



**Peterborough Utilities Group**  
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Thursday, March 17, 2016

**Peterborough Distribution Inc.**

The following Management Discussion and Analysis and Frequently Asked Questions ("FAQ") have been prepared by the Management of Peterborough Utilities Group to summarize key messages provided to City Council and the public with respect to the evaluation of the future of Peterborough Distribution Inc. (PDI).

It represents the summary evaluation by Peterborough Utilities Group, and does not reflect the opinion of City Council of the City of Peterborough.

We understand that the City of Peterborough will be continuing to collect public input for several weeks and we would encourage your input be provided through that process.

Sincerely,

A handwritten signature in black ink, appearing to read "John Stephenson", with a long horizontal line extending to the right.

John Stephenson  
President and CEO  
Peterborough Utilities Group

**Peterborough Distribution Inc.  
Management Discussion and Analysis and FAQ**

**INTRODUCTION**

**Why Consider Selling Peterborough Distribution Inc. (“PDI”)?**

Prior to industry deregulation in year 2000, there were over 300 municipal electric distribution utilities in the Province of Ontario. Industry consolidation commenced at that time in order to streamline the regulatory environment and reduce costs to the consumer. There is now less than 70 Local Distribution Companies (“LDCs”) distributing electricity in Ontario.

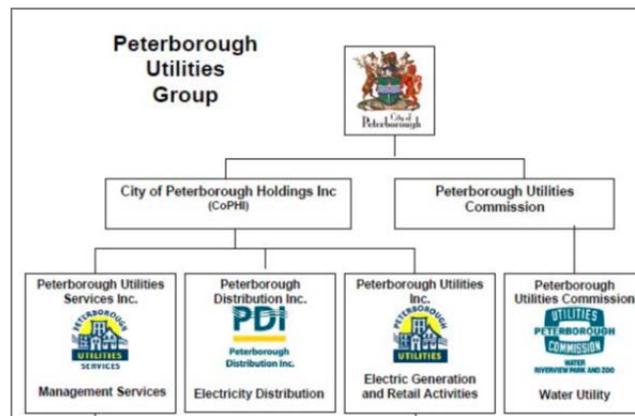
Since 2012, the Provincial Government has sponsored the Drummond Report, the Ontario Distribution Sector Review Panel (“ODSRP”), and the Premier’s Advisory Council on Government Assets. All of these reports have concluded that further distribution utility consolidation is necessary to remove inefficiencies, reduce costs and ultimately reduce consumer electricity rates. For reference, these reports can be found at:

*[http://www.peterboroughutilities.ca/Corporate/Corporate\\_News/Potential\\_Sale\\_of\\_Peterborough\\_Distribution\\_Inc\\_.htm](http://www.peterboroughutilities.ca/Corporate/Corporate_News/Potential_Sale_of_Peterborough_Distribution_Inc_.htm)*

***The ODSRP estimated Province wide savings of \$1.2 – \$1.35 billion could be achieved. It recommended that the remaining LDCs in the Province be consolidated to 8 regional utilities, with each having customer size of approximately 400,000 customers. In this context, PDI with 36,000 customers is simply not large enough to continue as a stand-alone utility.***

**What is Peterborough Utilities Group?**

Peterborough Utilities Group (“PUG”) is comprised of several companies, including the unregulated company, Peterborough Utilities Inc.; the services company, Peterborough Utilities Services Inc.; the water company, through the Peterborough Utilities Commission, and the regulated LDC, Peterborough Distribution Inc. (“PDI”). The Riverview Park and Zoo is also part of the group and operated by the Peterborough Utilities Commission.



PDI is the only company in PUG that is subject to regulation and the Province’s direction of consolidation for cost improvements. Therefore ***PDI, the electricity distributor, is the only company that is under consideration for disposition.***

***PUG will continue to own and operate all other companies in the group.*** Generation development and operations (in the unregulated business), the services and water businesses, and the Riverview Park and Zoo will continue operations as usual.

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**What is the Future of PUG?**

Should the City divest of PDI:

1. ***PUG will continue to have a significant local presence here in Peterborough through its remaining businesses.***

Over the past several years PUG has continued to diversify its overall operations with focus on renewable generation development. The result has been that PDI now accounts for approximately 37% of PUG's electricity assets, and 26% of the combined water and electricity assets. PDI accounts for approximately 24% of the overall annual cash contribution to the City and that is expected to decline to 18% in future years.

The Company has considerable future opportunity in the unregulated business having captured several opportunities with allotted Provincial Government energy procurement contracts. These development opportunities can be developed over the next several years. Recently constructed generation assets are long lived, and will continue to operate for 20 to 50 years. These developments are subject to secure, fixed price, long-term pricing arrangements that will ensure returns to the City over this horizon.

