



City of
Peterborough

To: **Members of Committee of the Whole**

From: **Allan Seabrooke, Chief Administrative Officer**

Meeting Date: **December 7, 2016**

Subject: **Report CAO16-018**
City of Peterborough Holdings Inc. Recommendation to City of
Peterborough – Peterborough Distribution Inc. Divestment to
Hydro One Inc.

Purpose

A report to approve the CoPHI recommendation, that the City accept the Hydro One proposal offer to purchase PDI, and authorize CoPHI to enter into a sale transaction with Hydro One.

Recommendations

That Council approve the recommendations outlined in Report CAO16-018 dated December 7, 2016, of the Chief Administrative Officer, as follows:

- a) That in accordance with the Shareholder Direction and Unanimous Shareholder Declaration dated July 30, 2012, the City hereby authorizes City of Peterborough Holdings Inc. ("CoPHI") to sell substantially all of the assets of Peterborough Distribution Inc. ("PDI") to Hydro One Inc. for the consideration and pursuant to the terms and conditions set out in the signed proposal letter and term sheet from Hydro One Inc. to CoPHI, dated September 26, 2016 ("Term Sheet") provided that:
 - (i) The gross proceeds for the sale transaction net of amounts to be determined and approved by the City, shall be paid to the City ("Net Proceeds") and

- (ii) Such payment of Net Proceeds shall be supported by declarations of dividends equal to such Net Proceeds from PDI to CoPHI and from CoPHI to the City.
- b) That the City authorizes the Chief Administrative Officer, the Director of Corporate Services and the City Solicitor, Director of Legal Services (collectively the “City Staff”) to work with legal counsel and other professional advisors to negotiate and finalize the Asset Purchase Agreement, an Agreement of Purchase and Sale for a new Operations Centre, a Transition Services Agreement and various ancillary agreements, documents, deeds and instruments, collectively the “Sale Agreements”.
- c) That the Mayor and the City Clerk are authorized for and on behalf of the City to execute and deliver the Sale Agreements, in the forms reviewed and approved by City Staff.
- d) That the Mayor and the Clerk are also authorized to do all such acts and things and to execute and deliver all such documents as in their opinion may be necessary or desirable to complete the sale transaction hereby approved and authorized.
- e) That the Net Proceeds of the sale be placed in an interest bearing reserve account under the control of the City Treasurer with details and options available to Council for investment of the funds to be reported to Council in the second quarter of 2017.
- f) That a by-law be adopted to authorize the sale of substantially all of the assets of PDI to Hydro One, authorize staff to negotiate and finalize the Sale Agreements and authorize the Mayor and Clerk to execute any documents pertaining to the sale transaction.

Budget and Financial Implications

The total purchase price offered by Hydro One for the assets of PDI is \$105 million. The Net Proceeds that the City will receive are expected to be in the range of \$50-\$55 million. Staff are recommending that the Net Proceeds be placed in an interest bearing reserve account under the control of the City Treasurer until staff can report back to Council on permanent long term investment options to generate an ongoing annual return to the City.

The Hydro One offer, under the terms of the transaction, provides PDI customers with a base distribution rate reduction of 1% frozen for five years after the sale. In the following five years (6-10), subject to Ontario Energy Board (OEB) approval, any electricity distribution rate increase would align with inflation.

Lastly, through an Earnings Sharing Mechanism, Hydro One is offering a guaranteed share of Years 6-10 earnings efficiencies to offset Peterborough rates in Years 11 onward.

As part of Hydro One's offer, the company will construct a new Regional Operations Centre and a new Fleet Maintenance Garage in Peterborough, having a combined space requirement of approximately 45,000 sq. ft. The land for this Centre will be purchased from the City at a cost of approximately \$600,000. The annual municipal tax revenue for the facility is estimated at \$100,000 per annum.

Background

Who is CoPHI and PDI?

CoPHI is a private business corporation, comprised of a number of subsidiaries, wholly owned by the City of Peterborough. One of the subsidiaries is PDI, Peterborough's regulated electricity distribution company (Appendix A). The City is CoPHI's sole shareholder, and as set out in the Shareholder Declaration, Council approval is required to divest part or all of PDI. CoPHI is mandated by the City, as sole shareholder, to manage the assets under its care to ensure the best long-term interests of Peterborough and its residents.

PDI was established on January 1, 2000 as a result of municipal restructuring of the former Public Utilities Commission operating within the City's boundaries, and is wholly owned by CoPHI, on behalf of the City. PDI is a licensed electricity distributor that owns and operates electricity distribution systems that deliver electricity to a diverse customer base. Through an extensive network of overhead and underground power lines of more than 564 km in length, PDI covers a service area of 64 square km. There are approximately 36,000 business and residential customers in the City of Peterborough, Village of Lakefield, in the Township of Selwyn, and Village of Norwood in the Township of Asphodel-Norwood. PDI's service territory is bordered by Hydro One service territory. PDI currently does not generate electricity through any forms of generation; however Peterborough Utilities Inc. (PUI), an affiliate of PDI, owns generation assets.

