# The Use Of Holding Companies For Ontario's Municipally Owned Electricity Utilities: Part 1 — What Are They Used For?



### Introduction

Holding companies (or "HoldCos") are ubiquitous in modern corporate and financial structures, and serve various business purposes. Within the realm of Ontario's electricity distribution sector, HoldCos are generally (but not universally) used as a vehicle through which municipal shareholders own the regulated electricity distributor and unregulated affiliates.¹

This article is the first of three parts on the use of HoldCos in the distribution sector. This first article provides an overview of the utility and advantages of the use of HoldCos in a general business and finance context. In Part 2, we will explore the particular history of how HoldCos were created under the *Electricity Act* when municipalities "corporatized" their distribution assets and businesses in connection with the restructuring of Ontario's electricity sector in the late 1990s and early 2000s. Finally, Paart 3 will conclude our series by discussing specific issues relating to HoldCo

corporate governance (with a comparison of municipal and corporate perspectives on fiduciary duties, conflicts of interest and regulatory requirements).

### The HoldCo Structure

By definition, a HoldCo is a company that is incorporated with the sole purpose of holding an equity interest in the securities of one or more other companies. Where the HoldCo has a controlling interest in the other company, the HoldCo is referred to as a "parent" and the owned company is a "subsidiary. An "affiliate" describes a relationship between companies where one controls another, one is controlled by another or the companies are under common control. Control generally means holding a majority of voting shares. Thus, a HoldCo may hold shares in another company, but if that other company is not controlled by the HoldCo, the HoldCo is not a parent, the other company is not a subsidiary, and the HoldCo and other company are not affiliates.

A HoldCo does not, generally speaking, produce any goods/services or engage in its own business operations but instead holds equity interests in one or more other entities. Generally, the company in which the holding company holds shares and that actively engages in business operations is referred to as an operating company.

# Advantages of HoldCos

HoldCos provide numerous advantages:

### 1. Control

Where a HoldCo controls an operating company, the HoldCo can elect the subsidiary's board of directors. While the board supervises the operation of the subsidiary, the HoldCo can,

through shareholders' direction and the ability to appoint or replace directors, ensure that it has approval rights for key decisions or is able to set parameters within which the subsidiary may carry on business. Such parameters may include:

- 1. amending its articles or bylaws;
- issuing additional shares;
- 3. limits on debt, whether based on debt-equity ratios or dollar amounts;
- 4. granting security other than in the normal course of business;
- 5. filing for bankruptcy;
- 6. changes in director compensation;
- 7. adoption or amendment of a dividend policy;
- 8. entry into strategic transactions, such as amalgamations, acquisitions or asset sales beyond specified thresholds;
- 9. any transactions beyond certain monetary thresholds;
- 10. incorporation of subsidiaries; and
- 11. permitting subsidiaries to take any actions mentioned above.

### 2. Separate Liability

The limitation of liability resulting from carving out separate legal entities is a key benefit of a HoldCo. Using a HoldCo allows the corporate group to isolate liability stemming from financial losses or lawsuits to each individual subsidiary or HoldCo directly affected. Thus, while a subsidiary may become insolvent and declare bankruptcy, the other subsidiaries held by the HoldCo should remain unaffected, and the HoldCo's losses will be limited to its investment in, or guarantees of the obligations of, the subsidiary.

## 3. Efficiency and Synergy

With control over the subsidiaries it holds, the HoldCo (depending on the nature of the HoldCo and subsidiary constating documents and other agreements) can elect to receive dividends from its subsidiaries, enter into asset and equipment lease agreements with its subsidiaries, centralize internal teams (such as IT, human resources or other forms of administration) across all HoldCo organizations, and purchase or sell assets or entire subsidiaries held by the HoldCo. This allows the HoldCo (or the parent holding the HoldCo) to maximize efficiency and minimize costs, all while providing it the flexibility it needs to predict changing circumstances or react quickly when prediction proves impossible.

### 4. Tax Structuring

While smaller businesses can use HoldCos to maximize benefits from capital gains exemptions, <sup>11</sup> income splitting and tax deferrals, <sup>12</sup> large corporations can also benefit from favourable tax treatment afforded to HoldCos. <sup>13</sup> One of the best examples is the tax-free movement of dividends between the HoldCo and its subsidiaries (also known as "inter-corporate dividends"). <sup>14</sup> This gives the HoldCo (and the parent, if any) additional flexibility in supporting a subsidiary that may be a startup or is encountering financial challenges.

### 5. Financing Flexibility

A HoldCo may be able to obtain capital and loans for its subsidiaries at better borrowing rates, or increase leverage beyond that which a subsidiary could obtain on its own. Where subsidiaries require funding, the HoldCo can pledge its shares to the lender as collateral for such loans, providing operating companies with access to financing at lower rates. Finally, HoldCos can act as internal bankers to the corporate structure and deploy capital at different times as needed by the operating companies.

# Drawbacks of HoldCos

Disadvantages of HoldCos include complexity and additional costs (the former generally being the cause of the latter). <sup>16</sup> Each corporate entity requires separate governance structures, corporate filings, board/shareholder meetings and tax returns. <sup>17</sup> In the absence of multiple distinct businesses or ventures that can take advantage of the benefits discussed above, the interpolation of a HoldCo between the ultimate shareholder and the operating company may not be worthwhile. <sup>18</sup>

# Next Instalment: The Establishment of HoldCos in the Context of Ontario Electricity Restructuring

In Part 2 of this series, we will discuss the regulatory and legislative history of how HoldCos for electricity distributors in Ontario were created under the *Electricity Act*.

### **Footnotes**

- 1 Guy Holburn and Semme Regnault, <u>Corporate Governance Transparency: A Scorecard For Electricity Distribution Utilities in Ontario</u> (London, ON: Ivey Business School, 2024) at 6.
- 2 Re Ontario (Energy Board), 1985 LNONOEB 1 at para 260 [Energy Board.
- 3 Kevin P. McGuinness & Maurice Coombs, *Canadian Business Corporations Law*, 4th ed, vol 3 (Toronto: LexisNexis Canada, 2024), ch 21 at 10.
- 4 Ibid at 23; 104.
- 5 Ibid at 24.
- 6 Ibid at 40.
- 7 Halsbury's Laws of Canada (online), Banking and Finance, "Bank Holding

Companies" (VI.1(1)) at HBF-270 "Overview" (2020 Reissue).

8 Mahannah v. Mahannah, 2012 BCSC 403 at para 28.

9 Atco Ltd v. Calgary Power Ltd., 1980 ABCA 267 (CanLII) at para 25 [Atco.

10 McGuinness & Coombs, supra note 3 at 10.

11 Ibid at 41-42.

12 Stuart Bollefer & David Malach, *The Business in Transition — Making the Succession Plan Work* (Toronto: LexisNexis Canada, 2008) at appendix to ch 4.

13 Ron W. Clark, Scott A. Stoll & Fred D. Cass, *Ontario Energy Law*, 2nd ed (Toronto: LexisNexis Canada, 2022), ch 6.13 at 1.

14 Ibid at 2.

15 Wolters Kluwer, "What is a Holding Company Structure and Why is it so Popular?" (July 2023), online: <a href="mass.org/sites/default/files/2023-07/issue-paper-CT-Corp-NASS-summer23.pdf">nass.org/sites/default/files/2023-07/issue-paper-CT-Corp-NASS-summer23.pdf</a>.

16 Energy Board, supra note 2 at para 261.

17 Wolters Kluwer, supra note 15.

18 Atco, supra note 9 at para 25.

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

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