Message

From: Tim Fryer [tfryer@collingwood.ca]
Sent: 2015-11-24 12:43:10 PM
To: Rodger, J.Mark [mrodger@blg.com]
Subject: Re: Collus CONFIDENTIAL

Hi Mark:

I have been thinking about our previous conversation and emails and thought I would note to you next opportunity that as part of my "retirement" agreement I had agreed to confidentiality terms. I know that you would have expected that anyway and will be treating it all as such, but that will explain my reason for marking this confidential. I don't see anything below that is major in this regard but I thought it was the right approach to use.

Please see below where I have inserted my responses.

As with the previous responses I have tried to provide enough detail without being too long. I think it would be best to have a conversation about it too. i can be available for a phone call if you like. Otherwise send me an email if you have any further questions.

Thanks

Tim

Sent from my iPad

On Nov 23, 2015, at 3:19 PM, Rodger, J.Mark <MRodger@blg.com> wrote:

> Hi Tim, I should have my draft report wrapped up later his week, but I have a few final points I am trying to clarify. If you have any insight into these matters I would be grateful.
> 1. The financial statements indicate that Solutions added a 20% administrative fee on charges levied to Collus Power. I am interpreting this admin fee to be a markup on Solutions costs. Is this a correct interpretation? What I am trying to understand is that if Solutions was set up as an "at cost" recovery operation, why would they need to charge any markup?

I had mentioned previously that the 20% was a bookmark factor that was used to include a "burden" markup during the regular monthly allocation of cost from Solutions to Power and to the CPUSB. The following detail will explain about the allocation process.

1. Actual labour cost was used when applying cost from Solutions to the other two companies(and in the case of IT the Town as well). It was determined by evaluation of each shared position that a certain percentage of time for each employee was split out. In my case I was basically 50/50 so half my working hours at my hourly rate of pay went to each company.

2. Cost associated to me as an employee of Solutions though weren't just working hours though. There were burden costs such as Vacation Exp and Employee Benefits etc.

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3. The 20% factor applied on each monthly allocation of cost for me was an estimate of the impact of these costs on top of my hourly rate.

4. At the end of the year an evaluation of the costs allocated (including reviewing the % split between the companies) and the actual costs was done. Adjustment was made from there that would mean that the original 20% factor was replaced by an actual "burden allocation factor". The determination of the correct factor would be based on Solutions basically breaking even as a bottom line. Obviously from the statements you will see that there was usually some small difference at the end because there were a few small unknown actual costs or revenue items that came in after the major review work had been done, so further adjustment wasn't made.

5. The independent auditor would examine these calculations at the year end audit to ensure that costs had been allocated out to the operating companies accurately.

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2. In a summary of the bids received for 50% of Collus Power, I noticed that one bidder (Hydro One) offered approximately $900,000 more than PowerStream. Just wondering what factors in PowerStream's proposal were considered superior to overcome the higher financial offer from Hydro One.

Yes that is correct. A major reason that even though their cash offer was higher is that although it received top marks for the Financial offer, PS had tops marks in all of the other factors. As you would expect a two envelope process was used in evaluating the responses. The working group established a percentage split of 30% for financial and 70% for operational(not sure if that term is a correct one to use but will for now). In my case I argued for the reverse but wasn't successful.

So based on only 30% financial points although the HONI cash offer was higher and they got the points associated with that when the 70% operating points were added in PS ended up with higher points overall.

3. In the 2013 financial statements payments were made from Solutions to PowerStream in the amount of $41,000 (for "services under disbursements") and to the Collus PowerStream Corp (the holdco) for $132,000 (for "services"). I can't figure out what these payments were for.

Since i left in 2012 I wouldn't know for certain. Seems like the $41k is the amount they determined to be the cost of having PS do certain services during the year. For example I know that PS staff assisted in the rate application process which would have been done in part of the 2013.

Regarding the other during my tenure at the utility we never once applied anything directly to the 'holdco' so really have no way of knowing but my guess would be that for some reason they didn't want the extra expense going through the operating companies. When I see the term services it makes me think that it was probably bonus payments to employees which I know they did for some employees when annual review of performance was done. When I was there I would allocate these between the the operating companies as part of the burden expense reconciliation but maybe they are doing it differently now?