PDI is regulated by the Ontario Energy Board (OEB), as are all Local Distribution Companies (LDC's) in the Province. The OEB is a provincial body with broad powers to distributors, make enquiries about customer service standards, investigate non-compliance, initiate enforcement proceedings and set all electricity rates in the Province. The structure of the Ontario Electricity Industry is shown in Appendix B.

PDI represents approximately 37% of the total CoPHI assets. The remaining assets including the City's water utility, Riverside Park & Zoo, solar and hydro generation are not part of PDI and as such are not part of the assets being purchased by Hydro One.

CoPHI Recommendation to City Council

Through Report CAO16-014, CoPHI Recommendation to Council – PDI Divestment to Hydro One was considered at the October 31, 2016 Committee of the Whole meeting and Council approved the following recommendation:

“That the presentation relating to the recommendation from CoPHI regarding the potential sale of PDI be received at the meeting held October 31, 2016 and that the recommendation from CoPHI be considered at a future Special Committee of the Whole and Special Council meeting.”

This report included correspondence from the CoPHI Chair dated October 26, 2016; correspondence from the Chief Financial Officer, Hydro One, dated September 26, 2016; Summary of Terms on the sale of PDI to Hydro One; and the formal resolutions of CoPHI (Appendix C). CoPHI Directors are of the view that Hydro One’s offer must be evaluated on the basis of local considerations, more particularly, what is best for the City of Peterborough and its residents. This is the basis on which CoPHI proceeded to evaluate and recommended that the City proceed with the sale transaction of PDI to Hydro One. CoPHI identified five key goals to guide evaluation of any transaction that would affect the future of PDI including:

1. Create the best financial value for the City;
2. Protect customers from increases in distribution rates;
3. Ensure customer service excellence;
4. Increase local jobs and economic activity;
5. Ensure fair treatment for existing employees.

CoPHI concluded that the Hydro One offer met or exceeded each of the five factors.

The recommended disposition of PDI is directly the result of a dramatically changing landscape for electricity distribution companies in Ontario. This sector is in a state of evolution. For the past two years, the CoPHI Board and senior management have reviewed the implications of the City’s investment in PDI, and the far reaching changes in public policy, regulations, technology and customer expectation that are afoot. These changes are one of the key factors driving consolidation in the Ontario distribution sector.

In the 1990’s there were over 300 distribution utilities in the Province. Since then, consolidation has reduced the number of distributors to approximately 65, including PDI. This trend is expected to continue; indeed the Report of the Distribution Sector Review Panel, (the full report can be viewed at www.energy.gov.on.ca/en/ldc-panel/) December 2012, concluded that the optimal number of electricity distribution companies for Ontario is eight, with each distributor having a minimum size of 400,000 customers. This trend raises serious issues about the continuing viability of smaller distributors such as PDI.

CoPHI has identified that continued ownership of PDI does not retain optimum value for the community. PDI has a strong record of financial performance and excellent customer service, however, the future performance is less certain. Surrounded by Hydro One's service area, PDI's business is not expected to grow substantially. At the same time, new regulatory requirements and required system and infrastructure upgrades are expected to significantly increase PDI's costs over the medium to long term. CoPHI's analysis indicates, PDI's annual dividend to the City will decrease over the next 5 years by 30 to 40%. Additionally, the future dividend may decline, as further regulations and customer service driven capital investment is required.

Over the last three years options for PDI were considered by management and the Board including mergers and the potential of selling to other distributors, before recommending negotiating with Hydro One. The Board's conclusion, however, based on these investigations, was that the optimal benefits for the company and its customers was a sale option and that Hydro One, in particular, provided the best opportunity given their scale, and contiguous service territory to PDI.

Hydro One

Hydro One is the largest electricity transmission and distribution company in Ontario, and spans approximately 75% of the Province. It has approximately 5,600 employees, \$22.6 billion in total assets and 1.3 million customers spanning 750,000 km of service territory in the Province. Hydro One's investment in capital averages \$1 billion annually. Hydro One has acquired 90 LDC's, the most recent being Woodstock, Norfolk and Haldimand, and has an application underway with the OEB to purchase Orillia's LDC.