The Company will continue to operate the water business and expects that the future will bring further opportunity for growth.

As previously noted, the Riverview Park and Zoo will always continue to be owned and operated by the Company for the Peterborough community.

2. ***The PDI business will be combined with a Regional Hub presence located in Peterborough.***

**PETERBOROUGH DISTRIBUTION INC.**

**Is Industry Consolidation Real?**

The Ontario electric distribution industry has consolidated considerably and will continue to do so. The following summarizes the history of consolidation of the industry:

<u>Period/Year</u>	<u>Number of LDCs</u>
1990's	307
2000's	150
2013	80
2016 (estimate)	50+/-

Several of the Premier's Advisory Council recommendations to the Provincial Government are being implemented including the merger of Powerstream, Horizon, Enersource and Hydro One Brampton LDCs and the initial privatization of Hydro One. Many Municipal owners throughout Ontario are considering their LDC's future. ***Industry consolidation is happening.***

To further facilitate industry consolidation, in the fiscal 2015 budget, the Provincial Government introduced tax changes to significantly reduce the amount of Provincial taxes ("Transfer Tax") that are payable by Municipal owners to the Province on the sale of LDCs.

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***For a period of three years commencing January 1, 2016:***

**1. For all LDCs**

The Transfer Tax rate was reduced from 33% to 22%. For the City of Peterborough that is a saving of ***approximately \$9.0 to \$11.0 million;***

**2. For LDCs with 30,000 Customers or Less**

A Transfer Tax Holiday (0%), is in effect.

Based on the OEB published 2014 statistics, 44 of the remaining Ontario LDC's have 30,000 customers or less. It is expected that over the next three years during the tax holiday, that several of these LDCs will be sold. LDCs with greater than 30,000 customers can also avoid significant tax by completing a transaction prior to January, 2019.

In addition, the OEB has introduced regulatory changes to facilitate consolidation in the industry.

These recent taxation and regulatory changes have provided a strong environment for accelerated industry consolidation to happen in the next few years.

**Why Now and Why Not Wait?**

The recent advisory reports to the Provincial Government confirm that Ontario, unlike many jurisdictions in North America and worldwide, simply has too many small utilities and this is cost ineffective. ***In Ontario, there are 63 utilities serving only 30% of the customers. PDI is one of these utilities.***

The pace of change and momentum to gain cost efficiencies for the electricity consumer is unprecedented. We must recognize what that means for PDI – specifically:

1. That the environment of change established by Provincial policy will significantly affect the industry and the existence of smaller LDCs in the long run.
2. That PDI, as a small utility of 36,000 customers, in this period of change, may become one of the smallest utilities;
3. That in this period of change and thereafter, PDI may not be as effective as it was historically. It will be challenged to provide the same level of service, rates, and financial return to the City.

The ODSRP and the Premier's Advisory Council on Government Assets, both acknowledge that LDCs lack the capability and capital to respond to future demands on the utility. Municipal owners may be required to provide funding to LDCs in the future, and many may not have the capability or desire to make that investment.

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4. That proactive consideration of LDC options in advance of other market participants may be advantageous. Voluntary determination or negotiation of terms – rates, employment, service and financial return, is better than ignoring change and becoming a small LDC making a decision too late or being told of the decision.

**What's Key to Any Decision?**

Key to any decision on the future of an LDC should be opportunities to:

- Preserve and Build Local Jobs;
- Protect Local Customer Rates and Service, and
- Preserve Financial Value for the City.

**What is the Financial Value at Hand?**

a) Estimated Annual City Return (Status Quo – No Sale)

The estimated future annual return to the City of Peterborough is expected to be approximately **\$1.0 million per annum**, and:

1. This annual amount is **not expected to grow** without considerable economic expansion in the service territory. That growth has not been seen historically and any recent growth has occurred in areas surrounding PDI's service territory and in Hydro One's service territory.
2. This annual amount is **more likely to decline** with increased regulatory pressure on rates, increased mandated performance criteria and required investment to address future utility infrastructure requirements.
3. Given the expected period of industry change and consolidation, the annual return to the City is at risk to continue over the long run (beyond 10 years).

