



City of  
**Peterborough**

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**To:** **Members of the General Committee**

**From:** **Sandra Clancy, Chief Administrative Officer**

**Meeting Date:** **January 21, 2019**

**Subject:** **Report CAO19-001  
Peterborough Distribution Inc. Sale to Hydro One – Current  
Status, Obligations, Financial Costs and Arbitration  
Mechanisms**

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## **Purpose**

A report to update Council on the current status, obligations, financial costs and arbitration mechanism of the sale of Peterborough Distribution Inc. to Hydro One.

## **Recommendation**

That Council approve the recommendation outlined in Report CAO19-001, dated January 21, 2019, of the Chief Administrative Officer as follows:

That Report CAO19-001 of the Chief Administrative Officer regarding the current status, obligations, financial costs and arbitration mechanism of the sale of Peterborough Distribution Inc. to Hydro One be received for information.

## **Budget and Financial Implications**

The total direct costs, as of December 31, 2018, that have been incurred by the City of Peterborough for expenses pertaining to activities and negotiations for the Peterborough Distribution Inc. divestment to Hydro One are approximately \$1.4 million. Additionally, legal fees have also been incurred by City of Peterborough Holdings Inc. in the amount of \$1.2 million. These fees represent 2% of the total transaction value of \$105 million and are in line with expected legal fees for a transaction of this size and complexity and the fact that negotiation of the sale documents finalized to date have

extended over a period of at least two years. The fees incurred by City of Peterborough Holdings Inc. have been accommodated as a reduction of the total proceeds, however, the transaction is still planned to have net proceeds of \$50 to \$55 million.

In addition to direct costs, substantial City staff time was spent over the last two-plus years during negotiations with Hydro One.

In anticipation of the completion of the transaction and to address transitional items such as personnel management, organizational change, system reporting and operational changes for readiness during the transition period, City of Peterborough Holdings Inc. internal and external resources have been expended in the range of \$860,000.

## Background

On December 10, 2018, Council approved the following motion:

That staff bring back a report to Council on the status, obligations, financial costs and arbitration mechanism, associated under the agreement with respect to the sale of PDI to Hydro One, no later than the 21<sup>st</sup> of January, 2019.

This report is in response to this request.

## Corporate Overview

City of Peterborough Holdings Inc. (CoPHI) is a private business corporation, comprised of a number of subsidiaries, wholly owned by the City of Peterborough, as sole Shareholder. One of the subsidiaries is Peterborough Distribution Inc. (PDI), Peterborough's regulated electricity distribution company. The subsidiary businesses that will continue to be retained by CoPHI, account for the largest share of CoPHI income and distributions to the City of Peterborough.

The Peterborough Utilities Commission (PUC) or water utility, provides safe and reliable water to the City and is a Municipal Service Board (as established under the **Municipal Act, 2001**), which includes the Peterborough Zoo. The PUC and Peterborough Zoo are not included in PDI and are not part of the sale to Hydro One.

## Council Direction 2016

Council, at its meeting of December 15, 2016, approved the recommendations in Report CAO16-018, City of Peterborough Holdings Inc. Recommendation to City of Peterborough – PDI Divestment to Hydro One 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");
  - (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; and
  - (iii) PDI and PUSI be reorganized as required by the Chief Administrative Officer, the Director of Corporate Services and the City Solicitor, Director of Legal Services (collectively the "City Staff"), in consultation with legal counsel and other professional advisors.
- 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, including an option to reinvest the funds in City of Peterborough Holdings Inc. to support renewable power generation projects with an interest rate of at least 6% as a point to compare all other options.

- 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.
- g) That through the Asset Purchase Agreement, Hydro One Inc. shall establish an Advisory Committee, to provide a forum for communication between the City and Hydro One as soon as practicable after closing. The City, in consultation with Hydro One Inc. and CoPHI, shall establish the mandate of the Advisory Committee, which will be comprised of representatives of the City, Hydro One Inc. and CoPHI.

### **Sale Agreements**

City staff and legal counsel from Miller Thomson, PDI staff and their legal counsel from Borden Ladner Gervais have worked with Hydro One staff and their legal counsel over the last two years negotiating and signing the following legal agreements (Agreements) pertaining to the asset sale. The Agreements that are asterisked have legally been in effect since July 31, 2018 and are briefly described below:

- Asset Purchase Agreement \* - the agreement where PDI assets - electrical distribution facilities (poles and wires) and business are being purchased by Hydro One;
- Municipal Access Agreement – an agreement allowing Hydro One access to their electrical distribution facilities on and over City- owned lands (parks and back-lanes);
- Letter of Agreement – Pole Attachments - an agreement allowing City equipment (traffic signal equipment, signage) on Hydro One poles.;
- Site Development Agreement \* - an agreement that sets out the specific site requirements for both the Regional Operations Center and Fleet Maintenance Facility (grading, water, sanitary / storm sewer services);
- Land Purchase for 1801 Fisher \* - an agreement for Hydro One to purchase lands for their Regional Operations Centre, subject to the completion of the Asset Purchase Agreement and compliance with the Site Development Agreement;
- Land Purchase for 290 Jameson \* - an agreement for Hydro One to purchase lands for their Fleet Maintenance Facility, subject to the completion of the Asset Purchase Agreement and compliance with the Site Development Agreement;
- Transfer Trip Agreement – an agreement relating to the installation by Hydro One of transfer trip protection after closing at generation facilities owned by PUI and currently connected to the PDI distribution system;