The Province currently owns 70% of Hydro One, but has announced plans to reduce ownership stake to 40%. The Province will remain as the largest controlling shareholder, through legislation governing ownership limits, where no one person other than the Province can own more than 10% of Hydro One. There is no ability for any single shareholder or groups of shareholders to control the company. Hydro One's current public float is 61% ownership by institutions and 39% by retail investors. The current ownership by institution is predominantly investment companies with the highest percent ownership of 1.51%

Summary of Terms – Sale of PDI to Hydro One

There are five components that make up the Hydro One offer to purchase PDI (Appendix C).

1. **Price:** The sale price is \$105 million for the sale of PDI.
2. **Customer Rates:** Base distribution rates will be reduced by 1% and frozen for five years. Year 6-10 rates will align with inflation, subject to OEB approval.

3. **Jobs:** Hydro One will employ all PDI staff, with a 12 month service and location guarantee and recognition of past service for seniority purposes.
4. **Economic Development:** Hydro One will construct a new Regional Centre in Peterborough, on land purchased from the City, retaining 70 existing Hydro One jobs and through consolidation bring an additional 30 jobs to the City.
5. **Service Levels:** Provision of service level commitments backed by monetary compensation to customers if not fulfilled. Continued community support that PDI provides in the community and benefits with additional community support programming from Hydro One.

City's Evaluation of Hydro One Offer

Navigant Consulting

The City has engaged the firm of Navigant Consulting Ltd., throughout this process, to provide third party advice on the electricity distribution sector and on several aspects of the proposed transaction.

Navigant is a specialized global professional services firm that focuses on assisting clients with decision making when facing transformational change. Navigant's Energy Sector Practice, based out of Toronto, has substantial energy market experience across a broad range of disciplines and has been involved with governments, utilities and municipalities on evaluating potential transactions, regulatory strategy and new business opportunities.

With respect to the assignment with the City of Peterborough, Navigant has provided information and advice on three separate occasions this year. Their first presentation was provided to Council on September 6, 2016 whereby Navigant explored the outlook for medium sized LDC's; the various taxes that would apply to a potential transaction; current market prices for electric utilities; a proposed decision framework for the City; and other options for PDI. The presentation is attached as Appendix D.

The highlights from this presentation involved creating an understanding of the complex Ontario Electricity Industry Structure whereby control is vested by the regulator – the OEB. Navigant highlighted global electricity trends and noted disruptive triggers involving regulation and policy, market demand, and technology innovation that must be considered. There are three key industry trends to consider. The first is distributed generation, with the notion that customers are increasingly seeking alternatives to traditional grid-supplied electricity. The second is sector consolidation resulting from the need for LDC's to search for growth, scale and efficiencies. Navigant drew attention to the 2015 Provincial budget that encouraged further consolidation by reducing the transfer tax rate on sales to privately owned companies from 33% to 22%. This tax measure advantage will apply from January 1, 2016 to December 31, 2018.

The third industry trend is smarter grids where technology is fueling a shift towards decentralized and smarter power systems. The trend that will impact PDI the most is consolidation. There are risks to retaining ownership of a small LDC, notably, with respect to future value and ability to access capital to maintain infrastructure and ensure acceptable service levels. With respect to smarter grids, decentralization and smarter power systems, PDI will be challenged to incorporate these into operations given the small customer base and capital costs of implementation.

Decision Making Framework

To assist the City decision making process, Navigant proposed a decision framework in their presentation upon which a potential sale should be evaluated. The three impacts to consider are:

- Impact on Shareholder
- Impact on Municipality
- Impact on the Ratepayers

In terms of the shareholder, the value of the LDC and Peterborough's capital requirements must be considered. The impact on the municipality involves a review of the services by PDI to the City and from the City to PDI, jobs in Peterborough and the municipal tax base impact. For ratepayers, the key considerations are how service levels to customers could be impacted, specifically customer service and response time; billing accuracy; and frequency and duration of outages. Second is how will distribution rates be impacted. Note that the three impact areas proposed by Navigant encompass the five key goals used by CoPHI to guide evaluation of any transactions. In other works, Navigant and CoPHI have considered similar criteria and objectives in their evaluation of the Hydro One offer.

Lastly, Navigant notes that the City could choose any of three strategic ownership alternatives for PDI. These include a sale to either a private LDC/utility or a municipally owned LDC, a merger or hold (status quo).

The second phase of Navigant's engagement was to provide an analysis of the Hydro One offer. CoPHI provided an evaluation and recommendations on the Hydro One offer to Council on October 31, 2016 and on this evening Navigant provided a brief overview of the key elements in the offer and reiterated the decision framework that they would use, when returning to Council with their evaluation in November (Appendix E).

Through Report CAO16-017, Navigant's analysis of the Hydro One offer was presented and received by Council (Appendix F) on November 24, 2016. The presentation analyzed the Hydro One offer from three perspectives including that of the shareholder, municipality and ratepayer.

