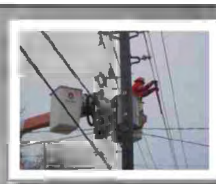


COLLINGWOOD UTILITY SERVICES

Confidential Review of Options

Monday, June 27, 2011

Background

The Reason for this Review

The Strategic Direction for Collingwood Utility Services begins and ends with our Shareholders. This review was initiated as Collus' ongoing approach to ensure that the Municipality is receiving the most value for its dollar.

The Context for this Review

During the initial electricity restructuring process in Ontario, the Town of Collingwood undertook a review of its ownership options with respect to the local electricity distribution utility. This review led to the Town's decision in 2000 to retain ownership of its distribution utility and to pursue opportunities for utility expansion.

This review also resulted in the current utility structure, in which a holding company (Collingwood Utility Services Corp., or "Collus") and affiliated service companies provide management and support services to both a wholly-owned electricity distribution utility ("Collus Power") and to the municipal water utility (Collingwood Public Utilities Service Board, or "CPU").

With the passage of time and changes in the Ontario electricity sector, Collus has initiated a new assessment of the ownership options for the Town. This report contains the results of this review.

Report Structure

In the first part of this report, we review the current environment of the electricity sector and its implications for municipal distribution utilities. The specific topics addressed are as follows:

- The current structure of the Ontario electricity distribution sector.
- Industry financial pressures.
- Regulatory environment.
- Implications for decision-making by the Town.

In the second part of this report, we review three options and the issues that influence these options. We then conclude with a summary of the advantages and disadvantages of the status quo option, the sale option and the “preferred option” which is the **Strategic Partnership** option.

Industry Environment

The Current Structure of the Ontario Electricity Distribution Sector

- The Province remains concerned about the continued operation of approximately 80 municipally-owned Local Distribution Companies ("LDCs").
- It believes that this results in additional costs through economies of scale.
- Many observers expect the Province to take steps to encourage additional LDC consolidation.
- These measures are likely to include a time-limited Transfer Tax holiday for mergers and acquisitions involving publicly-owned utilities.
- The Province is also concerned that hard-to-service rural areas will be left out of voluntary transactions. Hence, initiatives to encourage municipal consolidation may be tied to specific measures to create a number of large, regional utilities.

Transfer Tax

Tax Liability On Sale of Municipal Electric Utility

- Under the Ontario Electricity Act., the Town will pay a Transfer Tax equal to 33%, less Payments in-lieu of Taxes (PILS) of the proceeds if it sells its ownership interest in Collus to another entity.

- From time to time, the provincial government has introduced time-limited exemptions (or “holidays”) from this tax for sales of municipally-owned utilities to entities owned by municipalities or by the province (e.g. Hydro One).

- The exemptions introduced to date have not applied to sales to private-sector utilities.

- In a few instances, privately-owned companies such as Fortis, in order to reduce the effect of the tax, have structured transactions in the form of lease arrangements with an option to buy.

- The presence of the Transfer Tax means that, if a sale transaction is contemplated, it would make sense to wait until a new exemption is introduced to complete the transaction.

Financial Pressures

Electricity rates in Ontario have been rising at rates greater than inflation as a result of several factors. These include:

- The introduction of the HST.
- Increases in transmission and distribution charges as a result of the need for repair and renewal of electricity networks, implementation of Smart Meters, and general increases in regulatory and other costs.
- The construction of new clean energy plants (natural-gas fired combined cycle) to supply additional capacity in parallel with the phase-out of coal generation.
- The impact of Ontario Power Authority (OPA) contracts for renewable power at above-market rates.

