REDACTED PUBLIC VERSION

REPORT TO THE TOWN OF COLLINGWOOD

THE COLLUS FAMILY OF COMPANIES:

HISTORY, ORIENTATION, SERVICES PROVIDER

ROLE AND "GO FORWARD" OPTIONS

March 31, 2016

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Part 1 Executive Summary

Purpose of the Report

Following an *in camera* meeting with the Town of Collingwood Council held on October 5, 2015, BLG was asked to prepare a report for Council describing the history and evolution of the Collus family of companies[1] from their inception in 2000 until the present time. Specifically, we were provided with various information and asked to "paint a picture" for Council summarizing the supporting rationale and outcomes associated with the structure, operations, financial performance, and inter-relationships between the various Collus companies, the Town of Collingwood and the Town's water utility (including the process resulting in the 50% share sale to PowerStream in 2012).[2] In addition, Council resolved to request information on potential "go forward" options with respect to its interest in the Collus companies.

The objective of this report is to provide Council with a high-level synopsis on the Collus group, particularly for newly elected Councillors who seek a greater understanding of how Collus came to exist in its current form as a strategic partnership, to summarize findings from the information provided to us including prior reports to the Town and why recent developments point to the need for Council to consider options to the *status quo.*

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[1] The Collus corporate structure is provided at page 11 of this report. For ease of reference "Collus" collectively includes the holding parent company, the electricity distribution (Power) and the services company (Solutions).

[2] Our report is a summary of the information provided to us and not based on any independent assessment of the facts represented in the information we reviewed. We supplemented our review with exchanges with and information from various parties having knowledge of the Collus companies, including senior Collus officials, some of whom spoke to us on the condition that they not be identified. These discussions were useful in verifying some of the themes described in our report.

<u>Conclusions</u>

Collus Corporate Structure to 2012

1. Until the 50% share sale to PowerStream in 2012, Collus' corporate structure and operational orientation appear to be founded on the premise that Collingwood, on a collective community basis when considering the overall interests of taxpayers and ratepayers, would be best served if:

   a. profits generated by Collus Power, the electricity distributor, were kept within the electric utility as retained earnings for its future needs (and not provided to the Town through the declaration of dividends); and

   b. costs to operate Collus Power and the Collingwood water PUC would be lower (to the benefit of the Town, its taxpayers and ratepayers), if Collus Solutions could deliver lower cost services to the Town/PUC and Collus Power as opposed to having these same parties directly provide these services themselves at higher cost.

To substantiate the operational and structural approach taken, from 2002 until 2012 Collus produced reports which included "in-kind dividend" cost savings represented to have been realized from this arrangement. While we have no information which would allow us to make any judgement on the "in-kind payments" reported, these notional "payments" are critical to understanding the rationale upon which the Collus family of companies was based.

<u>Impacts of Collus' Corporate Structure</u>

2. While Collingwood was not the only Ontario municipality to adopt an affiliate services model response to mandatory Provincial electricity sector restructuring, the Collus approach produced a series of atypical results since 2000 including:

No Cash Dividends

a. the absence of any cash dividends from Collus Power from 2000 to the time of the 50% sale to PowerStream in 2012. We have no information with respect to the quantum of potential dividends that could have been declared from 2000 to 2012.[3]

Underutilization of Debt Financing

b. until the time of the PowerStream transaction, Collus Power had much lower actual debt capitalization than permitted by the Ontario Energy Board. The underutilization of debt, among other things, appears to reflect the goal of mimicking the former Public Utility Commission operational "power at cost" construct that existed prior to industry restructuring in 2000. There is a direct link between this issue and the absence of declared dividends described above in 2 a); and

50% Collus Share Sale Provided Funding for the 2 New Town Recreation Facilities

c. if Collus Power had adopted an actual debt equity capitalization structure as permitted by the Ontario Energy Board and declared annual dividends to the Town of Collingwood as sole shareholder since 2000, it is not clear to us whether the 50% share sale would have been necessary. We were asked to consider this question in the context of whether Collus' historical operational and capitalization approach had consequences which appeared, at least to some extent, to have led to the decision to seek a strategic partner in 2012.

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[3] However, Collus Executives have recently advised that the amount of dividends Collus could have provided to the Town over this 12 year period was approximately $4.6 million or $383,000 per year on average. We have no way of substantiating these figures.

d. In the preparation of our report, we have been provided with conflicting information about the facts underlying the 50% Collus share sale and the process through which the share sale was undertaken. On the one hand, some parties advised that the central rationale behind the sale was concern about the continued viability of Collus as a stand-alone entity in the context of ever increasing pressures towards electricity distributor consolidation. Others advised that the main driver was to "maximize value for the residents of Collingwood"[4] and to provide the Town with a cash infusion for municipal purposes[5]. In the end, we understand that Council applied the sale proceeds towards the Town's two new recreation facilities. However we are unable to draw any conclusion regarding the facts which were most significant in driving the 50% Collus sale.

Sources of Cash Received by the Town in 2012

Collus Management indicated that the 50% Collus sale and related "strategic review was initiated as Collus' ongoing approach to ensure that the Municipality is receiving the most value for its dollar".[6] In 2012 the Town received approximately $12.3 million from the following sources:

- $8 million from PowerStream for 50% of the shares of the parent Collus Holding company**;**

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[4] Memo from Dale West, former Collingwood Councillor, to Ed Houghton dated March 19, 2016

[5] In a January 23, 2012 Collingwood Staff Report to Council, Ms. Wingrove, Town CAO at the time, stated that one of the reasons for pursuing the strategic partnership was to provide "additional funding to the Town. The funds that are received as a result of this partnership transaction will allow the Municipality to reduce debt or to be available for valued community projects" (page 2).

[6] June 27, 2011 Collus slide deck entitled "Collingwood Utility Services Confidential Review of Options", page 2. However, as described later in this report, the cash component of offers received for 50% of Collus was much less important than other factors such as job protection and cultural fit in determining the winning RFP proponent.

- $4,096,789 million from Collus representing the recapitalization of Collus Power to increase its corporate debt to a level consistent with Ontario Energy Board permitted levels; and

- $234,429 dividend from the parent Collus Holding company.

- In addition, the Town continued to hold $1.7 million of debt in Collus Power in the form of a promissory note which has generated interest payments made to the Town.

<u>Transparency Concerns about Solutions' Costs</u>

3. The Collus Solutions services model has proven to be complicated with respect to understanding costs and cost allocation transparency. We are advised that both Town Council and the public have been raising such questions over many years, although Collus Management advises that they have never been made aware of any such concerns. This situation has resulted in various reports being produced including the HSG Group Report (2013), the Beacon 2020 Report (2014) and the BMA Report (2015). The Beacon 2020 report was particularly critical of core elements of the services arrangements between Solutions and the Town. The fact that multiple reports have been necessary in an attempt to try to understand the inner workings of the Collus Services Model underscores ongoing transparency concerns raised by Collingwood. Collus Management advise that they believed the Beacon and BMA Reports contained errors and communicated this to the Town and its consultants. Notwithstanding these concerns our understanding is that Beacon or BMA made only minor updates or no changes to their Reports as a result of Collus' input. We cannot draw any specific conclusions from the fact that minimal changes were made.

<u>The Proposed Re-assignment of Solutions' Services</u>

4. Given Collingwood's recent decision to:

a. have the Town take back functions that were previously provided by Solutions; and

b. enter into a new services agreement with PowerStream directly (not Solutions or Collus PowerStream),

we foresee no apparent basis for Solutions to achieve scale and scope economies and remain as a separate, stand-alone entity if it is only providing services to Collus Power. If the Town elects to maintain its 50% interest in Collus under a "status quo" hold scenario, consideration could be given to winding-up Solutions and transferring all justifiable LDC-related services from Solutions to Collus Power. Careful attention must be paid to ensuring that only costs directly related to providing LDC services are transferred to Collus Power. Any remaining or stranded costs associated with Solutions must be managed in other ways given that the Ontario Energy Board will not allow any extraneous Solutions costs to be passed onto Collus Power ratepayers through subsequent electricity distribution rate applications.

On the other hand, if the Town elects to dispose of its interest in Collus PowerStream through a sale or enter into a merger, maintaining Solutions in the near term may provide attractive opportunities for potential synergy savings through the isolation of certain costs kept within Collus Solutions (and separate from Collus Power). This matter requires further careful consideration by the Town and PowerStream, as the Collus PowerStream shareholders, prior to any final decisions being made concerning Collus Solutions.