Navigant noted that the reason Hydro One could and did make the offer provided, given the company's ability to create synergies and achieve significant cost savings by integrating PDI's assets and operations into Hydro One's distribution network. An illustration of the expected cost savings from Hydro One proposed purchase of Orillia Power Distribution is provided. Navigant suggests that the PDI savings may be less, however they are still significant. Hydro One's purchase price, employment and rate offers to PDI reflect the "sharing" of these synergies and savings by Hydro One with the City and PDI ratepayers.

Shareholder Perspective

For the shareholder, Navigant concludes from the market analysis, that the Hydro One offer is competitive with other transactions and is "in the market". Slide number 10 (Appendix F) provides a market analysis of transactions across North America and where PDI ranks in terms of the sale price. PDI sales price ranks in the top one-third of transactions for the highest enterprise value.

In terms of analyzing whether to retain ownership of PDI (status quo) or to sell, Navigant's approach is to focus on a comparative analysis of cash flows to the City of Peterborough. In effect, the value of continued ownership of PDI against the expected Net Proceeds from the sale of PDI to Hydro One. The Navigant Projections 2016 - 2025 of the dividend payments to the City, differ from that of PDI, in that Navigant has a more favorable view of the revenue that PDI will earn, plus expects that PDI could provide a higher dividend payment ratio (Slide 13 – Appendix F). If Navigant's projections were to be realized, it will have occurred because the OEB granted the maximum rate of return to PDI, permitting an even higher distribution rate to PDI customers.

PDI on the other hand, are of the opinion that the OEB will grant a lesser rate of return when they apply for the resetting of the rates, and the effect of this outcome is lower revenues to PDI, translating into lesser dividends to the City. Regardless of which scenario actually occurs, the key takeaway from the analysis, as Navigant states in their summary, is that there is additional value to the shareholder to sell versus holding onto PDI. The range is additional value on a sale from \$18 million to \$44 million.

Navigant also provided advice to the City that a key component of the deliberations involves assessing Peterborough's capital requirements. In a discussion section of the report that follows staff provides Council with more detailed comments on this aspect. Suffice to say, however, that staff are of the opinion that given the inherent risks associated with PDI's future cash flows, and the substantial present and future capital requirements of the City, unlocking the value of the asset and investing proceeds for an annual return is financially responsible.

Municipal Perspective

The municipal perspective is examined from three key perspectives. Navigant examined the Hydro One offer on the potential impact on local jobs in the City, service costs to the City resulting from the sale, and impact on the municipal tax base. The Hydro One offer provides the municipality with a net employment gain and more importantly secures the continued employment of the existing 70 Hydro One employees and PDI 60+ employees, with a new regional operating centre to be constructed by Hydro One. The economic development aspect of the transaction is positive with annual payments of \$100,000 in municipal taxes and a one-time payment of \$600,000 for the sale of land, all attributed to the new regional centre. Overall, the sale is viewed as a positive impact from the municipal perspective.

Peterborough Utilities Group (PUG) provides various services such as IT, customer service, billing, human resources and finance to the City and its affiliates. Navigant has examined the impact a sale would have in these areas. There will be some changes and re-alignment required within PUG, but the sale of PDI would not directly affect the provision of these services. The overall impact on the City and PUG costs and service levels from the changes resulting from the sale of PDI are not considered to be material.

Ratepayer Perspective

The ratepayer perspective must consider reliability, customer service and rates. Navigant concludes that there will be ratepayer savings through to Year 10, with the Hydro One offer and considering projected PDI rate increases. The rates for Years 11 onward are forecasted to be similar but some risk is evident (Appendix F, Slide 23), as accuracy of predicting rates a decade into the future is not an exact science.

Navigant has received system reliability data for PDI and Hydro One (around the Peterborough area) and found reliability rates to be similar (Appendix F, Slide 21). In terms of customer service examined through the performance categories of service quality and customer satisfaction with three measures for each, PDI and Hydro One have historically met or exceeded the Industry's Customer Service performance requirements and indeed are similar to each other (Appendix F, Slide 21).

Public Input

Based on Council direction through Report CAO16-005, PDI Divestment Update on February 22, 2016 which involved a presentation by PUG providing an update on a potential transaction involving the sale of PDI to Hydro One, staff were directed to initiate a public process to receive constituent input (Appendix G).