Forecasting total future return to the City from status quo (no sale) operations is now greatly influenced by the above noted risks of limited growth, rate pressure and industry change. **We can no longer assume that past returns can continue forever or unaltered.** Given these risks and assuming a 7 to 10 year horizon, the City's **total amount** expected from annual distributions from status quo (no sale) PDI operations **would not exceed \$7.5 to \$10.0 million.**

b) Illustrative Proceeds on Sale of PDI

Based on recent LDC transactions in the past few years, the total purchase price for PDI could be expected to be in the \$100.0 million range. After deduction for debt and transaction costs, the net cash proceeds that would be returned to the City is estimated to be in the range of **\$40.0 to \$50.0 million. For example, reinvestment of the expected proceeds at 2% - 5% would yield an annual return to the City of approximately \$1.0 to \$2.5 million.**

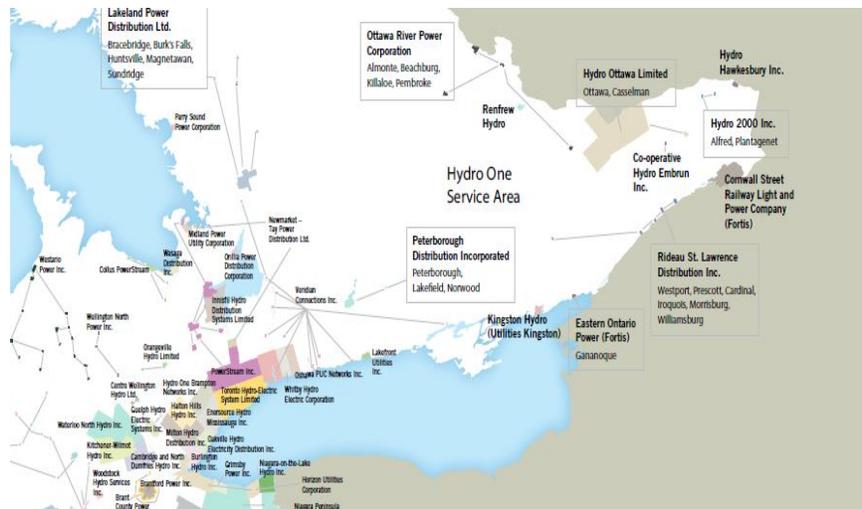
We expect that as the industry continues to consolidate, these market premiums will erode and the opportunity to make these gains will greatly diminish. Furthermore, completion of a transaction during the reduced tax rate period (expiring January, 2019) **will save the City of Peterborough approximately \$9.0 to \$11.0 million in taxes.**

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The opportunity to capture best value is now. However, as previously noted, financial return is only one criteria to consider in addition to employment, rates and service.

## Why consider selling PDI to Hydro One?

PDI's service territory is surrounded by Hydro One's service territory, and with no other LDCs in close proximity to Peterborough. This contiguous service territory can provide significant operational synergies and this has been recognized by the ODSRP as a requirement for effective consolidation.



The Hydro One proposal (to be negotiated) can provide:

### Expanded Regional Presence in Peterborough – Employment

Hydro One has approximately 70 jobs presently working in Peterborough in aging and congested facilities. PDI has approximately 60 - 65 jobs currently working in its operations.

As PDI's service territory is contiguous (shoulder to shoulder) with Hydro One's service territory, the opportunity to build a new Regional Hub Operation Centre in Peterborough becomes logical as the industry consolidates and Hydro One looks to upgrade and site its regional operations.

***The development of a new Regional Hub by Hydro One in Peterborough provides a strong opportunity for continued local presence in Peterborough, and retaining jobs in Peterborough. The related future economic benefit to the community is estimated to be \$100.0 - \$150.0 million over the next five years.***

As the industry consolidates, the future opportunity for regional operations in Peterborough will become less likely. Operations Centres will be sited in other regions as decisions are made in those areas. ***It should also be noted that this is a distinguishing component of a Hydro One proposal, made possible by contiguous service territory.*** Accordingly, such benefits cannot be easily replicated by other potential acquirors.

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**Distribution Rate Control and Certainty**

It is important to note that the ***OEB reviews and approves all distribution rates. Rate increases are adjudicated, controlled and approved by the OEB; not by PDI or any future owner of PDI.*** In addition to OEB control, the following is what is potentially available in a transaction:

**The First Five Years**

With reference to other completed transactions for LDCs, we would expect that the PDI existing distribution rate (the portion of total electricity rates directly controlled by PDI) ***would be reduced by 1% and frozen (“rate freeze”) at that level for five years.***

***In comparison, status quo PDI rates, as a minimum will go up 10% in total over that five year period.*** It is quite possible that with new capital spending requirements over the next five years that the aggregate rate increase may have to be larger than 10%.

Using 10% as the approximate aggregate rate increase for five years for PDI status quo, ***at the end of year five, distribution rates under a rate freeze proposal will be 11% lower than what PDI would have on its own (“the rate advantage”)***

**Beyond Five Years**

Given OEB control of rates, ***it would be difficult to quickly erode the “rate advantage” in the years beyond year five, with rate increases.***

In addition, Hydro One has proposed, as in past LDC transactions and subject to OEB approval, to establish an “Acquired Rate Class”. We would expect that this rate class would better align with the customer density of the City of Peterborough and the cost to serve of urban utilities acquired by Hydro One, and that rates would be comparable to the rate classes of all acquired urban utilities.