Understanding the Financial Performance of Collus PowerStream

5. Consol Asset Group Inc., a consulting firm retained by Collus, produced a slide presentation entitled “Third Party Review of the Collus PowerStream Strategic Partnership” (undated) which reported on the “benefits and successes that Collus PowerStream has been able to experience since its strategic partnership with PowerStream in 2012”. The benefits achieved appear to largely focus on Collus employee satisfaction and scale and scope leveraging such as deploying new technologies. The Consol Group also state that Collus PowerStream earned its highest annual net income in 2013 and issued a “material cash dividend to the Town which it has previously not been able to do in recent history”. This accurately describes the situation given the LDC’s historical operational focus on maximizing and keeping retained earnings within Collus Power and not declaring dividends to the Town.

To fully understand the performance of the strategic partnership it would be necessary to benchmark the actual economic performance of Collus Power against the objectives advanced in support of the strategic partnership with PowerStream which resulted in the 50% share sale in 2012. This information would assist the Town in its ongoing evaluation of options relating to the Collus family of companies (which were described at a high level during the October 5, 2015 *in camera* Council meeting and summarized in this report). We are advised that to date, Collus PowerStream has provided no business plan to the Town (as a shareholder) whereas we note that section 5.2 (b) of the Unanimous Shareholders Agreement (“USA”) dated July 31, 2012 states:

> “The Corporation (Collingwood Utility Services Corp. or Holdco) shall, in each financial year, present an updated business plan for the Corporation, approved by the Board, to the Shareholders for informational purposes.”

The form and substance needed to comprise an acceptable “updated business plan” in section 5.2(b) is not described in USA. It has become apparent that the Town and Collus have different views on what constitutes an updated business plan under this section of the USA. For example, we are advised that on November 27, 2015 the Town was provided with a copy of Collus’ 2015 Capital and Operations Budget. This budget contained neither any actual 2015 numbers (up to the date of the report in November) nor year end forecast figures for 2015. Also the budget did not include dividend forecasts for 2015 and beyond. Collus Management advises that their understanding is that this one year Capital and Operations Budgets constitute “an updated business plan” referenced in the USA. Therefore Collus Management indicates that they have discharged this USA requirement.

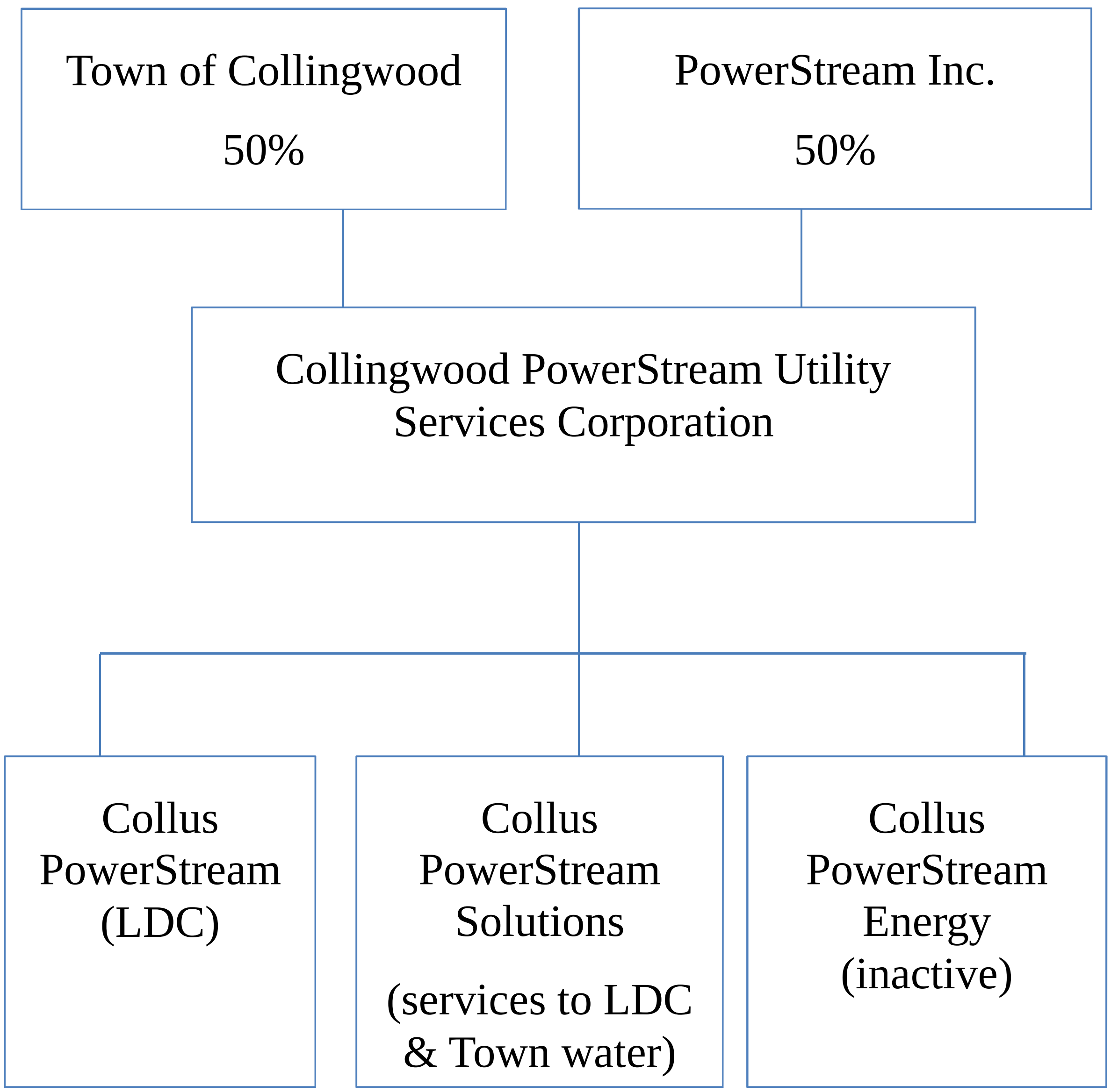
On the other hand the Town advises that it has a different understanding of what constitutes “an updated business plan “ which would include rate of return and dividend information (including future projected dividends), analysis of key strategic issues facing the company such as capital and OM&A requirements, smart grid and other emerging technology issues, distribution rate impacts, and other information which any owner of a commercial business would typically want to understand.

We recommend that Town Council would benefit if Collus were to provide a comprehensive business plan on an annual basis which clearly identifies “the Collus’ roadmap” of specific corporate objectives over different time periods (for example, one year, three years, five years) and which benchmark actual results achieved against prior year’s stated objectives. In this way the Town of Collingwood, as a shareholder, can clearly monitor and judge the effectiveness of the execution and implementation of business plans over time (and across different terms of Town Council).

Executive Summary

Collus Corporate Structure

The Collus family of companies comprises Collingwood PowerStream Utility Services Corporation (the parent company or "Holdco"), Collus PowerStream (the electricity distributor, "Collus Power" or the "LDC"), Collus PowerStream Solutions (the services company or "Solutions") and Collus PowerStream Energy (an inactive company).



Goals of the Affiliate Services Model

From the time of the Ontario electricity sector restructuring in 2000 and the provincially mandated requirement that Ontario municipalities transform their municipal electric utilities ("MEUs") into Ontario *Business Corporations Act* companies, the Collus companies have pursued an "affiliate services model" approach to operating the electricity distribution and Town water systems.

From a financial management perspective, from 2000 until the time of the 50% Holdco sale to PowerStream in 2012, from the information provided to us Collus Power appears to have operated based upon four fundamental principles:

Low Level of Debt Financing

1. to utilize the Ontario Energy Board's ("OEB's") "deemed" debt equity ratio for purposes of setting distribution rates but having an actual debt equity ratio materially lower than the deemed ratio;

PILs Minimization

2. to structure Collus' financial affairs in such a manner which resulted in the least amount of Payments in Lieu of Taxes ("PILs") being paid to the Province of Ontario;

Retirement of External Debt

3. to retire approximately $3.3 million of external debt incurred by the LDC to acquire the electricity distribution assets of Thornbury, Stayner and Creemore; and

Retained Earnings Held by Collus Power

4. to hold all retained earnings within the LDC in reserve in the event that investment funds were required for LDC requirements or for new opportunities (as opposed to

declaring dividends to Holdco and ultimately, to the Town of Collingwood as shareholder).