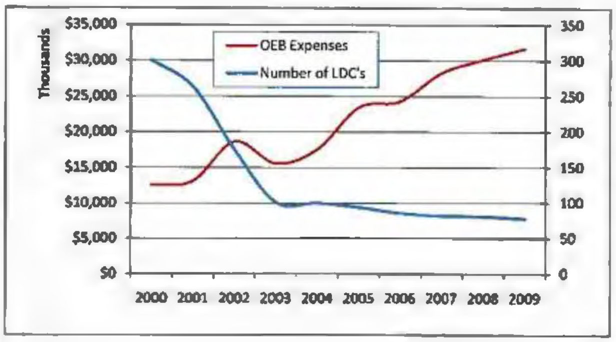
This has resulted in additional political sensitivity to power costs and may make future Provincial policies somewhat uncertain and subject to change.

Regulatory Environment

Regulatory Oversight

- After market restructuring in the late 1990's, the Ontario Energy Board (OEB) assumed oversight over the Ontario electricity distribution sector. In this role, the OEB controls electricity rates and service standards, and sets rules with respect to utility operations.
- Under the OEB's current rate setting approach, LDCs are required to submit a full Cost of Service Application every 3 to 4 years. This rebasing process results in rates that cover allowed utility costs and that provide for a regulated return on a utility's invested capital (or Rate Base).
- Between rebasing applications, the OEB adjusts an LDC's rates through an annual indexing process. This indexing process takes into account general cost trends and changes in the financial market conditions.
- The OEB rate setting and regulatory processes put significant pressure on all LDCs, but particularly smaller LDCs with limited management resources.

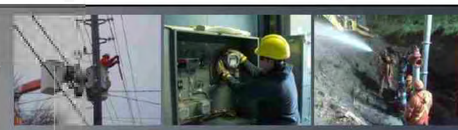
Regulatory Environment (cont'd):



Implications of the Industry Environment

Changes in the industry environment noted earlier may have implications for a decision to be made by the Town of Collingwood with respect to its ownership options:

- Anticipated provincial actions to encourage consolidation could result in an increase in sale transactions in the future which could decrease individual utility value.
- A Town that may wish to sell its utility in the future would be wise to position itself to best take advantage of potential future changes in policy and hence buyer interest. This may mean examining sale options before changes in policy affect buyer interest or market value, perhaps negatively.
- The move to a Smart Grid will increase utility spending requirements and the need for specialized technical expertise at the LDC level.
- Concerns over future rate increases could result in regulatory or government action to minimize rate increases, potentially depressing future returns to utility owners.



Restructuring Options

The Town of Collingwood has a number of options with respect to its electricity LDC. The three options are:

- **Status Quo:** The Town can continue ownership and operation of the utility under its current structure.

- **Sale:** The Town can entertain offers for purchase from interested parties. A number of variants are open under this Option. These include:
  - The Town could sell its ownership interest in its entirety.
  - The Town could seek to sell only a partial interest in the utility, retaining either a minority or majority share.

- **Strategic Partnership:** The Town can seek financial or technical partners or both. Consideration could also be given to a lease arrangement such as mentioned previously .

These options, and their variants, will be discussed in further detail in the sections below.

Utility Valuation

- In theory, regulated utilities should sell at values close to their book value since they are regulated based on their actual costs and by applying a regulated return on their invested capital.
- In practice, utilities often trade at a premium above book value.
- The willingness to pay a premium over book value for a given utility will depend, in part, on the ability to reduce costs which will influence a purchaser's future expected income stream.
- In the longer term, operating cost reductions, if achievable, will generally be passed through to consumers and should thus result in lower rates.
- Purchasers may also pay a premium for "strategic" assets that can help them gain further in-roads into a sector or geographic region. Collus may have strategic value as a utility that is at the centre of an area with a number of other potential acquisition targets. A buyer that purchases Collus may have an operating cost advantage in purchasing additional utilities in the area in the future. This may be a factor that influences market value if there is strong provincial policy support for additional LDC consolidation.

