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**Ministry of the Attorney General**
***Briefing Note***
**Civil Law Division**
**Legal Services Branch**
**ENERGY/MEDG/MRIS/MOI/ADO**

# FAIR HYDRO PLAN – PROVINCIAL GUARANTEE

## A. Issue

- Provincial Support Agreement Term Sheet

## B. Background

- Under the terms of the proposed *Ontario Fair Hydro Plan Act, 2017* (the "Act"), it is anticipated that the Ontario Power Generation ("OPG") will establish a subsidiary entity (the "Financing Entity") that will undertake a public debt offering to finance the implementation of the Ontario Fair Hydro Plan (the "Fair Hydro Plan").

- The Ontario Finance Authority (the "OFA") is in the process of negotiating a term sheet with OPG that would outline the basis upon which the government of Ontario ("Ontario") would provide financial assurance to support such a debt offering.

- OPG has advised that a term sheet codifying Ontario's commitment, at least at a high level, will be necessary to support OPG's pending discussions with credit rating agencies, as well as the anticipated triple-A rating of the proposed debt offering.

- In furtherance of these objectives, OPG provided the OFA with a draft of a proposed term sheet dated May 12, 2017 (the "Term Sheet"). The key features of the Term Sheet are as follows:

  - **Beneficiaries** – Ontario would provide the guarantees set out in the Term Sheet to a broad class of investors and other parties with any financial interest in the proposed debt offering (including, senior and subordinated noteholders, hedge counterparties, credit enhancers, liquidity providers, and any other parties to whom the Trust/Financing Entity owes obligations).

  - **Performance Guarantee** – Ontario would guarantee the performance of all of the obligations of the Independent Electricity System Operator (the "IESO") and local distribution companies (LDCs). These obligations would include the billing, collection and remittance of clean energy adjustments ("CEAs") payable by specified consumers.

- **Payment Guarantee** – Ontario would guarantee the payment of all amounts owed by the Financing Entity to investors and others in certain, limited circumstances. This payment guarantee would triggered upon the occurrence of one of the following "Payment Guarantee Events":
  - the repeal of the Act;
  - any amendment to the Act, or a regulation made under the Act, that adversely affects the ability of any beneficiary to fully recover its investment interest;
  - a judicial determination that the Act, or a portion of the Act, is *ultra vires* in a way that adversely affects the ability of any beneficiary to fully recover its investment interest; or
  - the occurrence of a "market disruption" resulting in capital not being available to refinance the Financing Entity's funding obligations for a period of six (6) months or more.

- **Put Option** – Upon the occurrence of any Payment Guarantee Event, investors would also have the option of requiring Ontario to immediately buy back their investment (at a put price of 101% of the principal amount plus accrued and unpaid interest).

## C. Analysis

- On June 7, 2017, counsel from the Ministry of Energy, the Ministry of Finance ("MOF-LSB") and Blake, Cassels & Graydon LLP ("Blakes") met with representatives from the OFA and the Office of the Provincial Controller (the "Provincial Controller") to discuss a number of significant legal issues arising out of the provisions of the draft Term Sheet. The main issues discussed at that meeting included the following:

  - **Beneficiaries** – The description of "beneficiaries" in the draft Term Sheet is much too broad. Many of the groups identified in the enumerated list (*i.e.*, hedge counterparties, credit enhancers, liquidity providers) do not represent clearly defined classes. This broad and uncertain definition could unintentionally expose Ontario to claims for compensation by fairly remote parties claiming some indirect financial interest in the proposed debt offering.

  - **Included Transactions** – Ontario's liability under the Term Sheet is not restricted to any particular debt offering (or related transaction) undertaken by the Financing Entity. Rather, the province's commitment is framed as a "program-wide" guarantee that would encompass any and all future transactions undertaken by Financing Entity in connection with Fair Hydro Plan. It would be preferable to limit the province's commitment to individual transactions and specified creditors, negotiated at the time of each transaction.

- **Performance Guarantee** –Blakes advised that performance guarantees are quite typical in structured finance offerings and, in fact, are generally regarded as being less onerous than an outright payment guarantee (because the guarantor is only guaranteeing the performance of certain specified obligations, as opposed to the payment of the underlying obligation).