Impact of Services Model

No Dividends Paid

As a result of its operations under these principles, Collus Power declared no cash dividends from 2000 to 2012 (until the time of the 50% sale to PowerStream) and by 2011 Power had debt capitalization well below the OEB's deemed capital structure. However, throughout this 12 year period Collus Power paid interest to the Town on the $1.7 million promissory note held by Collingwood since the time of restructuring in 2000. The amount of debt servicing payments received by the Town on an annual basis total approximately $124,000.00 per year from 2002 to 2009[7] . We are advised that in 2015 the Town monetized its promissory note and has now received full payment from Collus. We assume that Collus Power has replaced this same amount by incurring new external debt. Collus Management also advises that between 2000 to 2012 Collus paid the Town approximately $1.8 million in lease payments for use of Town facilities for Collus operations. Town Staff advise that these payments only recover Collingwood's costs in connection with these Town facilities.

Collus Solutions, an affiliate company of Collus PowerStream, was established to provide services to Collus PowerStream, the water utility, and the Town. In the materials we reviewed for this report[8], Collus Solutions has been described as operating on a "cost recovery" basis.[9] We are

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[7] "Cash & In-kind Services Collus & CPU to Town of Collingwood spreadsheet" (undated). We are advised that in 2009, notwithstanding that the OEB reduced the 7.25% interest rate payable on the Town note, Collus did not reduce the amount of debt servicing payments paid to the Town but maintained the 7.25% interest rate.

[8] The materials provided to BLG upon which this report is based are identified in Appendix A hereto.

[9] Since 2000 the Collus financial statements indicate that Solutions imposes a "20% administrative fee" on services rendered. We are advised that this administrative fee was not a separate charge but a placeholder which formed part of

further advised that this affiliate corporate structure was selected to implement an operating philosophy based on the principle that the Collus "services model" approach would achieve overall cost savings to the Collingwood community as compared to having personnel and other services delivered directly through the LDC, the Town or water utility staff at higher cost (the "Services Model").

In other words, the theory underlying the Collus structure was that an affiliate company – Collus Solutions - would produce overall or global "scale and scope savings" to the Town through the deployment of services from one single, stand-alone services provider. As evidence for the success of the Services Model approach, spreadsheet summaries were produced by Collus entitled ***"Cash & In-kind Services Collus and CPU to Town of Collingwood"*** which purport to show annual "In-kind Services" benefits to the Town of Collingwood ranging from $202,000 in 2002 to $476,000 in 2011[10].

While it is beyond the scope of this report to assess and verify these "in-kind payments", these notional contributions are critical in determining whether the services model approach had been successful from 2000 to 2012. We have no information which would allow us to make any judgement on the "in-kind payments" reported but this is an area where Council could seek further information and explanation. Further, we are advised that the annual in-kind" cash benefits report presented to Town Council was an estimation only of the <u>value of the services</u> rendered as opposed to depicting actual dollars realized.

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the cost allocation methodology utilized by Solutions to reconcile projected with actual costs.. However we have no information to verify exactly how this mechanism operated.

[10] See "Cash & In-kind Services Collus & CPU to Town of Collingwood spreadsheet (undated) and p. 39 entitled "Our Financial Plan – Shareholder", Town of Collingwood Payments Received from the Corporations (2009-2011) attached as Appendix B hereto.

Concerns Related to Viability of the Collus Companies

We are not privy to what undoubtedly has been an extensive amount of correspondence, communications and other exchanges between the Town and the Collus family of companies over the years since the time of industry restructuring in 2000. Given the limited body of materials we have reviewed in preparing of our report, we cannot claim to have a thorough understanding of the full context of how all issues pertaining to Collus have evolved over the past 15 years.

However the "snapshot picture" emerging from the information made available to us is that by 2011 concerns were being raised by the Town about the continued viability of the Collus family of companies given the approach adopted with respect to Collus Power and Collus Solutions and by Collus itself given the increasing focus on electric distributor consolidation in Ontario. Specifically, Collus Management advise that the status quo was not an option on a go-forward basis and a strategic partnership was necessary to ensure that Collus Power remained sustainable into the future. In addition, the Town advises that concerns had been raised by both Collingwood and the public for many years with respect to transparency regarding Solutions' costs and pricing approach for services rendered.

50% Share Sale of Collus Holdco

By 2011 it was determined that 50% of Collus Power (not the holding company) should be sold to an arm's length third party buyer. Different parties who provided us with information provided different reasons for the Collus sale. In addition to the viability concern in the context of distribution sector consolidation described above, some advised that the central driver for this ownership change resulted from a strategic planning exercise which focused on ways to maximize the financial value of Town assets (including Collus). Collus Management advise that pursuing the 50% sale option would produce an opportunity for greater financial value in any future disposition of the utility by the Town of Collingwood. Others advised that the main driver was simply to provide the Town with a cash infusion for needed municipal purposes but others reject this notion.

Given the conflicting information received on this topic, we are unable to draw any definitive conclusions about the underlying central drivers for the Collus sale.

Utilizing a competitive solicitation process, 50% of Collus Holdco ultimately was sold to PowerStream.[11] The timing of the sale transaction coincided with the financial restructuring of Collus Power to bring it into line with many other Ontario electric distributors so that Collus Power's debt equity structure reflected the more common, typical approach across Ontario LDCs. The financial restructuring that occurred (i.e. taking on additional debt) also facilitated the payment of a dividend from Collus in the amount of $4,096,789 paid to the Town in 2012. This dividend appears to be financed from the increased debt level which the LDC assumed to become consistent with the typical industry standard. The 50–50 Town/PowerStream ownership structure of Holdco remains

External Reviews of the Services Model

In July, 2014 Town Council commissioned Beacon 2020 Inc. and True North consultants to conduct a "value for money" review of services the Town acquires from Solutions (the "Beacon Report"). The consultants found that they were unable to conclude whether the Town was in fact receiving "value for money". The Beacon Report identified various deficiencies in the Services Agreement(s) between Solutions and the Town.

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[11] It is unclear exactly when the change was made from selling 50% Collus Power to 50% of Collus Holdco (which meant that one half interest in the parent company was being disposed of as compared to selling 50% of the local distribution company only (Collus Power). Town Staff advise that they have no information concerning whether an addendum was provided to RFP proponents which gave notice of the change in transaction focus from Collus Power only to the parent Collus holding company. Collus Management advise that in order to avoid a punitive 33% transfer tax on the sale of the shares, the change was made to sell the Holding company so that the Town would be the vendor (and thereby avoid the Town paying transfer tax to the Province of Ontario).

In 2015 BMA Management Consulting Inc. prepared a further report for the Town entitled "Water and Wastewater Services Review – Final Report" (the "BMA Report"). This report concluded that the Town could realize potential net annual savings of $706,521 by consolidating water and wastewater operations and bringing related services (currently provided by Solutions) back to the Town (Table 8-5: High Level Potential Annual Savings, p. 41).

The findings in the BMA Report directly challenge the fundamental premise that Solutions' reason to exist was because it delivered services to the Town as the lowest cost provider. We were recently advised by the Town Treasurer that for fiscal 2016 the Town expects to secure net savings in the amount of approximately $741,000 as a result of bringing back water services to the Town which exceeds the annual savings potential identified in the BMA Report.

Certain Services to be Provided by the Town

The Town advises that a new services agreement is contemplated for the remaining services to the supplied by PowerStream (not Solutions) to the Town in connection with the provision of water services. We understand that this new services agreement between the Town and PowerStream has yet to be finalized. Town Staff advise that they have been unable to obtain specific costing information from Collus Solutions which would allow them to establish a new "market-based pricing regime" for services provided by PowerStream, particularly with respect to Solutions' staff remuneration.

We are advised that Town Council recently passed a Shareholder Declaration requiring Collus to provide Council with various costing information (including total employee remuneration) from the time of Collus' incorporation in 2000. The expectation is that this information will allow the Town to better assess the new "market-based pricing regime" for services to be provided by PowerStream and to obtain details of Collus' historical costs so the Town can better understand how Collus' costs have evolved and changed over time.

With various functions and activities being taken away from Solution and returned to the Town and with PowerStream to offer other services to the Town directly under a new services agreement, it is unclear how Solutions will be able to maintain its existing operational cost structure. Any remaining Solutions' costs resulting from services taken back by the Town and PowerStream will not be permitted to be added onto existing costs for services rendered to Collus PowerStream, the regulated electricity distributor. We note that other electric utilities, such as Toronto Hydro, EnWin Utilities (Windsor), and Brantford Hydro, who each originally pursued affiliate services models similar to Collus, ended up merging their respective distribution and services companies into one single Local Distribution Company (or in Brantford's case, transferring employees from the municipality to the LDC). Collus Management advise that the Collus board of directors are seeking legal and financial advice to determine the appropriate future direction for Solutions, although we have no other details about this matter at this time.[12] Any fundamental changes proposed for Solutions' would first need to be fully reviewed and approved by both Town Council and PowerStream.