March 3, 2016 Public Meeting

On March 3, 2016, a public meeting was held at Market Hall, Peterborough. In addition, public input on the matter was accepted through on line comment cards. The meeting was hosted by the City in the form of a panel discussion and consisted of presentations by John Stephenson, President and CEO of PUG; Mark Rodger, Senior Partner at the Toronto law firm Borden Ladner Gervais; Richard Bertolo, Director of Value Growth, Hydro One; and Daffyd Roderick, Director of Corporate Affairs, Hydro One. The speakers entertained questions and comments from the public in attendance, throughout the presentations.

The presentations provided the public with background on the utility sector; the current structure, service territory and size of PDI; future perspectives regarding the utility; and information on Hydro One's network, overview of Hydro One's current performance, past challenges and customer commitments and guarantees.

During the public meeting 41 individuals addressed questions and/or comments to the speakers (Appendix H). The speakers main comments centered around the general disagreement with privatization, concerns about increased hydro rates, prospects for loss of local jobs from unions, desire for local control, and the perception of the poor performance of the former Ontario Hydro, continuing with Hydro One including service response and their business model. There was also a desire to ensure that the Riverview Park and Zoo and the water service remain under local ownership and that any potential sale would not impact the financial feasibility of the remaining parts of the businesses.

From the comment cards, on-line, through the City website, there were a total of 251 questions or comments through these processes. Where questions were posed, answers were provided (Appendix I). The majority of respondents expressed opposition to a sale citing the following:

- Concern about increased rates
- Disagreement with the principle of privatization
- Poor reputation of Hydro One
- Loss of local jobs
- Desire to slow the process down
- Keeping local ownership

Community Engagement Plan

Through Report CAO16-012, Community Engagement Plan – Potential Sale of Peterborough Distribution Inc. (PDI), on October 17, 2016, Committee of the Whole considered, and Council approved the following recommendation:

That Report CAO16-012 outlining a community engagement plan to provide information to the public on the potential sale of PDI be approved (Appendix J).

The community engagement plan outlined the plan's goals – What we will achieve; the approach – How will we achieve this; and desired outcomes. There were four broad objectives set out by staff, as part of the overall plan, to achieve, as follows:

Objective 1: Engage constituents through different channels that encourage diversity of participation in a way that is respectful of their time and capability.

This was achieved through a series of both traditional and technology based communication and engagement activities (referred to collectively as “talk PDI”) that were implemented: hosting of seven Community Open Houses (one in each ward, and in each of Norwood and Lakefield); resourcing seven pop-up events in places where people carried out their day-to-day business (e.g. Petes game, bookstore); creating a talk PDI website with online forms to leave comments; allocating a dedicated phone and email to collect messages; conducting a Twitter Town Hall; and enabling conversations on Facebook by using a paid advertisement. The wide variety of channels created numerous touch points that allowed people who were interested in participating to connect with the City when, where and how they wanted. In all, the City held fourteen talk PDI events across the Greater Peterborough Area.

Objective 2: Provide adequate notification and awareness of engagement opportunities.

This proved highly successful with the establishment of a robust communication plan that included considerable press releases, radio, television and print media advertisements, promotion via social media, posters in City facilities and community notices.

Objective 3: Obtain input from community leaders to provide a perspective on the impact of PDI divestment on the City's future.

This was achieved by conducting telephone interviews with six identified leaders in the Peterborough community, the results of which are captured in the Community Engagement Plan summary results prepared by C2C Strategies.

Objective 4: Develop a robust body of supporting materials to support the engagement.

Display boards were prepared to provide visual representations at all Community Open Houses. In addition, talk PDI print materials and handouts were available and distributed at engagement locations and at most City facilities; video information was prepared and posted on the City website; and frequently asked questions with answers were posted on the website.

In summary, the established goals and objectives for the Community Engagement Plan were met. The City engaged C2C that specialize in community engagement to assist with the organization, delivery and compilation of data for community engagement. The report is attached as Appendix K.

C2C Strategies Report – Community Engagement Process Results Summary

In summary, 777 participants were tallied as attending in-person events, with all activities generating just over 900 individual comments.

A total of 576 individuals attended the seven advertised Community Open Houses. Sign-in sheets indicated that individuals from across ward boundaries attended whichever open house was convenient to their location and/or schedule. Some individuals attended multiple in-person events. There were 238 responses received in terms of comments at the open houses. For pop-up events, the number of individuals who stopped by to get more information was 201. There were 154 comment cards completed at these events, which also includes hard copy comment cards deposited into standing comment boxes (such as those at City Hall, Social Services and arenas).

Through online, social media and voicemail participation 522 comments were received, with the majority obtained through social media.