Any assistance would be appreciated.
Many thanks,
Mark

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- <!--[if !supportLists]--><!--[endif]--> Mark Rodger Professional Corporation

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From: Tim Fryer [mailto:tfryer@collingwood.ca]
Sent: November-10-15 10:50 AM
To: Rodger, J.Mark
Subject: Re: Collus
Hi Mark: I will be on hand tomorrow for our planned call.
After reading your outline below truthfully I could go into great detail and/or we could discuss for hours. But I will try to succinctly give some summary of my point of view of a very complex matter.
You note that you have spoke to David and Jonathan for some helpful information. What needs to be kept in mind is that COLLUS was only one portion of the overall concept being considered during the restructuring requirements. The Collingwood PUC had a hydro and a water division and was considered one of the most efficient utilities in Ontario coming into 2000, Our goal in following the restructuring requirements was to maintain the synergies of a PUC operation and through various avenues provide benefit both directly and indirectly to the Town. COLLUS was structured to maximize return but not in the usual (I won't say conventional because that may imply it wasn't for the best) way you are familiar with for some of our peer municipal utilities.
In the end I would maintain that was achieved but that is a much longer conversation to provide reasoning to you. Also everything changed in 2012 when the sale went through. But in order to fully consider input from other key people who were involved in 2000s changes I suggest you could speak to former mayor and PUC Chair Doug Garbutt and also former mayor Terry Geddes for a Town perspective of success up until 2012.
From a report standpoint you could review the Annual Report and Business Plan that COLLUS and Cwood PUC jointly prepared annually and provided to the shareholder. It contains a summary report that is title Cash and In-Kind Dividend showing the current year's actual and budgeted amounts, prior years actual and the next year's budget. The report included data that showed performance comparison in various categories. During the years we were providing this(when I had input into it because I did the CIKD report) the overall dividend from utility operation grew. Council received this report annually and discussed it with us.
The CIKD report also was an important element for use in dealing with our independent audit firm. For me this was probably more important to me that having it for the shareholder(Town). This was the way that I authenticated to the auditor that although there were shared operations we were tracking and ensuring that the proper costing was applied to the appropriate company. I think the audit firm would be another opportunity for you to get another perspective on some of the issues. If you wanted I could provide a name or two for them.
I will leave that as a summary for now and we can have our discussion tomorrow on it. I will also though put a few short comments in the list below to also assist. I have done this rather rushed because I thought it was important to help us with tomorrow. So I made need to clarify some areas as I expect it will not be fully explained or may be off on an improper tangent.
Thanks
Tim

Sent from my iPad

On Nov 10, 2015, at 9:39 AM, Rodger, J.Mark <MRodger@blg.com> wrote:

Great Time, I will call you at 9:30 am tomorrow.
Here are the main themes for which I need further background and understanding. I have had calls with David McFadden and Jonathan Erling of KPMG which were very helpful, but I want to ensure that I give an accurate and fair overview of Collus' history in my report as I respond to the various questions from the Town.

1. <!--[if !supportLists]--><!--[endif]--> From 2000 until the PowerStream deal, it appears that Collus was essentially set up and operated as a not for profit entity. That is, the debt – equity structure did not follow that of the vast majority of the rest of the distribution sector (e.g. 60-40 debt equity ratio), no dividends were declared for over a decade, etc. What is not clear to me is why the LDC was set up this way in the first place?

It wasn't set up as a not for profit. The original d/e ratio was 50/50 and we decided to grow the company and purchase 2 other small local utilities. The cost of the purchase was funded with 3rd party debt and that is where the $1.7M amount came from. That was the difference to get to 50/50 and was set up as prom note with the Town. This allowed a very high interest rate to be paid on the paper debt. The intention was to grow the Prom Note once the debt for the purchase loan was paid but shortly before we were to do that the OEB introduced the "no further increase to prom note debt rule". That was unfortunate because if we could have increased the prom note and then to the level of a 60/40 split the interest payment would have been substantial and most importantly future investment by the Town could be made with out having to put it in as equity.
While no dividends were directly declared again the reasoning here was to keep the profit in the corporation and hopefully reinvest it into projects that would have a high rate of return. Solar was something I kept pushing as a possible investment opportunity but I had difficulty getting support. As you know there are utilities that have done solar projects and earned annual returns greater than 20%.
Regarding the reason for the eventual set up that was done we can talk directly about that tomorrow.

2. <!--[if !supportLists]--><!--[endif]-->I noticed in both the Collus Power and Collus Solutions financial statements (since 2000), that Solutions included a 20% administrative fee to the services it provided. Was this fee essentially a mark-up of Solutions costs? If so, was there any net income or retained earning associated with Solutions? I know that Solutions never declared any dividends either so I am trying to reconcile the admin fee with the other statements found elsewhere in the documents I have been provided with that Solutions was/is always operated as a cost recovery operation.