We expect that this will address current comparability issues of the Hydro One existing “Urban” rate class with current LDC rate classes, including PDI.

The future expectation is that rate increases beyond the rate freeze period would be similar to rate increases experienced for urban utilities or if PDI remained status quo.

**Reliability and Customer Service**

Hydro One has admitted to having been challenged with the introduction of its new billing system two years ago. They have provided evidence of considerable improvement of that service with their 2015 Performance Scorecard filed with the OEB. That performance is close to PDI’s reported performance.

Secondly, Hydro One has proposed the leverage of PDI local staff to maintain existing service level delivery.

Thirdly, the increased attention and monitoring of LDC service performance through recently developed OEB Performance Scorecard Reporting will bring focus and transparency to all LDC and Hydro One future performance.

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**Transaction Value**

Any proposed transaction will be measured in relation to past and anticipated market values for similar transactions in Ontario. ***Refer to Financial Value at Hand Section.***

**FREQUENTLY ASKED QUESTIONS**

**What would happen to PDI Staff and would there be job losses?**

We anticipate and are working towards providing employment for all PDI staff and we believe that Peterborough will enjoy a net employment gain in the longer term.

**Is PDI in financial trouble?**

PDI is not in any financial trouble.

Historically, PDI has operated efficiently and provided its ratepayers with competitive electricity distribution rates, and provided the City of Peterborough with a competitive rate of a return. However, in light of the Provincial Government direction to consolidate the electricity distribution sector, and the increasing need for new infrastructure investment, as forecasted in the ODRSP report, it is likely that PDI will be unable to continue its historic performance in the future.

**Who is required to approve a sale of PDI?**

The City Council must approve any sale of PDI. There will be an opportunity for customers of PDI to have input and commentary into the process. Should City Council approve a Hydro One proposal, the OEB would then hold a public hearing to determine if the sale of PDI to Hydro One is in the public interest. This public hearing process could take six months or longer to complete. OEB approval is required before any sale can be completed.

**Who would provide my electric bill?**

In the short term, PDI would continue to provide customers of Peterborough and Lakefield with a combined water and electricity bill; and an electricity bill for the customers of Norwood.

If a Hydro One transaction was approved by City Council, over a period of several months after final OEB approval is received PDI's electric services would be transferred to Hydro One and subsequently electricity billings would be produced by Hydro One.

**How would I be billed for water?**

The Peterborough Utilities Commission (water) and Peterborough Utilities Inc. (water heater, rental equipment and generation) would continue to invoice customers for water and rental equipment directly. The frequency of these invoices may change from monthly to bi-monthly or quarterly, but customers would be informed of all changes well ahead of time.

**Would there be any local presence in Peterborough?**

We fully anticipate a significant continued local presence in Peterborough, to retain and enhance future employment. In cementing a contiguous service territory we believe that the opportunity for local presence is strengthened.

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**How would customer service be handled?**

Presently all customer service transactions with PDI can be done over the phone or electronically. This would remain the same if a transition of electric accounts to Hydro One was completed.

**Would my electricity distribution rates go up when I am billed by Hydro One**

PDI, as a Local Distribution Company, only accounts for and controls an estimated 19% of the total electricity bill. We would expect that arrangements with Hydro One would provide distribution rate protection for a period of five years. Thereafter, the electricity distribution rates would continue to be approved and controlled by the OEB.

In comparison, as a stand-alone utility the PDI distribution rate would increase on average by approximately 1.5% to 2% per annum over a typical five year regulatory cycle. Any distribution rate protection would be lower than PDI's status quo distribution rates, if PDI was maintained as a stand-alone utility.

The non-distribution remainder of the total electricity bill (not controlled by PDI) would continue to be subject to increases that are largely determined at the Provincial level or by the OEB.

**Would the level of service and reliability change for PDI customers?**

PDI customers should see no change in reliability or service. We would anticipate some measures to ensure that system and customer service performance is continued at historic levels for a period of time. We further believe that a local presence in Peterborough serves to provide commitment to continued strong future performance.

**How would Peterborough City Council continue to influence local electric service delivery?**

If a Hydro One transaction was approved by City Council, and with reference to other completed transactions for LDCs, a Municipal Advisory Board could be created comprised of local City representation and senior Hydro One officials to address any future electricity related issues. The Municipal Advisory Board would provide a regularly scheduled forum for the City to directly raise electricity issues with senior Hydro One officials.

Post transition, the Hydro One Board of Directors and Hydro One senior management would be responsible for managing electricity operations and services in Peterborough, Lakefield and Norwood. The Ontario Energy Board would continue to regulate these activities and establish all future distribution rates.