In total there were 914 individual pieces of data that were reviewed and analyzed in combination with additional input from the research with Community Leaders, by C2C. C2C's analysis focused on identifying dominant concerns articulated by those involved in the engagement process. The data analyzed by C2C only reflects the comments of those who chose to complete and submit comment cards, either while attending a talk PDI event or electronically. Note that 60% of Open House respondents indicated they had participated in other streams of engagement. C2C was able to validate multiple occurrences of input from the same individual. In addition, when analyzing Facebook conversation threads, data was provided in a manner that did not link a specific comment to an identified user, making it impossible to determine the number of unique users participating in a conversation thread or online feed. For all of these reasons, any analysis based on frequency is likely subject to bias, and conclusions from this research, according to C2C, should neither be interpreted as representing the views of the majority of the populace, nor as statistically sound. Nevertheless, the data identifies dominant themes, interrelationships and important directional feedback to Council. The

findings can be useful in providing information as Council moves forward in its decision making, and for consideration in the planning of future matters, necessitating public engagement.

Synopsis of Dominant Themes

The community feedback in terms of interests, questions and concerns was sorted into five common areas defined by C2C as the engagement process, trust, transparency, key offer elements and future implications for the City. The C2C report (Appendix K) provided details on the five common areas but can be discussed with four key findings to focus decision making in a way that objectively addresses the needs expressed by the community.

Key Finding 1 – Engagement Process

A large number of talk PDI participants expressed dissatisfaction regarding the public engagement process adopted by the City. In general, the public wished to have been informed earlier in the process and wanted to collectively participate more in the decision making process going forward. November's engagement, which was based on the presentation of a final offer, occurred too late in the process.

Key Finding 2 – Trust and Transparency

The community would have seen the engagement process as more trustworthy if greater communications of alternative options to the sale had occurred in a more timely and supportive process. Participants felt that Navigant Consulting should have been available earlier in the process so that participants would understand the consequence of the decision on the sale. In summary, lack of timely access to information and availability of "balanced" information inhibited participants from moving forward in evaluating and accepting content.

Key Finding 3 – Offer Elements

In purely business terms, some participants felt the sale was a very good option and an opportune time for the City to accept the offer. The business case appeared robust and the evaluation fair. In general, the key points raised by participants include:

- A negative perception of Hydro One's reputation
- Losing local and public control
- Skepticism about employment guarantees/new Operations Centre
- Inability to realize green and sustainable energy solutions

There were expressions of caution and skepticism regarding Hydro One's commitment and ability to fulfill some terms in the offer.

Key Finding 4 – Future Implications

Participants felt materials focused on the short term financial windfall of the sale without due consideration of the long term implications of the decision. Concerns largely fell into two areas: accountability over how the proceeds of the sale might be used and impact of this decision for future generations. The community wants to see a clear plan on how the proceeds will be utilized to return a benefit to the community in a sustained way.

Special Committee of the Whole Meeting – November 24, 2016

Navigant's analysis of the Hydro one offer was presented and received by Council on November 24, 2016. The Navigant presentation was summarized in an earlier section of the report and is attached as Appendix F. At the conclusion of the presentations, Council suspended the rules of order to facilitate questions and comments from the public. A panel consisting of representatives from Navigant, CoPHI, City and Hydro One responded to questions posed by the public in attendance. There were 22 recorded speakers from the general public and approximately 150 people in attendance. A summary of the various comments, questions and responses from the panel are attached in Appendix L.

The respondents expressed opposition to a sale with concerns similar to the March 3, 2016 Public Meetings, citing the following:

- Disagreement with the principles of privatization
- Poor reputation of Hydro One
- Loss of local control over water/energy
- Concern for PDI employees' jobs/pensions
- Validity of Navigant's information

Discussion

From the City's perspective, the main concern is risk. This risk manifests itself in what the future Ontario electrical distribution system will look like, the value of PDI and the cost of supplying electrical service to the residents and businesses of Peterborough.

To better understand these risks and to formulate a position on the matter of selling PDI staff considered the following five key elements:

- Trends in the Ontario Electricity Distribution Sector
- Provincial Government Regulations/Influences and OEB
- The Future of PDI
- Hydro One's Offer
- Long Term Best Interest for the City and Residents

Trends in the Ontario Electricity Distribution Sector

Ontario's Electricity Distribution sector is a complex and unique system that is clearly in a state of evolution. There are imminent changes that are either occurring now or will happen in the near future. Consolidation of LDS's has been ongoing for some time. Public policy, increased regulation and technology, are all in a state of flux with significant indications of changes. Customer demands and expectations are continually increasing.

In 1923, Ontario had 393 different electrical supply utilities. This was the state of affairs until 1996 when a provincially appointed Committee recommended significant changes to the structure of municipal electric utilities (MEW). Even though legislation did not mandate a wholesale consolidation of LDC's, many mergers and acquisitions did occur around this period reducing the number of utilities from 307 to 89 with Hydro One Networks buying 88 of the smaller utilities. Presently, there are only 65 LDC's left in the Province. No other jurisdiction has chosen to operate with such a preponderance of small LDC's.