After the first couple of years Solutions became essentially a not for profit arm (or cost recovery as you identified above) of COLLUS. But for the Power side it continued to take maximum return in rate settings. Solutions didn't need to have much cash in reserve because it only had people in the organization and not an physical assets to eventually replace. Thus the break-even concept after 2002.
Regarding the Admin fee, if you see that reference in the FS then the note isn't fully explanatory. The Admin fee % was mostly used as an estimate factor throughout the year. It was applied on the direct costs (wages) of the tracked work that was being expensed from Solutions into either Power or PUC. The 20% was meant to cover the indirect costs (payroll expenses, insurance, etc). For yearend reconciliation actual indirect costs were determined and adjustment was made to Power and PUC based on the proportionate share of total direct expense for the year.

3. <!--[if !supportLists]--><!--[endif]-->Any background on why the 50% sale option was selected as the optimum solution (as opposed to a 100% sale, 10% sale or a merger)?

The only real background I can give you is that I found out about the 50/50 consideration at a working group meeting when it was brought up for discussion. The working group discussed it and the voting members decided to pursue it.

4. <!--[if !supportLists]--><!--[endif]-->I am not clear about how the Collus Power financial restructuring worked when PowerStream acquired 50%. I had initially thought the Town prom note was paid out,

but I don't that is correct. I think what happened is that new IO debt was arranged and this debt was the basis for the dividend payment to the Town but I am not sure.

The intention was that the Prom Note would be paid out in a future year. It happened that it was 2015 that the suggestion to exercise the option came forward. As a member of council I opposed the idea based on my understanding of the current financial position of COLLUS and requirements of the share sale agreement. A majority of council also opposed it.

Yes 3rd party debt was taken out so that a 60/40(actually slightly higher at about 62/38) d/e ratio was in place. That is after as much dividend could be taken out was done. I informed the working group that this could be done with out selling any portion of the company because they were simply removing all of the earnings that had been made over the years that previous councils had decided to leave in for reinvestment purposes by the utility.

5. <!--[if !supportLists]--><!--[endif]-->In general, the benefits that were/are assumed to be associated with Solutions (as opposed to keeping everything in the LDC and managing the Town's water service from the LDC, for example).

This is one of those full days conversations but we can talk about it some tomorrow.

Thanks again Tim.
Mark

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- Mark Rodger Professional Corporation

From: Tim Fryer [mailto:tfryer@collingwood.ca]
Sent: November-10-15 9:20 AM
To: Rodger, J.Mark
Subject: Re: Collus

Hi Mark: If you want to plan to call me at [redacted] tomorrow at 9:30am that will work for me.

If you can perhaps sending me some notes about the issues you would like to discuss could help get things covered with the call. As you have identified context is very important in reviewing this matter especially going back more than 15 years. Unfortunately during my discussions with others about the municipal utility matters over the period, things get singled out. Some of them have to be looked at in the complete context to be understood clearly.

Anyway i look forward to speaking with you tomorrow.

Thanks
Tim

Sent from my iPad

On Nov 10, 2015, at 9:09 AM, Rodger, J.Mark <MRodger@blg.com> wrote:

> Thanks Tim, how about 9:30 am or 1 pm tomorrow (Wednesday)? Let me know the best number to reach you. Regards, Mark

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- Mark Rodger Professional Corporation

From: Tim Fryer [mailto:tfryer@collingwood.ca]
Sent: November-10-15 7:937 AM
To: Rodger-445836, J.Mark
Subject: Re: Collus
Hi Mark: Yes everything is good and I hope it is for you too.
If you want to give me some time slots for this afternoon or the next couple of days, I should be able to match up to some of them.
Thanks
Tim

Sent from my iPad

On Nov 9, 2015, at 1:31 PM, Rodger, J.Mark <MRodger@blg.com> wrote:

> Hi Tim, trust you are well.
> I am in the process of preparing a report for Council that deals with various issues that arose during our in camera meeting recently.
> I have also been asked by Town staff to review some other Collus-related reports and background documents in order to provide a high level "history of Collus" since the time of industry restructuring in 2000.
> I have a number of issues that I need some further context and insight.
> Would you mind if I gave you a call sometime this week to discuss?
> Let me know what dates and times suit you best.
> Many thanks Tim,
> Regards,
> Mark

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