- Transition Services Agreement \* - an agreement setting out the services to be provided by PUG Services Corp to Hydro One prior to the integration of PDI's business with Hydro One's business (billing, collection, reporting, IT system integration);
- Signal Hop Agreement - an agreement by Hydro One to permit PUSI to use a portion of Hydro One's advanced metering system after closing for billing water consumption;
- 1867 Ashburnham – Lease Agreement – an agreement allowing Hydro One to lease from PUSI a part of the building at 1867 Ashburnham until such time as a new Regional Operations Center is constructed;and
- Indemnity Agreement – a guarantee by Hydro One to PUSI of the obligations of Hydro One's acquisition company under the 1887 Ashburnham Lease Agreement.

The key terms and conditions are:

- A sale price of \$105 million with net sale proceeds, which would come to the City, estimated at \$50-\$55 million;
- A 1% distribution rate reduction, a 5 year freeze in distribution rates for customers and a second 5 year period with distribution rate increases limited to inflation and an earnings sharing mechanism to offset rates in year 11 and onward;
- Protection for PDI employees;
- An agreement to develop a Regional Operations Centre and new Fleet Maintenance Facility in the Peterborough community with an estimate of 30 new jobs. The estimated annual municipal taxes from the Centre is \$100,000, in addition to Building Permit fees and an investment in infrastructure to develop the lands, and
- Provision of a Service Level Commitment for excellent customer service including Service Guarantees that are direct pledges to customers backed by monetary compensation should guarantees not be fulfilled.

In addition to the benefits of the above terms and conditions, one of the reasons for the sale was to take action as the Ontario Government has stated that well capitalized, larger distribution companies will be needed to achieve efficiency gains and cost reduction. Smaller distributors have been strongly encouraged to voluntarily sell or merge to reduce the number of electricity distributors in the Province.

This encouragement is continuing as evidenced by the recent provincial announcement where the Ontario Government stated that “Ontario is committed to encouraging consolidation and efficiencies in the electricity distribution sector.” As further evidence of the Province’s commitment to encourage and allow for more time to achieve sale or mergers, the Province is extending two time limited transfer tax incentives and an exemption for capital gains under the deemed disposition rules until December 31, 2022.

PDI has not submitted a cost of service rate application to the Ontario Energy Board (OEB), since 2013 and should have completed such an application in 2017. The application has been held in abeyance since the proposed sale transaction is being reviewed with the OEB. In the event that the transaction did not proceed, the utility predicts that a cost of service application would need to proceed immediately and the utility would need to request an increase in the range of 15% to bring the distribution rate to the proper current level. The increase is required to catch up on natural operating and capital costs increases that have occurred over the past six years that have not been reflected in distribution rates. The normal course filing of the cost of service application would have corrected this issue.

Over the next ten years the overall distribution rate for PDI would need to increase by approximately 30%, compared to approximately 6.5% predicted over the same ten year period when the sale transaction with Hydro One is completed.

### **Current Status**

The Agreements between Hydro One, the City and PDI were signed on July 31, 2018. The sale transaction is subject to approval by the OEB. Hydro One submitted the application for approval to the OEB in October 2018 and the OEB issued a notice to the public regarding the sale on December 18, 2018. Approval is expected in months. The closing of the sale transaction will occur approximately within 90 days of receipt of OEB approval with an estimated closing date in summer 2019.

In compliance with the Site Development Agreement and the Agreements of Purchase and Sale, pre-engineering work, site studies and surveying has begun on the sites for the new Hydro One Operations Centre (1801 Fisher Drive) and Fleet Maintenance Facility (290 Jameson Drive). Prior to the completion of the Operations Centre, Hydro One will lease PDI’s current office and warehouse facility on Ashburnham Drive. They will pay market rent to Peterborough Utilities Services Inc. (PUSI).

In compliance with the Asset Purchase Agreement and the Transition Services Agreement, PUSI has been reorganized and a new company has been created (Peterborough Services Corp) to separate out the electrical utilities operation (staff and assets) from the water and other operations in preparation for finalization of the sale transaction. There will be a transition period immediately after the financial close where the electrical business will be operated very much like it is now for Hydro One until a successful integration of the business into Hydro One’s business. To prepare for that,

information systems, reporting and business proactive changes have been made or are occurring to meet the expected requirements from Hydro One.