The previous consolidations have shown that a reduction in the number of utilities can result in significant cost savings. There is strong consensus in the industry that the fragmented nature of the distribution system in Ontario is an impediment to cost effective planning, development of electricity infrastructure, and a barrier to innovation needed in the sector. A more practical and workable solution would be to have fewer utilities.

Staff is of the opinion that the consolidation trend must and will continue since consolidation is a proven method to curb costs, ensure the broadest adoption of technological innovations and make the necessary funding available at the lowest price. Industry reports suggest no more than eight regional distributors with a minimum of 400,000 customers.

Inaction is not in the best interest of PDI in terms of realizing value. There is considerable risk in becoming one of the last remaining smaller LDC's from a value viewpoint.

Provincial Government Regulations/Influences and OEB

The Provincial government is a key player in the electricity sector controlling, via legislation, regulations, policies, the working of the Ministry of Energy and the OEB. Accordingly, all decisions related to LDC's must consider the direction and influence of the Province.

In 2012, the Ontario government appointed the Ontario Distribution Review Panel to review the Province's LDC's. The Panel recommendations and conclusions are far reaching. The key conclusion was that the present foundation on which Ontario's

electricity system was built is not suitable for the challenge and opportunities of the future.

The Province has not to date mandated change, but their actions and tax incentives to encourage change with the small LDC's clearly support a future preferred direction. Other Provincial reports consistently point to changes in the sector and drive consolidation in the belief that economics of scale will result, leading to more favourable provincial hydro rates.

There has been considerable reference through this process, notably from community engagement that residents prefer to maintain "local" control of PDI. The extent of local control is limited with respect to the highly regulated electricity distribution section. Local control is by name only. While PDI is owned by the City, an understanding of the role of the OEB is important to understand when evaluating the notion and perceived benefit of local control. The OEB mandate is determined by the Province and is embodied in legislation regulations and directives. Their powers are broad and involve approving or denying utility costs for local distributors, licensing distributors, protecting the interests of consumers, promoting cost effectiveness in the electricity industry, investigating non-compliance and initiating enforcement proceedings. All distribution companies, including PDI and Hydro One, are subject to the same OEB rules and regulations. PDI effectively has little control over most aspects of the business. It is also important to recognize that the OEB has the power and mandate necessary to protect electricity consumers in Peterborough going forward. In deciding whether to approve the sale, the OEB must be satisfied that the sale does not harm PDI customers with respect to matters such as distribution rate impacts, reliability and quality of service when compared to the status quo.

It is believed that continued ownership of PDI given the Provinces' goals and actions and the control of OEB is not in the best long term interest of residents.

The Future of PDI

For the last three years the CoPHI Board and senior PDI management have reviewed and analyzed all aspects of the operation of PDI. CoPHI has concluded that PDI as a small utility of approximately 36,000 customers will be unable to effectively operate in the current changing environment due to its inability to achieve the scale necessary to reduce costs, and to access the capital needed to effectively maintain existing, and address future customer service and regulatory standards.

The Board projects declining dividends to the City from PDI as costs rise, revenue growth is limited and expensive capital investment will be required in the near future. PDI has a strong record of financial performance and excellent customer services, and are praised in the community as a well run business. The same people who manage PDI are giving their recommendation to sell based on their experience and knowledge.

Navigant has a slightly more optimistic view of the dividend PDI can return to the City over time. This view assumes that the OEB will grant the maximum rate of return to PDI. The other side of this, of course, is that a higher rate of return to PDI translates into higher distribution rates to PDI customers. The Hydro One offer protects PDI customers for up to ten years with distribution rate increases lower for this period than what PDI is projecting. The greater risk with continued ownership of PDI is that either consumer rates will increase and/or PDI dividends to the City will decrease. Investing the funds from the sale of PDI will provide the City with a steady income stream with minimal risk.

From this perspective, continued ownership of PDI is not in the long term best interests of the City.

Hydro One's Offer

Overall, Hydro One has presented a strong offer. The purchase price of \$105 million is a significant premium over book value and is very comparable to other purchases across the Province. The offer protects PDI customers for up to ten years with distribution rate increases lower for this period than what PDI is projecting.

The guaranteed service levels backed by monetary compensation from Hydro One and the job security for PDI employees are essential components to have as part of the agreement but in and of themselves do not factor strongly in the overall evaluation as these both exist if the City retains ownership of PDI.