In 2015 Henley International Inc. provided an economic valuation of Collus Power for the Town which, among other things, considered the impact of premiums being paid above rate base in recent electricity distributor sale transactions. The Henley valuation is important new information for Town Council as it contemplates various possible options with respect to the future of the Collus family of companies, particularly in the context of the existing Collus – PowerStream shareholder's agreement which was reviewed with Town Council on October 5, 2015.

"Go Forward" Options

Given ongoing and new developments regarding LDC sector consolidation, it may be that 2016 will provide the Town with additional opportunities to consider how shareholder and ratepayer value can be maximized with respect to its holdings in Collus PowerStream. However the Town

[12] March 22, 2016 email from Ed Houghton

must first carefully consider its obligations contained in the USA with PowerStream before pursuing any course of action; [redacted].

Inconsistent Information about the Facts

Finally, in conducting our work for this report there have been occasions where we have been provided with conflicting information about the nature of certain events, the central drivers underlying why events unfolded the way they did, and how events should be interpreted. It is beyond our mandate (or ability) to draw conclusions and make judgements on which factual interpretations presented to us are correct. Instead, this Report considers the facts (for example, that Collus declared no dividends for a period of 12 years, Collus' historical Return of Equity or that Collus Power had low actual debt levels, etc.) and then draws observations about these facts based on a combination of documentation and discussions with various Collus insiders (for example, on the rationale underpinning the Collus Solutions services model).

However, it is clear to us that a breakdown in communication and, at some levels, a mutual erosion of trust exists between Collus and the Town with respect to matters (especially regarding certain events occurring in the prior years and process resulting in the 50% share sale in 2012).

For example, the most significant reason(s) why the 50% sale option was determined to be the optimum option for the Town cannot be determined by us from the information we have been provided with. This unclear situation has been exacerbated by gaps in the documentary evidence with respect to how and when certain decisions were made and implemented (such as the absence of Council resolutions to create the Strategic Partnership Task Force and with respect to the RFP process and bid evaluation criteria).

Another area where conflicting interpretations exist is with respect to the issue of transparency concerns associated with Collus Solutions' costs. Collus Management indicated that they have never been made aware of any concerns along these lines from the Town since the company was created in 2000. However some Town Councillors and staff have indicated to us that an identified need to examine and understand of the reasonableness of Solutions' costs has been a concern of the Town and public for many years. Accordingly, from time to time we acknowledge the fact that very different interpretations of events have been presented to us in the information we have considered in preparing our report.

Part 2 Discussion

Historical Overview of Collus Power[13] (the local distribution company) since 2000

Collus Power is the OEB licensed electricity distribution utility (the "LDC") that serves the Town of Collingwood and the neighbouring communities of Thornbury, Stayner and Creemore. Collus Power subcontracts various personnel services from its affiliate company, Collus Solutions Corporation, whose employees and costs were historically allocated approximately 60% - 40% between Collus Power and Collingwood Public Utilities Services Board/the Town of Collingwood.

At the time of the electricity sector restructuring in 2000, some Ontario electric utilities predicted that the Province's proposed restructured and competitive electricity market would afford a potentially wide array of new commercial opportunities for these municipally-owned companies. In an attempt to exploit these new business opportunities or in the belief that the use of a services model approach could reduce overall costs in the provision of electricity distribution and other services (such as water), LDC affiliate companies were created to provide various services to multiple parties (potentially) including the LDC. In the case of the Collingwood services company, called Collus Solutions, it provided personnel services to Collus Power, the water utility and the Town.

We are advised that when Collus Power was first established in 2000 it was created with a debt equity ratio of approximately 50-50. This debt equity level was generally typical of other electricity distributors created at that time and was consistent with the OEB's deemed capital structure (for rate making purposes) for distributors of Collus Power's size. The debt comprised a promissory note held by the Town in the amount of approximately $1.7 million bearing an interest rate of 7.25%. In 2001 Collus Power acquired the distribution assets of Thornbury, Stayner and

[13] Collus Power was renamed Collus PowerStream in 2012. In this section of the report we refer to Collus Power since the focus is largely on the history of the LDC between 2000 and the time of the 50% share sale to PowerStream in 2012.

Creemore for a collective purchase price of approximately $3.3 million (the "Acquisition Debt") (producing a total debt capitalization in Collus of approximately $5 million). We are further advised that Collus Power borrowed the entire amount of the Acquisition Debt to buy these LDC assets and subsequently repaid the $3.3million loan over the next 7-10 years.

It also appears that as Collus Power was retiring the Acquisition Debt, it was not replacing that debt with new debt to ensure that the LDC maintained the 50 -50 ratio, and later, a 60-40 debt equity ratio. As regulated entities, electricity distributors typically do not pay down debt as if it were an obligation similar to a house mortgage. Specific loans may be paid off over time but then new debt replaces retired debt so the overall debt level remains constant to fund operations. LDC debt capitalization is an efficient and cost effective way to finance electricity distribution operations. It appears that the underutilization of debt had the effect of increasing the amount of Payments in Lieu of Taxes ("PILs") paid by Collus Power since it did not have the maximum amount of interest expense deductions that would have existed if Collus Power actually held the maximum of amount of debt allowed. This outcome would be contrary to one of the guiding principles of Collus noted above which was to pay the least amount of PILs to the Province of Ontario.

Accordingly, over the years since industry restructuring and by 2010 Collus Power was financially de-leveraged (it had too much equity and insufficient debt). We are further advised that throughout this period Collus Power did have retained earnings, however this cash was kept within the utility as a "nest egg" in the event that future investment dollars were needed (i.e. perhaps to acquire additional distribution assets, reinvest in the Collingwood distribution network, or to invest in affiliate renewable generation projects such as solar power).

We are unable to determine what levels of retained earnings were maintained within the LDC or how retained earnings were managed (inside or beyond Collus Power). Given this orientation and approach, Collus Power declared no dividends from 2000 until 2012 (the time of the PowerStream transaction discussed below). However Collus Management advise that the amount of dividends Collus could have provided to the Town over this 12 year period was approximately $4.6 million or $383,000 per year on average. We have no way of substantiating these figures.

Collus Financial Metrics Highlights

The table below uses data taken from the OEB's Yearbook for electricity distribution companies and illustrates the financial performance of Collus Power and compares it to the average for a comparator group consisting of some 23 LDCs of similar size. The focus is on just a few measures in which Collus Power would seem to stand out from the others, namely revenues per customer, operating costs per customer, fixed assets/customer, capital structure and Return on Equity ("ROE").

On average, Collus Power's revenues per customer were some 21% below the average for the comparator group. This may have something to do with the composition of customers but it seems unlikely that Collus would vary too much from the broad comparator group chosen. It may be related to the electric utility's stated policy of keeping customer distribution rates as low as possible.

Operations, Maintenance and Administration ("OM&A") costs per customer were about 8% higher than the comparator group on average. The profile shows that Collus Power was about the same as the group in 2007, went considerably above during the following years, and came back to the group average by 2013. Because Collus Power's revenues per customer are so low the utility's operating costs tell a different story looked at from the perspective of the share of each dollar of revenue that went to OM&A. On this basis Collus Power spent 69% on OM&A compared to 51% for the comparator group. It is not clear to us why OM&A would be so much higher.

The most significant divergence in the table is in the area of capital intensity. Fixed assets per customer for Collus Power was roughly about 60% of that for the comparator group of distributors. The size of the gap is unlikely to be explained by differences in capitalization policy. There was no information available for the purpose of this report that explained the magnitude of the difference. However we are advised that a standard accounting practice at Collus Power was to expense costs rather than to capitalize them. If those "expensed" costs were instead capitalized this would have increased Collus Power's rate base thereby affording the utility with increased financial returns.

Collus Power remained well below the deemed level of debt to total capital over the period shown in the table and well below the average for the comparator group, even with conservative approach followed by the latter. With recapitalization in 2012 at the time of the partial sale to PowerStream the debt ratio increased significantly but still remained below the deemed level in 2013.

Finally, the Return on Equity of Collus Power at 4.44% remained well below the level allowed by the OEB (9%) and below the average for the comparator group (6.73%) between the 2007 and 2013 period. A major part of this was due to Collus Power's capital structure policy. While Collus included the available PILs deductions related to the OEB deemed debt levels into distribution rates (which had the effect of lowering distribution rates), it did not take advantage of the tax deduction in actual financial performance (because of Collus Power's debt levels were too low).

Following the PowerStream transaction and capital restructuring of Collus in 2012, the utility has pursued achieving the maximum permitted ROE allowed by the Ontario Energy Board.. Since 2013 CollusPowerStream has been able to service the LDC's debt and declare annual dividends which is much more consistent with other Ontario distributors compared to Collus' historical approach.