Operating Synergies

Potential sources of operating synergies are as follows:

- **Billing and Collecting Costs**. A utility sector partner may expand its existing billing and collection system to service customers in Collingwood at relatively low incremental cost. This will result in savings from the elimination of Collus's existing operations in this area.
- **Regulatory Costs**. A utility sector partner would likely integrate Collus's operations into its existing business and apply for harmonized rates on an overall basis. This would allow it to eliminate the costs of a separate rate application for Collus, saving costs associated with periodic rate filings and regulatory reporting.
- **Operating Costs**. A utility sector partner with nearby or adjacent service territories may be able to integrate operating and maintenance functions and to combine service centres, leading to efficiencies in the deployment of line staff and in real estate costs.
- **Other Overhead Costs**. Other support functions may be provided from a utility sector partner. It must be noted, however, that Collus already obtains some of these types of synergies by providing support services jointly to the LDC (Collus Power), the Town's water utility (CPU), IT Services and Public Works.

Operating Dis-Synergies and Rate Harmonization

Dis-Synergies

Potential sources of dis-synergies are as follows:

- **Harmonization of Wages and Benefits**. A utility sector partner may provide its employees with higher wages and benefits than at Collus. This would thus result in an increase in wages and benefits for Collus's existing employees, increasing overall payroll costs. Harmonization may be a particular issue for Collus, since it has lower wage rates than many potential purchasers based in the GTA.
- **Costs of On-Going Operation**. Integration of Collus's operations into those of a utility sector partner may lead to some additional costs related to the operation of a utility with a larger and more geographically-dispersed service territory. These include costs for transportation and travel time and perhaps a loss in some decision-making effectiveness because of a remote management team.

Rate Harmonization

If a utility sector partner has higher rates, then harmonization of rates could increase rates for Collus consumers. This is not a dis-synergy, because it does not reflect increases in operating costs as a result of a merger. However, it will nevertheless have a negative result for Collingwood consumers.

Affiliate Relationships

Impact on Relationships with the Town and Water Utility

Collus provides management and support services to the LDC, the water utility, IT Services and Public Works. Any sale transaction could result in changes in these management and support service arrangements, and this could have an impact on costs going forward at the Town and the water utility. Any such impacts would ultimately need to be examined as part of the financial analysis, from the Town's perspective, of any proposed transaction.

Potential purchasers of the utility may have a variety of preferences with respect to operating structure.

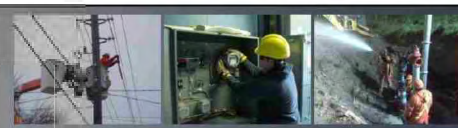
- A purchaser may wish to continue Collus's current approach to combining support services, and would thus be interested in continuing to provide services to the water utility and potentially also to the Town.
- A purchaser of the LDC may wish to operate it independently of the water utility and the Town and may thus wish to sever existing affiliate transactions. This decision would likely depend on the purchaser's ability to obtain management and support services from its other existing, operating companies.

Considerations:

- **Rate Impacts.** The largest portion of an electricity bill is the commodity, the transmission charges, global adjustment, etc. The distribution portion is relatively small. If the utility can operate more cost-effectively on a stand-alone basis, then rates should be somewhat lower. Conversely, if stand-alone costs are higher, then rates will be somewhat higher.

- **Utility Consolidation**. It is possible that a future provincial government may mandate the consolidation of distribution utilities on a regional basis. In this case, the Town may lose control over the utility and may also have limited influence on a transition process.

- **Business Complexity**. The business of operating a local distribution utility is becoming more complex with the transition to a Smart Grid, increased requirements for regulatory reporting and compliance, and technical and business expertise going forward. A utility operating on a stand-alone basis will need to be comfortable with these challenges.



Considerations (cont'd):

- **Demographic Challenges**. Like many other utilities in the Province, Collus is facing issues associated with the aging of its work force and the need to replace retiring employees. If operated on a stand-alone basis, the utility will need to have a plan for addressing potential future staff shortfalls. A strategic partner may view expected future retirements at Collus as a positive, since they provide an opportunity to reduce costs.

