to write regulations that benefit them and not electricity consumers or the environment.

Avoid the lure of arbitrary deadlines

The argument has also been made that now is the time to sell because of the transfer tax holiday enjoyed by any utility that purchases another before October 31, 2008. Indeed, there is speculation that the province may extend the holiday to private purchasers. We urge council not to be lured by arbitrary deadlines into making a too-hasty decision.

The Borealis deal shows how easily mistakes can be made. With a mere 10% stake in Enersource, Borealis has incredible power and control over the utility. It may appear harmless to sell an even greater share to Borealis or similar entity, but once a utility is sold, it can be sold again. There is no telling who could end up with final control. If councilors were concerned about the possibility of the City of Vaughan being control, imagine Enersource in the hands of a company like Enron.

When profit motivates, service deteriorates

We have very little experience with private power in Canada. Big private electrical companies have international teams of negotiators who go up against inexperienced local municipalities. They have deep pockets, legal power and are not afraid to sue. Selling Enersource could be the biggest mistake this council ever makes and far more damaging to the people of Mississauga than borrowing money to make infrastructure improvements.

Many municipalities are already experiencing the downsides of the corporatization that was forced on their utilities by the province. With a focus on financial return – or profit – they have seen failure to maintain adequate staff and failure to perform maintenance. This reality should ring alarm bells for a city like Mississauga that is already grappling with the problem of deteriorating infrastructure.

Once it's gone, it's gone forever

Selling Enersource would not solve Mississauga's infrastructure problems, it would only postpone borrowing that has become necessary because higher levels of government have abdicated their responsibility. Once Enersource is gone, it will be gone forever. Do not make another bad deal. Keep the ownership, control and the financial return in your hands for the benefit of the people of Mississauga – and keep pressing the federal government to support municipal infrastructure needs in a meaningful way.

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- ⁱ Prepared by Jim Stanford, Ph.D., Economist, Canadian Auto Workers union, stanford@caw.ca.
- ⁱⁱ Source: Enersource audited annual financial statements, 2005 through 2007, available at www.sedar.com.
- ⁱⁱⁱ Return on average equity equals the company's after-tax net income in a given year (from the company's income statement), divided by the average of the shareholder's equity (from the company's balance sheet) at the beginning of that year and at the end of that year.
- ^{iv} The City of Mississauga reports the value of its investment in Enersource to equal 90% of Enersource's reported shareholder equity; see p.22 and p.26 of the 2006 City of Mississauga Financial Report, available at http://www.mississauga.ca/file/COM/2006_Financial_Statement.pdf.
- ^v Source: Enersource audited annual financial statements, 2005 through 2007, available at www.sedar.com.
- ^{vi} The dividend payout ratio equals the annual dividend divided by the value of the investment (which in this case equals the City's equity in Enersource).
- ^{vii} This equals 90% of the \$10.336 million in dividend payments reported by Enersource in its 2007 Consolidated Statement of Cash Flows, available at www.sedar.com.
- ^{viii} For example, in "Enersource sale: What's at stake for Mississauga," Carolyn Parrish, *Toronto Star*, April 15 2008.
- ^{ix} Information regarding the dividend payouts and total return of Research in Motion available at www.sedar.com.