Table A – Summary Financial Performance Measures

	2007	2008	2009	2010	2011	2012	2013	Average
Revenues/customer								
COLLUS	345	340	366	376	381	463	397	381
Comparator avg	460	454	463	477	487	507	522	482
OM&A/customer								
COLLUS	229	250	263	257	259	308	273	263
Comparator avg	232	229	226	230	241	267	272	243
Fixed assets/customer								
COLLUS	718	832	841	857	865	990	947	864
Comparator avg	1,361	1,410	1,481	1,525	1,581	1,712	1,808	1,554
Debt Ratio								
COLLUS	20	17	10	25	23	49	51	28
Comparator avg	42	41	40	43	48	47	44	43
ROE								
COLLUS	5.76	2.82	4.32	3.70	4.16	2.08	8.25	4.44
Comparator avg	4.28	5.63	6.91	8.53	6.43	7.65	7.65	6.73
OEB Allowed	9.00	9.00	9.00	9.85	9.58	9.12	8.98	9.22

Events Leading to the PowerStream Transaction: The KPMG Report (2011)

By 2011 Collus Holdco began exploring transaction options. We are advised the main drivers behind this initiative were the desire to provide the Town of Collingwood with cash and concerns about the ongoing viability of Collus Power in the context of increasing consolidation amongst electric distributors in Ontario (although as described above the actual drivers for the sale are not clear to us). KMPG was retained by Collus Power to undertake an economic evaluation of the LDC.

On May 20, 2011 KPMG prepared a report for Collus Power Corporation entitled “Calculation of Value” (the “Value Report”). The copy of the Value Report we received was marked “Draft for Discussion Purposes” and we are unclear whether this was the last version of the report delivered to Collus Power or whether another final Value Report exists. In the Value Report we reviewed, KPMG states that it was retained by Collus Power to provide a calculation of the fair market value of all the common shares of Collus Power as at December 31, 2010.

In the Value Report KPMG defined fair market value as “the highest price available in an open and unrestricted market between informed, prudent parties acting at arm’s length and under no compulsion to act, expressed in terms of cash”.[14]

The calculations and comments expressed by KPMG represented their calculation of the “*en bloc*” fair market value of the shares of Collus Power. That is, the valuation was based upon what an arm’s length buyer would pay for 100% of Collus Power. While not stated in the report, it is reasonable to assume that less than 100% divestiture of the distribution utility would produce a discounted market price since selling part of an enterprise would be less attractive to buyers than if the entire business was sold, in KPMG’s words “*en bloc*”. Furthermore, we would expect that the 50% sale would also reduce the level of market interest in the remaining Collus shares in any future disposition scenario contemplated by Collingwood Town Council. In its July 11, 2011 presentation

[14] KPMG Report dated May 20, 2011, para. 7.

on the Partial Sale Option, KPMG stated, with respect to Buyer Interest, that “Only certain buyers may entertain a partial sale transaction, thus reducing the potential pool of purchasers”[15]

given that some buyers will insist on total control of the business being acquired rather than shared control.

KPMG’s fair market value projections also assumed that Collus Power would pursue the maximization of the allowed rate of return earned on its invested capital (i.e. equity returns of 9.85% in 2010) and its next rate rebasing that was projected to take place on May 1, 2013. In addition, KPMG’s financial projections assumed that realization of financial returns would flow from an actual capital structure of 60% debt and 40% equity for periods after April 30, 2013.

As KPMG noted in the Value Report, Collus Power’s low (30% - 70%) debt to equity ratio in 2010 would allow an acquirer to inject additional leverage into the utility (i.e. increase the debt up to the OEB deemed 60% level).

We would note however, that Collus Power did not need to be sold, in whole or in part, to obtain a typical 60 - 40 debt equity ratio as the utility could have achieved this refinancing, at any time, on its own. However, it may have been that the LDC refinancing, by itself, would not have generated a sufficient amount of cash for the Town which was needed for municipal purposes (that is, the Town’s ultimate investment in the two new recreation facilities), but we cannot confirm this view.

The Value Report also noted the relatively low after-tax rates of return generated by Collus Power relative to the net book value of shareholders’ equity.[16] In short, the low levels of return are a consequence of the capitalization approach selected by Collus Power compared to most other Ontario LDCs (as described above).

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[15] KPMC slide deck presentation entitled “Collingwood Utility Services Review of Services” dated July 11, 2011, page 16.

[16] KPMG May 20, 2011 Report, para. 82.

KPMG concluded that the fair market value of all of the issued and outstanding common shares of Collus Power (the LDC) fell in the range of [redacted] as of December 31, 2010. The midpoint of this value range is [redacted]. The aggregate value of the common shares and the promissory note payable held by the Town of Collingwood fell in the range of [redacted] to [redacted] with a midpoint value of [redacted].[17]

Collus Power's RFP Solicitation for a "Strategic Partner" (2011)

In June 2011 Collus Power commenced an investigation and later, through a competitive solicitation process, obtained various proposals for a possible partial sale transaction involving the LDC. On October 4, 2011 Collus Power issued a "Request for Proposal – Strategic Partnership" ("RFP"). The request for proposal was issued by Collus Power and the Town of Collingwood and described a key need from a strategic partner as the "purchase of shares of up to 50% of Collus Power (p. 2). Town staff advise that they can locate no resolution of Town Council approving the terms of the RFP or the specific objective of selling up to 50% of Collus Power.

At some point the nature of the transaction changed from the sale of up to 50% of Collus Power, the distribution company, to 50% of the holding, parent company, Collingwood Utility Services Corporation. Collus Management advise that in order to avoid a punitive 33% transfer tax on the sale of the shares, the RFP changes were made to sell the Holding company (and thereby all subsidiary affiliate companies) so that the Town would be the vendor (and thereby avoid the transfer tax).

From the materials we reviewed, it appears that four proponents submitted proposals. We were provided with a slide deck presentation dated December 5, 2011 prepared by Collus Power entitled "Strategic Partnership Request for Proposal - Results and Evaluations" (the "December, 2011 Slides").

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[17] KPMG Report May 20, 2011, paras. 105 and 107.

Page 1 of this slide deck states that proposals were evaluated using identified criteria and weighting (for a total of 100 points). "Investment for up to 50% of shares" (which we assume to mean cash offered) and "Other considerations (unspecified) were given 30 points. "Provision of strategic and specialized resources", "Support for employees and their careers", "Customer experience and satisfaction", "Competitive distribution rate and cost structure of Collus" and "Cultural and synergistic fit" were given 70 points.[18]

We note on page 12 of the slide deck that there appeared to have been a higher cash offer submitted for a 50% interest in Collus beyond what was ultimately accepted. One unsuccessful offer appears to be almost $900,000 higher than what was selected**.**

This exemplifies how other evaluation criteria were deemed to be of higher importance than purchase price. In the materials we reviewed, we can find no rationale or background concerning why the "up to 50% sale" of the LDC was selected as the optimum transaction (as opposed to a 100% sale or the sale of a smaller percentage of the LDC (e.g. 10%) or a merger). Town Staff advise that they have been unable to find any information or documentation provided to Town Council which describes the supporting rationale for the objectives or approach taken in the RFP process for the sale of 50% of Collus. Collus Management provided us with a KPMG slide deck entitled "Collingwood Utility Services Review of Options" which Collus Management says "mirrors" that which was presented to Town Council on June 27, 2011. However the KPMG slide deck does not identify or discuss a 50% sale option but instead describes a partial sale approach where the Town could retain "either a minority or majority equity stake".[19]

In addition, we are advised that significant factors in selecting the winning proponent included concerns about pending staff retirements at Solutions and the prospect of leveraging PowerStream's size and financial capacity to expand the scope of Solutions' services to other

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[18] Slide 2 of this slide deck.

[19] KPMG slide deck presentation dated May 24, 2011 entitled "Collingwood Utility Services Review of Options".

Ontario LDCs and municipalities. We have no information with respect to whether this strategy has been successful between 2012 and 2015.

Page 13 of the December, 2011 Slides also indicates that an $8 million payment for 50% of the equity of Collus Power would represent a premium offered by PowerStream of 1.6 times book value or "pretty well the highest that has been paid in the sector". However we note that the usual benchmark used for the comparison of utility values is not the book value of equity. This would be unreliable due to the effects of leverage, the timing of capital expenditures, etc. Rather the premium benchmark used is enterprise price/rate base. Using the typical benchmark, the $8M for 50% of Collus represents a premium of 1.4 times rate base after the $4M recapitalization.[20] We note that this multiple is lower than the last four subsequent Ontario LDC sales (Norfolk County, Brant County, Haldimand County and City of Woodstock) which represented an average premium of 1.57 times rate base, although these transactions all involved 100% sale of the LDCs and they occurred after the Collus - PowerStream transaction. If the Town would have accepted the higher $900,000 financial offer from another bidder, the premium in that transaction would have reflected a premium of 1.45 times rate base after recapitalization.