- **Control.** As a regulated utility, Collus Power is subject to oversight by the Ontario Energy Board (OEB). Thus, decisions on rates and services quality for any owner are constrained by OEB rules in place. Under the Status Quo option, the ability of the Town to control rates and service quality is therefore subject to limits. In decisions to date, we note that Collus Power has applied in its rate applications for the maximum rates allowed under OEB guidelines. Hence, the Town has not exercised its option to accept lower rates of return than allowed by the OEB. Under the Sale Option, the Town would lose direct control over rate applications made, but can take comfort that utility decisions will still be subject to external regulatory oversight.

Evaluation of Status Quo Option

Under a Status Quo option, the Town retains the risks and the rewards of utility operation.

Specific advantages and disadvantages of the Status Quo option are outlined below.

Advantages

- **Income Potential**. The Town retains the potential to earn a future dividend stream from the utility.
- **Control**. The Town retains direct control of the utility and its decisions with respect to levels of customer service, local employment, promotion of economic development, and rate levels, subject to OEB oversight.
- **Operating Synergies with the Town.** The Town retains the ability to obtain operating cost synergies through the integration of support functions with the water utility and IT.

Disadvantages

- **Business Risk**. The Town retains the risks of being in the electricity distribution business, which is becoming more complex over time. Thus, the Town will need to ensure that the utility has the requisite management resources and risk management processes. As with any business, the expected future earnings stream may be impacted by adverse events.
- **Policy Challenges**. This option does not address the expected push for additional consolidation of LDCs in the province.

Evaluation of a Full Sale Option

Under a Full Sale option, the Town transfers ownership of the business to a new owner. Specific advantages and disadvantages of the Sale option are outlined below.

Advantages

- **Cash Payment**. Town will achieve an immediate cash payment that can be used for municipal purposes.
- **Reduced Risk**. The Town mitigates the risks of being in the electricity distribution business.
- **Policy Challenges**. This option does address the expected push for additional consolidation of LDCs in the province.

Disadvantages

- **Transfer Tax Payable**. In the absence of an exemption, the Town will pay a Transfer Tax equal to 33% of the proceeds from a sale, less any corporate income taxes or PILS that have been paid since market restructuring. This will reduce the net proceeds received.
- **Loss of Income Stream**. The Town will eliminate the potential to earn a future dividend stream. The foregone dividend stream may be higher than the potential to earn interest income if the proceeds from sale are invested in interest-bearing instruments.
- **Operating Synergies with the Town**. The Town may lose the ability to obtain operating cost synergies through the integration of support functions with the water utility and IT.
- **Control**. The Town loses direct control of the utility and its decisions with respect to levels of customer service, local employment, promotion of economic development, and rate levels, subject to OEB oversight.

Evaluation of a Partial Sale Option

Under a Partial Sale option, the Town transfers ownership of the business to a new owner while investing a portion of the value with the new owner. It thus mitigates itself from the business risks of electricity distribution, but retains the ability to earn an associated income stream based on the investment in the new owner's LDC. Specific advantages and disadvantages of the Partial Sale option are outlined below.

Advantages

- **Cash Payment**. Town will achieve an immediate cash payment that can be used for municipal purposes.
- **Reduced Risk**. The Town distances itself from the risks of being in the electricity distribution business.
- **Retains an Income Stream.** The Town continues the potential to earn a future dividend stream based on the equity ownership in the new owner's LDC.
- **Policy Challenges**. This option does address the expected push for additional consolidation of LDCs in the province.

Disadvantages

- **Transfer Tax Payable**. In the absence of an exemption, the Town will pay a Transfer Tax equal to 33% of the proceeds from a sale transaction, less any corporate income taxes or PILS that have been paid since market restructuring. This will reduce the net proceeds received.