Information sessions and participation has occurred between PDI and PUSI employees and the Union, where applicable, and Hydro One to address employee questions and options. The employee transition plan is well advanced at this stage in the overall process.

Hydro One staff and the City's Corporate Sponsorship Coordinator are discussing opportunities for Hydro One to sponsor City events and/or programs as required of Hydro One under the Asset Purchase Agreement. The City and community charitable and non-profit organizations will have access to Hydro One's community investment programs which may include sponsorship of community based events; an employee volunteer grant program and the Safe Community Grants Program for projects to help enhance community safety, security or accessibility.

### **Obligations**

The City, PDI, PUSI and CoPHI, have signed legally binding Agreements with Hydro One as listed above. With regards to OEB approval of the sale transaction, Article 7.1 of the Asset Purchase Agreement stipulates that PDI, PUSI and Hydro One shall use their best efforts to cooperate and assist each other in obtaining OEB approval. The OEB has given public notice of the filing of the approval application by PDI and Hydro One.

Article 9.4 of the Asset Purchase Agreement requires the City to confirm its guarantee of PDI's and PUSI's obligations under the Asset Purchase Agreement. Under Article 12.13 of the Asset Purchase Agreement, this guarantee is already legally in effect but is only applicable if CoPHI fails to honour its guarantee of PDI and PUSI's obligations.

### **Financial Costs Incurred**

The following financial costs have been incurred:

- City of Peterborough direct costs as of December 31, 2018 are \$1.4 million
- PDI direct costs are \$2.0 million
- Countless staff hours (in the thousands) drafting and reviewing wording for the Agreements and negotiations ; setting up the new company (PUG Services Corp) and financial systems, integration of PDI's Customer Information System to Hydro One's billing system 85% complete and separation of electric and water accounts in January 2019 for which customers have already been informed.

### **Arbitration Mechanism**

Article 10 of the Asset Purchase Agreement contains arbitration language typical to commercial contracts in Canada it states that:

**Any dispute, controversy or claim arising out of or in connection with, or relating to this Agreement, including the Confidentiality Agreement, or the performance, breach, termination or validity thereof, shall be finally settled by arbitration.**

The Arbitration language is only applicable and deals only with the consequences of issues that have been expressly provided for or permitted under the Asset Purchase Agreement that the parties cannot agree upon. The arbitration language sets out a process by which remedies are available to the parties and it does not itself grant a right to breach an obligation of a party under the Asset Purchase Agreement or to terminate the Asset Purchase Agreement.

Article 8.2 of the Asset Purchase Agreement sets out four conditions that must be fulfilled or performed by Hydro One either at or prior to closing of the sale transaction. If any of the conditions are not fulfilled by Hydro One, PDI, PUSI and the City together may terminate the Asset Purchase Agreement. The conditions are: all representations and warranties of Hydro One are true and correct; Hydro One has complied with all their performance obligations under the Asset Purchase Agreement; all required approvals for the transaction have been obtained (primarily the approval of the OEB) and there are no orders or actions outstanding to prohibit the transaction. Except for the approval of the OEB, it is unlikely that these conditions will not be fulfilled by Hydro One.

## **Media Coverage**

The media during 2018, featured articles and opinions relating to the sale transaction, including the potential of stopping the sale. Staff have reviewed some of the consequences of this potential action, which are:

1. All terms of the sale transaction, listed on page 5 of this report will be lost, such as:
  - a. PDI will not have consolidated in accordance with the Province's announced encouragement;
  - b. No \$105 million, with net proceeds of \$50-55 million. Another option will not support this size of financial compensation;
  - c. Instead of rates being reduced, frozen and then limited to inflation, they will have to increase by a greater percentage in order to maintain the infrastructure and the cost to replace the current billing system;
  - d. There may be no protection or as favourable an option for employees if industry consolidation happens under a different mechanism;
  - e. There will be no local Regional Operations Centre, no new jobs or municipal taxes associated with it.



2. In addition to the legal and related costs of approximately \$3.46 million incurred to date by the City and PDI, which will be lost expenditures, there may be other, potentially significant financial implications for the City arising from a decision to not proceed with the sale.
3. Future potential electrical distribution partners or purchasers may lack confidence in dealing with the City and may question the City's reliability. In addition, future partnerships for general projects with the City or Peterborough Utilities Inc. (PUI) may be at risk due to uncertainty and lack of assurance that agreements may be altered or cancelled.
4. Employees and PDI, PUSI and CoPHI will lose confidence in the City's direction as Shareholder. After a period of prolonged uncertainty and change, through the process of negotiating the sale transaction, PDI employees have become more settled. Career uncertainty will re-emerge.

## Summary

This report has provided an update to Council on the sale of PDI to Hydro One, specifically the current status of the various legally binding Agreements and actions taken since the signing of the Agreements in July 2018; the City's obligations under the Agreements; the financial direct costs incurred for both the City and PDI relating to the sale transaction and an explanation of the arbitration mechanism in the Asset Purchase Agreement.

Submitted by,

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