<u>The Collus RFP and 50% share sale process</u>

On the basis of information provided to us, we were also asked to comment on a preliminary basis with respect to the creation of the Collus Power Strategic Partnership Task Force Team ("Task Force") and the records pertaining to the execution of its mandate. At some point during the spring/summer of 2011 the Task Force was formed and the 50% sale option was determined to be the sole, optimum option to be pursued through a RFP. While Council must have been aware of the existence of the 9 member Task Force (which included the Mayor, another Councillor, and Town CAO) it appears that at no time did Town Council pass a resolution to actually establish the Task Force or formally define and approve a scope of authority within which the Task Force was to undertake its work on behalf of Council as the owner of Collus.

[20] Prior to the $4 million recapitalization, $8 million for 50% of Collus represents a premium of 1.16 times rate base.

While the Town unanimously approved the 50% sale as evidenced by Council By-Law No. 2012-011 dated January 23, 2012**,** information gaps exist about the Task Force and the nature of its delegated authority from Town Council. In particular we have been provided with neither Council resolutions nor formal Council directions that:

- established the Task Force;
- approved the bid evaluation framework and criteria which the Task Force (and later Collus) ultimately applied when reviewing the RFP proposals received; and
- defined the municipality's goals and approach to be taken with respect to the negotiations which the Task Force (and later Collus) undertook with bidders who responded to the RFP to acquire the Collus shares.

It may very well be, as suggested by some correspondence we have reviewed, that Collus officials discussed these and other various issues related to the sale with Council *in-camera*[20]. However, if this is the case we have not been provided with any resolutions or minutes arising from such consideration. Such resolutions would assist in clarifying the historical record for Council related to the questions under review.

In this regard we have also been asked to provide examples of some outstanding questions that arise as a result of the absence of Council resolutions or other records on the matters described above. The fundamental issue is what available evidence exists to show that Council's goals and objectives with respect to the Collus share sale were being pursued appropriately by others on Council's behalf?

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[20] A note dated March 18, 2016 entitled " Items for Clarification and Confirmation" provided by Collus Management and signed by some members of Town Council who served during the time of the 50% Collus share sale in 2011 suggests that approvals and directions were communicated *in camera* (but not, it would appear, by Council resolution). We are advised that *in camera* meetings on Collus were held on June 27, 2011, October 3, 2011, November 17, 2011, December 5, 2011 and January 16, 2012. These *in camera* meetings suggest the Town was involved but we have inadequate records on the nature of the discussions that may have taken place to form any opinion on these matters.

The first example relates to the bid evaluation criteria utilized by the Task Force (and later Collus). As summarized in a previous section of our report, proposals were evaluated using specific criteria and weighting which placed much lower emphasis on the purchase price being offered and much greater emphasis on other factors (provision of strategic and specialized resources, support for employees and their careers, cultural and synergistic fit, etc.) A council resolution confirming this approach would have made it clear that these were the appropriate criteria and weights which the Town had determined and accepted as being in <u>its</u> best interests as shareholder. The Town, as sole shareholder, had every right to determine which criteria and weighting were most important to the Town, but we have not been provided with any records of Council's actions confirming this (except for the Resolution approving the share sale).

Another example relates to the approach to be taken in the share sale negotiation process. We were provided with the minutes of a Task Force meeting dated August 29, 2011. The following is recorded at page 3 of these minutes:

> "Mr. Houghton posed the question about negotiations after review of the RFP's and whether this would be/should be allowed? ***<u>It was decided that the price would be the price and not negotiated,</u>*** but we will look at the best deal and negotiate the finer details."[21] (emphasis added)

In our experience, this was an unusual decision for a vendor (or vendor's agent) of a LDC to take in a competitive RFP process: whatever initial share price was offered would simply be accepted without any further bargaining. For a municipality to adopt this approach for the sale of such an important Town asset we would have expected this atypical approach, and its underlying rationale, to be documented and formally communicated by Council to the Task Force.

On the other hand, if this approach was decided upon by the Task Force itself, it raises the question of what authority did the Task Force have to adopt this position in the absence of clear Council

[21] Strategic Partnership Team Meeting Minutes, Monday August 29, 2011, page 3.

direction? While we note in other information provided to us there is an indication that some price negotiation occurred with PowerStream on the issue of share price, we cite this example to show the relevance of having records which clearly documents Council approval on such critical sale issues.

Further, to the extent to which maximizing financial value for the Town was a driver for the share sale, one would have thought that any negotiation approach which had the potential to realize a lower financial value for the Town would only be undertaken at the express direction of Council because of other trade-offs that Council deemed to be more important.

This section of the report is not, and should not be taken as, a legal opinion on municipal council delegation authority pursuant to the Ontario *Municipal Act*. If the Town requires more information on the issue of delegated authority by council this is certainly a matter we can assist with, but it is beyond the scope of this report. We have explored certain issues raised by the Task Force RFP process because the Town has asked us to do so in the context of providing Council with the overview of the events and process which resulted in the 50% share sale.

HSG Group Inc. Review of Cost Allocation Methodology (2013)

In April 2013 the HSG Group produced a report on developing and implementing a cost allocation methodology to distribute the costs of services provided by Solutions to Power, the Town and the water utility, and to consider whether the cost allocation approach selected complied with Ontario Energy Board requirements, particularly with respect to affiliate relationships. The report provided a summary of cost allocation results as follows:

Percentage of services allocated from Collus Solutions:

To Collus Power	59.4%
To Collingwood Water	32.7%
To Collingwood	7.9%
Total	100%

The HSG Group report concluded that " the methodology to compute Asset Use Fees is cost-based and the allocation of those costs reflects cost causation, and is therefore reasonable and appropriate".[22]

The Beacon 2020/True North Consultants Report (2014)

A further report, dated December 20, 2014, was prepared by Beacon 2020 Inc. and True North Consultants Inc. (the "Beacon Report"). The Beacon Report assessed the original 2003 shared services arrangements between Collingwood Public Utilities ("CPU") and Collus Solutions. This report was prepared on behalf of the Town of Collingwood and Collingwood Public Utilities. The genesis of the report results from a July 21, 2014 Town Council Resolution directing Town staff to conduct an independent operational review of the services agreement between CPU and Collus PowerStream Solutions Corp. The purpose of the review was to determine whether or not the agreement provided value for money to the Town's water ratepayers in light of the CPU Auditors' management letter dated May 12, 2014 stating the agreement ended January 1, 2005 and should be reviewed.

The Beacon Report was critical of the 2003 services agreement which continued to be in effect. A summary of the key findings of the Beacon Report are as follows:

- The agreement described 18 services and 1 activity of which only 10 were actually delivered.

- According to the CPU auditor, the agreement ended January 1, 2005. Subsequently the Town received a legal opinion that the agreement is still in force until January 1, 2016. [23] Regardless the term of the agreement is unclear.

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[22] Page 11, HSG Report dated April 2013

[23] The services contract dated January 1, 2005 was a "roll over" agreement containing automatic renewal provisions which were subject only to prior notice obligations should the CPU wish to terminate the arrangement. However Town

- Monthly payments were based on estimating and allocating Collus Solutions Corp. staff time spent on Collingwood Public Utilities business, not based on individual services delivered or service levels achieved.

- There was no documented record of service performance reporting as was required under the agreement.

- There was no documented evidence of value for money and few benchmarking comparators.

- There were some indications of value in the working service relationship.

- It was difficult to find documentation related to the agreement and there was no official system of record for the agreement.

- Stakeholder interviews revealed a low level of awareness of the agreement, its status and its content.

- The change in Collus ownership and governance in 2012 caused conflicts of interest and role confusion in the management of the agreement.

- There is a lack of recognizable identity and cultural cohesion in water and waste water and little independence from Collus PowerStream in the management of the agreement.

The Beacon Report produced multiple recommendations including;

1. Start from first principles rather than continuing the status quo beyond an interim period or trying to update or adapt the 2003 agreement. Set a clear vision for water

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Staff advise that the services agreement was not reported to Council and Town Staff believes that Council was unaware of the "roll over" renewal component or the notice requirements to terminate the services contract.

and waste water management and governance, clearly define required services and service levels, define the best delivery method for each service, then establish any necessary agreements.

2. In the interim, retain water and waste water under CPU with increased Town oversight, give the required six month notice to terminate the agreement before January 1, 2016 and continue the current working relationship for business support services until January 1, 2016 to enable an orderly definition of requirements and associated changes.