Evaluation of a Partial Sale Option, *Continued*

- **Loss of Control**. The Town loses partial control of the utility and its decisions with respect to levels of customer service, promotion of economic development, and rate setting (although these remain constrained by OEB oversight.
- **Operating Synergies with the Town**. The Town may lose the ability to obtain operating cost synergies through the integration of support functions with the water utility and IT.
- **Loss of Local Employment**. The Town may lose some local employment if a buyer reduces costs by centralizing some functions at its head office.
- **Loss of Partial Income Stream**. The Town will receive a smaller future dividend stream based on the equity ownership in the new owner's LDC.

The Strategic Partner Option

- A **Strategic Partner** would value the expertise and reputation of Collus, as well as its strategic geographic location as the foundation for the development of a regional electrical utility based in Collingwood to serve the Georgian Bay area and beyond.

- In a **Strategic Partnership** arrangement, depending upon the type of structure negotiated, the Town would become the recipient of cash and could either have a substantial ownership position in the existing LDC (Collus Power) or in a new LDC created for the specific partnership purpose, or a minority position in the acquiring partner.

- In addition, it is possible that such a **Strategic Partner** would see the management and facilities of the Collingwood Public Utilities as the nucleus upon which to develop a regional water operations utility to serve the expanding water needs of Simcoe County.

Evaluation of a Strategic Partner Option

Under a Strategic Partner option, the Town may receive many of the benefits of the preceding options. Specific potential advantages and disadvantages of this option are outlined below.

Advantages

- **Cash Payment**. Town will achieve an immediate cash payment that can be used for municipal purposes.
- **Reduced Risk**. The Town will reduce/mitigate itself from the risks of being in the electricity distribution business through oversight by a strategic partner.
- **Retains an Income Stream.** The Town may earn a future dividend stream based on equity ownership in the new partner's LDC.
- **Operating Synergies with the Town**. The Town retains the ability to obtain operating cost synergies through the integration of support functions with the water utility and IT.
- **Control**. The Town retains joint-control of the utility and its decisions with respect to levels of customer service, promotion of economic development, rates, subject to OEB oversight.
- **Policy Challenges**. This option does address the expected push for additional consolidation of LDCs in the province.

Evaluation of a Strategic Partner Option (cont'd)

Advantages (cont'd)

- **Other Opportunities.** The Strategic Partner may be interested in investing in the proven Management team operating the water system and creating a similar company to Epcor, retaining employment in Collingwood and having the potential for expanding related businesses. A lease arrangement may also be considered under this option.
- **Interest in Collus.** A Strategic Partner may "buy" an interest in Collus and so a new LDC would not be created but rather the existing corporation continue with new share arrangements and expanded Board of Directors.

Disadvantages

- **Transfer Tax Payable**. In the absence of an exemption, the Town will pay a Transfer Tax equal to 33% of the proceeds from a sale transaction, less any corporate income taxes or PILS that have been paid since market restructuring. This will reduce the net proceeds received.

Next Steps:

1. It would be the intention to identify and investigate potential parties interested in the opportunities surrounding the Strategic Partnership Option. President & CEO, Ed Houghton should speak with potential Strategic Partners to determine/stimulate levels of interest.

2. (Possible Step) Prepare an Expression of Interest.

3. Establish a Team comprised of the Collus Power Board (Dean Muncaster, Mayor Sandra Cooper & Independent Director David McFadden), Ed Houghton, Tim Fryer, CAO Kim Wingrove and a Council Representative to meet with all interested Strategic Partners to outline the needs, wants and desires.

4. Prepare a Request For Proposal for the end of August.

5. Call the RFP for end of October, 2011.

Conclusions:

- Timing is critical considering the upcoming election, possible provincial policy changes, upcoming town budge deliberations and current value.
- Confidentiality is critical to ensure that the greatest value is fully recognized.
- Any action taken must provide the greatest value to our Shareholder with the least impact to our customers and our staff.