A significant aspect of the offer is the location of a new Regional Operations Centre and a new fleet maintenance garage in Peterborough. These facilities ensure the retention of the current 70 Hydro One jobs existing in Peterborough and facilitate the addition of 30 new jobs into the City. The additional annual municipal tax income of approximately \$100,000 is a benefitting piece overall for the City as well.

Both COPHI and the City's consultant, Navigant, have determined that the Hydro One proposal is, on balance, a good deal for the City. A major part of their analysis is the reduced risk to the City from a financial basis.

From this perspective, continued ownership of PDI is not in the long term best interests of the City.

Long Term Best Interest for the City and Residents

During the Community Engagement Plan, numerous opinions and views were received from the public. Many respondents expressed opposition to a sale citing disagreement with the principle of privatization, poor reputation of Hydro One, loss of local jobs, concern about increased rates and loss of local control. The privatization of Hydro One is not an issue that can be dealt with by the City. The Government of Ontario has stated that no one entity can own more than 10% of Hydro One shares and the

Province itself would retain 40%. Accordingly, Hydro One will remain under public control and this fact does not really fit into the discussion around the sale of PDI.

There have been reports, some recently, about Hydro One billing problems, reliability and customer service concerns. Navigant examined this aspect and determined that both PDI and Hydro One provided “similar” reliability and customer service. Hydro One has “put its’ money where its’ mouth is” by offering financial compensations for delayed responses to its customers.

All discussion around the matter of jobs indicates that selling PDI to Hydro One will result in more, well paying, jobs in the City. There is, of course, the possibility that certain jobs presently performed by PDI staff will change in either content or even location. Nevertheless, taken in total, the proposal by Hydro One will provide more jobs in Peterborough.

The issue of increased rates has been dealt with by both COPHI and Navigant. The highest risk to increasing rates lies with retaining ownership of PDI. The matter of local control was discussed earlier in this report. To sum, local control is by name only in as much as the OEB has full control in the setting of rates and rate of return for all distribution entities.

In total, after consideration of the major concerns of Peterborough residents, continued ownership of PDI is not in the long term best interests of the City.

Overall

In evaluating this offer, staff weighed the relative risks to the City and its residents of retaining ownership of PDI versus ownership by Hydro One.

On balance, considering all relevant factors, the risks are viewed to be greater, in the long term, in retaining ownership of PDI. By unlocking the value of the asset, the Net Proceeds of the sale in the range of \$50 million to \$55 million, can be invested to generate an ongoing annual dividend. The increase in the City’s revenue from this transaction is a direct benefit to taxpayers in controlling annual property taxes.

Summary

CoPHI is a private business corporation, wholly owned by the City of Peterborough, and is comprised of several companies including Peterborough’s regulated electricity distribution Company, PDI. The City is CoPHI’s sole shareholder and as such City Council approval is required to divest all or part of PDI.

CoPHI’s Board of Directors has assessed that PDI, as a small utility, in this changing industry, will be unable to effectively operate in the long term due to its inability to achieve the scale necessary to reduce costs, or access the necessary capital and

technology to effectively maintain existing, and address future customer service and regulatory standards. Therefore, after reviewing and analyzing potential mergers and opportunities with other distributors, over the last three years, and analyzing the risk of status quo, the Board is unanimously recommending that the City accept the Hydro One proposal to purchase PDI.

On balance, considering all relevant factors, staff conclude that the risks are greater in the long term, in retaining ownership of PDI, and concur with CoPHI's recommendation to enter into a sale transaction with Hydro One.

Submitted by,

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Attachments:

- Appendix A – Peterborough Utilities Group Business Structure
- Appendix B – Ontario Electricity Industry Structure
- Appendix C – Report CAO16-014 – City of Peterborough Holdings Inc. (CoPHI) Recommendation to Council – Peterborough Distribution Inc. (PDI) Divestment to Hydro One Inc.
- Appendix D – Peterborough Distribution Inc. Sale Review – City of Peterborough Presentation September 6, 2016
- Appendix E – Peterborough Distribution Inc. Sale Review: Summary of Key Terms of Hydro One Offer – City of Peterborough Presentation October 31, 2016
- Appendix F – Peterborough Distribution Inc. Sale Review: Analysis of Hydro One Offer – City of Peterborough Presentation November 24, 2016
- Appendix G – Report CAO16-005 – Peterborough Distribution Inc. Divestment Update
- Appendix H – Possible PDI Sale, Public Information Session – March 2, 2016 Comments
- Appendix I – Comment Cards – Potential Sale of PDI to Hydro One
- Appendix J – Report CAO16-012 – Community Engagement Plan – Potential Sale of PDI
- Appendix K – C2C Strategies Report – Community Engagement Process regarding offer by Hydro One to purchase PDI
- Appendix L – Special Committee of the Whole Meeting – November 24, 2016 Summary