3. Discuss opportunities for shared efficiencies with PowerStream, as there may be mutually beneficial economies of scale in areas such as customer service and billing.

4. Reflect good principles and best practices in any future service relationships.

5. Ensure the pricing model associated with any future service relationships reflects the chosen governance structure, e.g. for services received from an external provider, use a fee for service basis rather than the current cost allocation method. Include the following requirements in any future service relationships:

   (a) monthly performance reporting that would accompany the submittal of invoices; and

   (b) a schedule of benchmarking or market testing and finally build a clear, strong identity and culture for CPU/water and waste water services.

Among other findings it was noted that the cost for all of the services defined in the agreement for 2003 were set at $670,000 (with an automatic annual increase of 3.5%) but with no documented relationship defined between that cost and the services provided. The first record of payment was $544,000 a year later.

The Beacon Report also indicates that there has never been any relationship documented between the individual services provided and the monies paid by CPU to Collus Solutions. Everything was transacted at the aggregate service grouping level (i.e. all business support functions).[24]

The Beacon Report concluded that it was not possible to perform a value for money analysis of the services provided under the agreement. The Beacon Report also indicated that there was not enough documented evidences of performance management or market testing of the services to determine whether or not they were competitively delivered.[25] The report also concluded that the current governance and service relationship would remain in place with strengthened Town oversight in the interim period. Collus Management indicated that they believe the Beacon Report contained errors and communicated these concerns to the Town and to Beacon. Notwithstanding these concerns our understanding is that Beacon either did not change or only made minor changes to its report as a result of Collus' input. We cannot draw any specific conclusions from the fact that minimal changes were made.

Finally, from the review of materials provided to us along with the exchanges we have had with various parties, it appears that Beacon was unaware of an amending agreement dated July 31, 2012 ("Letter Agreement") between the Town and Collus when Beacon prepared its report. This Letter Agreement waived the fulfillment of certain conditions in the Collus share sale agreement with PowerStream that pertained to the 2003 Solutions shared services agreement. For example, the Letter Agreement contained, among other things, the requirement that the Town and Collus agreed by July 30, 2013 that all services purchased by the Town from Collus shall not exceed fair market value. We have no information regarding whether the determination of fair market value was ever completed pursuant to the Letter Agreement and, if it was completed, whether Beacon had access to this information.[26]

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[24] Page 7 of the report.

[25] Page 16 of the report.

[26] March 24, 2015 letter (with Letter Agreement excerpt attachment) from PowerStream to John Brown, CAO

<u>Town of Collingwood Water & Wastewater Services Review – Final Report (2015)</u>

On June 16, 2015 BMA Management Consulting Inc. delivered its Final Report to the Town entitled "Town of Collingwood Water & Wastewater Services Review" (the "BMA Report"). The purpose of the BMA Report, commissioned by the Town, was to assess the current water and wastewater operations as part of the overall review of the Town's operations and to make recommendations for improvement. The report identifies the key issues, observations and recommendations respecting water and wastewater.

The BMA Report contained 22 Observations and Recommendations. With respect to the issue of cost allocation and charges levied by Solutions to the Town PUC the Report concluded, in part:

- The Solutions charge to the Town water utility on an allocation basis as opposed to a fee for services basis should be reviewed for consistency with the service agreement (p. 39); and

- Top priority should be given to transparency, clear lines of accountability and cost control which are a challenge under the then existing arrangements with Solutions (p. 40).

In addition, BMA recommended that the current water and wastewater operations be returned to the Town to achieve enhanced cost effectiveness (p. 39). The BMA Report concluded that the Town could realize potential net annual savings of $706,521 by consolidating water and wastewater operations and bringing related personnel services (currently provided by Solutions) back to the Town (Table 8-5: High Level Potential Annual Savings, p. 41).

Our understanding is that the BMA Report was relied upon as a key factor for the Town's decision to transfer water-related services currently provided by Solutions, back to the Town of Collingwood. We were recently advised by the Town Treasurer that for fiscal 2016 the Town expects to secure net savings in the amount of approximately $741,000 which exceeds the annual savings potential identified in the BMA Report.

Collus Management advise that they believed the BMA Report contained errors and communicated these concerns to the Town and BMA. Notwithstanding these concerns our understanding is that BMA either did not change or made only minor changes to its report as a result of Collus' input. We cannot draw any specific conclusions from the fact that minimal changes were made.

Collus Power Economic Valuation Prepared by Henley International Inc. (2015)

On June 16, 2015 Henley International Inc. prepared a confidential economic evaluation of Collingwood PowerStream Utilities Services Corporation for the Town. Henley's evaluations are as at the end of 2013 since 2014 financial information was not available. [redacted]

[redacted]

[redacted]

[27] Page 7 of the Henley Report

[redacted]

[redacted]

[redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

[redacted] [redacted]

Part 3 "Go Forward" Options

As part of the briefing to Town Council made at an *in camera* meeting held on October 5, 2015, we provided a summary of ongoing electricity sector developments since the PowerStream transaction, an overview on key provisions contained in the Collus PowerStream Shareholders Agreement, and some options available to the Town should Council consider a change in course. Each of these themes will be summarized below.

Ongoing Electricity Sector Developments since 2012

Since the PowerStream transaction in 2012 there has been a continuing focus on consolidation within the Ontario electricity distribution sector. In February 2012 the Drummond Report was released which contained various recommendations to make Ontario's public services economically sustainable long term and to balance Ontario's budget by 2017-2018. The Drummond Report also recommended the consolidation of Ontario's remaining 70 local electricity distributors along regional lines to create economies of scale and to reduce $1.35 billion spent on operations, maintenance and administration by Ontario LDCs.

The Drummond Report was followed by the Distribution Sector Review Panel report which also concluded that LDC consolidation should occur, first by voluntary transactions but followed by mandatory consolidation (if necessary), and that significant cost savings could result from significantly reducing the number of Ontario distributors. This report was advice to the government of Ontario but in no way was binding on the Province.

On March 9, 2015 in a keynote speech to the Electricity Distributors Association, Minister Bob Chiarelli was clear that LDC consolidation needed to occur. In his speech Minister Chiarelli said that a fundamental question for Ontario for the 21st century was whether the Province and Municipalities "really need to be in the distribution business?" He also said that the existing LDC sector configuration "just doesn't make sense…" and that "our system has established and enshrined some major inefficiencies that disadvantage ratepayers…"

Last spring the Clark Report on "Optimizing Government Assets" was adopted by the Province, the privatization of Hydro One has begun with the sale of the first 15% tranche of shares on the Toronto Stock Exchange and the so called "mega-LDC merger" (the amalgamation of Enersource Hydro Mississauga, PowerStream and Horizon Utilities and the acquisition of Hydro One Brampton to create the second largest electricity distributor in Ontario) has now been agreed and is subject to OEB and *Competition Act* approval.

In addition, as of January 1, 2016 the Province changed the law with respect to Transfer Tax and Departure Tax to provide more of a level playing field for private sector buyers to acquire LDCs. Finally, other new legislation, such as the *Strengthening Consumer Protection & Electricity System Oversight Act*, among other things, expands the scope of commercial activities for LDC s and their affiliates which is expected to advantageous, particularly for the larger, well capitalized utilities.

<u>Challenges Facing Smaller LDCs</u>

The complete adoption of the Clark Report by the Province and the ensuing events described above have triggered debates at Municipal Councils across Ontario about what to do with their respective holdings in LDCs. A wide range of issues and concerns are being considered including:

- Some councils are concerned that the Province could mandate change directly (by legislation) or indirectly (through regulatory changes or policy directives) to drive and realize further sector consolidation;

- Given that Ontario now has very high electricity rates compared to most other jurisdictions in North America, the focus on LDC consolidation will continue as one means to deliver customer benefits in the form of lower distribution OM&A costs or reducing or slowing the rate of LDC cost increases; and

- While municipal shareholders must benefit from industry consolidation, the reality is that "scale and scope" cost savings are eventually passed onto customers.

Municipal Shareholder Considerations

Municipal owners of LDCs must balance and assess multiple considerations including:

- Is this the optimal time to “harvest the asset” through a sale (in whole or in part) or some other transaction (such as a merger)? The level of premiums being paid for LDCs over the past 3 years are among the highest ever seen in Ontario since industry restructuring in 2000.

- How does a transaction compare with the status quo “hold” scenario? What is the best financial decision for both the Town and its electricity ratepayers?