  However, the performance guarantee described in the draft Term Sheet is too broad. Ontario would be guaranteeing the performance obligations of LDCs under the Fair Hydro Plan, in addition to the obligations of the IESO. It would be preferable to limit Ontario's performance guarantee to the IESO and leave it to the IESO to enforce performance by the LDCs through its direct contractual relationship with those agencies.

- **Payment Guarantee** – One of the main concerns motivating the requirement for a provincial guarantee to support a debt offering by the Financing Authority is the prospect that a future government may legislate in a way that adversely affects the rights of investors. The transaction is modelled on similar transactions in the U.S. and we understand that a concern has arisen because there is no legal way to limit the right of the Legislature to override and even expropriate private rights by statute (with or without compensation). Some form of payment guarantee triggered by adverse legislative action will likely be necessary to offer some assurance to potential investors concerning the government's intent to abide by the commitments made in connection with the Fair Hydro Plan.

  Again, however, the form of payment guarantee currently included in the Term Sheet is too broad. The kinds of future legislative actions that would trigger a Payment Guarantee Event are framed in vague terms and are not subject to any materiality threshold. This means that a beneficiary could potentially seek to trigger the guarantee in response to routine legislative amendments affecting the value of their investment interest only indirectly or in insignificant ways (*e.g.*, a merely theoretical diminution in the value of the regulatory asset or some kind of timing issue that modestly delays payment). Similarly, the concept of "market disruption" in the Term Sheet is vague and could unreasonably expose the government to risks around future refinancing transactions (*i.e.*, by effectively requiring Ontario to be the "standby purchaser" of any securities in the case of a lack of liquidity in the financial markets).

- **Put Option** – It is not clear why Ontario should agree to repurchase investments from beneficiaries in response to Payment Guarantee Events. The Put Option is of particular concern as a result of the ambiguity in the description of the various Payment Guarantee Events that would trigger this right. Under the current structure of the Term Sheet, investors could require the province to repurchase their investments in response to regulatory amendments affecting the value of their investments in only incidental or immaterial ways. Blakes cautioned that Ontario should be wary about providing a form of assurance that might enable U.S. hedge funds to hold the government hostage for the next 30 years.

- **Accounting Risks** – In addition to the purely legal risks outlined above, any over breadth in the scope of Ontario's commitments in the Term Sheet could exacerbate the risk that the Financing Entity's obligations could be treated as liabilities of the province for accounting purposes. The Provincial Controller and the OFA agreed that this was a potentially serious concern that they had independently identified in their review of the Term Sheet.

## D. Recommendations and Next Steps

- Blakes delivered a mark-up reflecting the consolidated legal comments dated June 14, 2017 (attached).

- The main features of the revised Term Sheet are as follows:

  - **Beneficiaries** – The only beneficiary of the commitments made by the province under the revised Term Sheet would be the Financing Entity. Investors and other interested parties would benefit from the provincial commitments only indirectly, through the subsequent assignment of security interests in those rights by the Financing Entity (which would be subject to provincial approval).

  - **Performance Guarantee** – Ontario would provide a performance guarantee covering the billing, collection and remittance functions of the IESO under the Fair Hydro Plan. The guarantee would not include the underlying obligations of the LDCs.

  - **Payment Guarantee** – Ontario would provide a more limited payment guarantee that would be triggered only by (i) *material* adverse legislative action on the part of Ontario; or (ii) a judicial determination that the legislation is *ultra vires* in a way that *materially* affects the investments interests of the Financing Entity. The concept of market disruption has been deleted from the list of Payment Guarantee Events.

  - **Undertakings re "Mismatches"** – In substitution for the concept of "market disruption" in the list of Payment Guarantee Events, the Term Sheet would incorporate provisions signalling Ontario's willingness to consider future requests for financial support by the Financing Entity in circumstances where refinancing funds are not otherwise available in the market on commercially reasonable terms. However, the new provisions would make it clear that Ontario is not obligated to provide such funding and, if advanced, such funding would be made available on terms approved by the Ministers of Energy and Finances, acting together.

- The mark up of the term sheet will be provided to OPG for further discussion and negotiation.

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