- Several municipalities have decided that now is the time to explore or enter into a transaction involving their LDC. These include:

  Completed Sales/Pending Sales: Norfolk County, Brant County, Haldimand County, City of Woodstock, City of Orillia, City of Peterborough, Province of Ontario (Hydro One Brampton) (others not public at this time);

  Exploring A Transaction: Town of Midland (others not public at this time); and

  Mergers: Enersource, PowerStream, Horizon, Hydro One Brampton. Also Lakeland and Parry Sound amalgamated in 2015 (others underway but not public at this time).

Important Terms of Unanimous Shareholders Agreement

Among other issues, the agreement between the Town and PowerStream dated July 31, 2012 contains the following provisions:

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

[redacted]

Appendix A - Materials Reviewed For This Report

- Aird & Berlis slide deck entitled “A Strategic Partnership between Collingwood Utility Services and PowerStream Inc, Town of Collingwood Council” dated January 16, 2012
- Beacon 2020 Inc. and True North Consultants Inc. Report entitled “Collingwood Public Utilities Service Agreement Review” dated December 22, 2014
- BMA Report entitle “Town of Collingwood Water & Wastewater Services Review - Final Report” dated June 16, 2015
- Cash & In-kind Services Collus & CPU to Town of Collingwood spreadsheets (undated)
- Collus News Release dated November 17, 2011
- Collus Power Corp and Collus Solutions Corp. Meeting Minutes dated December 2, 2011
- Collus Power Corp. Financial Statements from 2000 to 2014
- Collus Power Corp Request for Proposal – Strategic Partnership, October 4, 2011
- Collus PowerStream Corp. Capital Budget 2015 (undated)
- Collus Power Corp. Public Information Centre Slide Deck and opening remarks of Dean Muncaster dated November 22, 2011
- Collus Solutions Corp. Financial Statements from 2000 to 2014
- CollusPowerStream comments dated February 23, 2016 on draft BLG Report
- Collus Power Corporation letters to RFP respondents dated September 6, 2011
- CollusPowerStream letters dated January 9, 2015 and January 27, 2016 on the Beacon 2020 Report

- Collus Power Corp. spreadsheet entitled “Comparison of Proposals – Financial Considerations” dated December 2, 2011 and marked “Draft Strictly Private and Confidential”
- Collus Power Corp. slide deck presentation entitled “Strategic Partnership Update to Council” dated October 3, 2011
- Collus Power Corp. slide deck presentation entitled “Strategic Partnership Request for Proposal Results and Evaluations” dated December 5, 2011
- Collus Power Corp. slide deck presentation entitled “Strategic Partnership Request for Proposal Results and Evaluations Update to Council” dated December 5, 2011
- Collus Power Corp. slide deck presentation entitled “Strategic Partnership Request for Proposal Update to Clearview Township Council” dated December 12, 2011
- Collus Power Corp. slide deck presentation entitled “Strategic Partnership Initiative presented to Town of Collingwood Council” dated January 23, 2012
- Collus Utility Services Confidential Review of Options dated June 27, 2011
- Collus Utility Services Board of Director Meeting Minutes dated January 20, 2012
- Henley International Report entitled “Report on Valuation Results – Collingwood PowerStream Utility Services Corporation” dated June 16, 2015 and marked “Confidential”
- HSG Group Inc. Report entitled “Collus/PowerStream Solutions Corp. – Review of Cost Allocation Methodology” dated April 2013
- KPMG “Calculation of Value” Report prepared for Collus Power Corp. dated May 20, 2011 and marked “Draft for Discussion Purposes”
- KPMG “Collingwood Utility Services – Review of Options” dated May 24, 2011
- KPMG “Collingwood Utility Services – Review of Options“ dated July 11, 2011

- KPMG retainer letter dated September 9, 2011
- Letter dated March 24, 2015 from PowerStream (with Letter Agreement excerpt attached) to John Brown, Collingwood CAO
- Memo from Dale West to Ed Houghton dated March 19, 2016 entitled "My views on the process leading to the Collus/PowerStream partnership"
- Notes entitled "Appendix A – Revised Estimate of Rate Base Multiples Based on PowerStream Offer (December 2011)" and "Appendix B –Estimated Purchase Prices ($000's) as at December 2011" dated March 16, 2016 and marked "Strictly Private and Confidential" provided by Collus (source document unknown)
- Note entitled "Items for Clarification and Confirmation" dated March 18, 2016 signed by various Town of Collingwood Councillors who served during the time of the 50% share sale
- Note entitled "Debunking the Collus Myths" (undated) provided by Collus. Collus advised this note was authored by Ian Chadwick, a former Collingwood Councillor
- Pearson & Associates Corp. slide deck entitled "Collus Strategic Plan 2010-2015 Draft Documentation" (undated)
- Scorecard – Collus PowerStream Corp.(undated)
- Strategic Partnership Team Meeting Notes and slide deck entitled "Confidential Update" dated August 3, 2011
- Strategic Partnership Team Meeting Notes dated August 29, 2011
- Strategic Partnership Team Meeting Notes on Evaluation of Proposals dated November 23, 2011

- Strategic Partnership Team Meeting Notes on Comparison of Proposals with KPMG dated November 28, 2011

- Town of Collingwood Council Minutes dated November 17, 2011

- Town of Collingwood Staff Report CAO 2012-01 dated January 23, 2012

- Town of Collingwood By-Law No. 2012-011 dated January 23, 2012

- Unanimous Shareholders Agreement between the Town of Collingwood, PowerStream Inc. and Collingwood Utility Services Corp. dated July 31, 2012

- Various email exchanges between Collus and the Town

Appendix B "Cash & In-Kind Services Collus & CPU to Town of Collingwood" and "Financial Plan – Shareholder: Town of Collingwood Payments Received from the Corporations" excerpts

Our Financial Plan - Shareholder

COLLUS Power And Collingwood Public Utilities

The Financial Plan outlined on the previous pages provides detailed information of the historic, budgeted and forecasted business operations of the corporations. While setting our corporate goals we equally consider the needs of our customers and the benefit we provide to our Shareholder. The financial information that has been presented provides the detail of the growth in value of their investment. The chart below is an indication of some of the measurable direct benefits.

Town Of Collingwood Payments Received From The Corporations

Company	Description	2001	2002	2003	2004	2005
COLLUS Power	Interest on Promissory Note	$85,000	$123,987	$123,987	$123,987	$123,987
COLLUS Solutions	Municipal Services Payment	$50,000	N/A	N/A	N/A	N/A
Public Utilities	Operations Center Rental	$80,000	$91,000	$90,458	$92,000	$92,000
Public Utilities	New Tecumseth	$60,000	$60,013	$60,555	$82,437	$100,000
COLLUS Solutions	In-kind Services	$125,000	$135,000	$165,000	$180,000	$200,000
Public Utilities	In-kind Services	$15,000	$17,000	$22,000	$10,000	$20,000
Public Utilities	Sewer Charge Administration Cost	$30,000	$30,000	$40,000	$42,000	$50,000
COLLUS & Public Utilities	In-kind Community Services	$20,000	$20,000	$30,000	$30,000	$30,000
	Total Cash	$275,000	$275,000	$275,000	$298,424	$315,987
	Total In-kind Services	$190,000	$202,000	$257,000	$262,000	$300,000
	Total Cash & In-kind	**$465,000**	**$477,000**	**$532,000**	**$560,424**	**$615,987**

Our Financial Plan - Shareholder

COLLUS Power And Collingwood Public Utilities

The Financial Plan outlined on the previous pages provides detailed information of the historic, budgeted and forecasted business operations of the corporations. While setting our corporate goals we equally consider the needs of our customers and the benefit we provide to our Shareholder. The financial information that has been presented provides the detail of the growth in value of their investment. The chart below is an indication of some of the measurable direct benefits.

Town Of Collingwood Payments Received From The Corporations

Company	Description	2008 Actual	2009 Projected
COLLUS Power	Interest on Promissory Note	$124,000	$124,000
Public Utilities	Operations Center Rental	$195,000	$200,000
Public Utilities	New Tecumseth	$95,000	$95,000
COLLUS Solutions	In-kind Services	$265,000	$280,000
Public Utilities	In-kind Services	$35,000	$38,000
Public Utilities	Sewer Administration & Accounting Platform	$86,000	$88,000
COLLUS & Public Utilities	In-kind Community Services	$37,000	$40,000
	Total Cash	$414,000	$419,000
	Total In-kind Services	$423,000	$446,000
	Total Cash & In-kind	**$837,000**	**$865,000**
Public Utilities	**Extraordinary Events—Library**	**$350,000**	
COLLUS Power	**Extraordinary Events—South End**	**$410,000**	
		$1,597,000	

The dynamics of our industry are such that our projections are being done on an annual basis.