Hydro One

ISSUE

Following recommendations from the Premier's Advisory Council on Government Assets (Council), the government broadened the ownership of Hydro One.

The Initial Public Offering (IPO) closed in November 2015.

A secondary share offering of Hydro One was completed in April 2016 generating approximately $2 billion in gross proceeds.

1. SUGGESTED RESPONSE ON BROADENING HYDRO ONE OWNERSHIP

- In April 2014, our government asked the Premier's Advisory Council on Government Assets to review options for maximizing the value of government assets, including Hydro One

- Following recommendations from the council, our government broadened the ownership of Hydro One to create lasting public benefits and ongoing public protections.

- The IPO was the first phase in broadening the ownership of Hydro One.

- The Province completed the Hydro One Ltd. IPO in November 2015 and raised approximately $1.83 billion in gross proceeds and about $116 million from related share sales.

- The secondary share offering of Hydro One was completed in April 2016, generating approximately $2 billion in gross proceeds.

- The government continues to hold approximately 70 per cent of Hydro One and will proceed with future offerings in a careful, staged, and prudent manner, over time reducing Ontario's stake to 40 per cent while remaining the largest shareholder.

- By law no other shareholder or group of shareholders is permitted to own more than 10 per cent of Hydro One.

- Ontario remains on track to generate approximately $9 billion in gross proceeds and other revenue benefits. This includes $4 billion in net revenue gains that will be invested in infrastructure and $5 billion to reduce debt. As an example, assuming a long-term interest rate of 3 per cent, $5 billion in reduced debt would provide annual interest savings of about $150 million.

- As of August 25, 2016, $3.2 billion from the sale of Hydro One shares in 2015 has been dedicated to the Trillium Trust, a fund for infrastructure projects that will help create jobs and strengthen the economy.

2. SUGGESTED RESPONSE ON HYDRO ONE GOVERNANCE & OVERSIGHT

- The Ontario government remains the largest shareholder of Hydro One, and by law no other shareholder or group of shareholders is permitted to own more than 10 per cent.

  Rates will continue to be set by the independent regulator, the Ontario Energy Board (OEB).

- **The government has passed legislation which strengthens the OEB's role so that it continues to have a robust set of tools to protect ratepayers and regulate the sector.**

- **The Strengthening Consumer Protection and Electricity System Oversight Act, 2015 includes measures to enhance consumer protection, provide further opportunities for consumer advocacy, clarify the role of Local Distribution Companies (LDCs) and their affiliates and extend the OEB's emergency powers to transmission. It also enhances the oversight of utility transactions and provides the government with the ability to prioritize critical transmission infrastructure, which will allow key transmission infrastructure to be considered without undergoing a 'needs' test by the OEB.**

- **The province required by law that Hydro One create a dedicated Ombudsman, similar to those found at other public companies to address and resolve complaints from its customers and affected groups. Hydro One has appointed Fiona Crean as the Ombudsman of Hydro One as of November 2015. Her office is now operative.**

3. <u>SUGGESTED RESPONSE ON Q3 2016 FINANCIAL RESULTS:</u>

- **As Hydro One is now a publicly traded company, any questions or concerns regarding its financials should be directed to Hydro One.**

4. <u>SUGGESTED RESPONSE ON RATES:</u>

2017 Custom IR Year 3 Update

- **The OEB has approved Hydro One's Rate Order for 2017 distribution rates, effective January 1, 2017, based on the framework approved for its 2015-2017 multi-year distribution rate setting plan, which was approved in March 2015. This is the final adjustment under the current multi-year arrangement.**
  - **To set 2017 distribution rates, the OEB approved annual updates to cost of capital, cost allocation, and certain other updates.**

- **In setting Hydro One's 2017 distribution rates, the OEB approved an increased monthly Rural and Remote Rate Protection (RRRP) amount to offset the cost of delivery to Hydro One R2 residential customers. This monthly amount increases from $31.50 per month to $60.50 per month, effective January 1, 2017, a monthly increase of $29.00. This reflects the implementation of the Government's changes to O.Reg. 442/01 to provide rate relief to eligible low-density residential customers.**

- **As a result, a typical medium density residential (R1) customer using 750 kWh per month will see a monthly bill decrease of $1.54, and a typical low density residential (R2) customer using 750 kWh per month will see a monthly bill decrease of $26.11.**

- **The OEB also approved changes based on the continued implementation of its new Distribution Rate Design for Residential Electricity Consumers (moving towards fully fixed distribution rates for these customers).**

2017-18 Transmission Rate Application

- **On May 31, 2016, Hydro One filed an application with the Ontario Energy Board requesting its transmission revenue requirement for the two-year period 2017-18. As a result of the request, Hydro One estimates transmission rates will increase 4.6% in 2017 and 5.2% in 2018.**
  - **If approved as filed, Hydro One estimates that these increases would result in a typical Hydro One R1 (medium density) residential customer using 750 kWh per month seeing a total bill increase of about 0.2% in 2017 and 0.3% in**

2018.

- **These rates enable Hydro One to maintain a reliable, cost effective transmission system and make investments to renew aging infrastructure and address longer-term transmission system needs.**

- **The application is currently under review at the Ontario Energy Board (OEB). The OEB has a thorough and transparent process to assess cost-of-service applications, such as Hydro One's Transmission Application. The OEB process allows for interested parties, such as groups representing consumers and industry, to participate. The OEB is the independent regulator of electricity and natural gas utilities in Ontario, with a mandate to protect the interests of consumers, among other things.**

Distribution System Code (DSC) Exemption Application

- **On May 6, 2015, Hydro One applied to the Ontario Energy Board (OEB) for an exemption from certain sections of the Distribution System Code (DSC) that deals with estimated billing and billing accuracy.**

- **The OEB issued its decision on September 24, 2015 in favour of the application.**

- **Hydro One will be exempt from the requirement to provide monthly bills based on actual reads 98% of the time to certain hard-to-reach customers.**

- **The exemption is effective April 15, 2015 until December 31, 2019.**

- **The exemption applies to approximately 170,000 hard-to-reach customers located in remote and sparsely populated areas with no existing commercial cellular network or a low level of communication reliability.**

- **Hydro One was granted a similar exemption for these same hard-to-reach customers relating to the mandated Time-of-Use (TOU) pricing date.**

5. SUGGESTED RESPONSE ON FIRST NATION AGREEMENT-IN-PRINCIPLE FOR SALE OF HYDRO ONE SHARES:

- **On July 12, 2016, the Province and First Nations in Ontario announced an agreement-in-principle for the Province to sell to First Nations for their collective benefit, shares of Hydro One Limited.**

- **The Province would sell up to approximately 15 million shares (2.5 per cent of total current outstanding Hydro One common shares), depending on the level of First Nation participation, to a new collective investment vehicle owned by First Nations. The Province will continue to own over 67% of the shares of Hydro One after the sale.**

- **The First Nations investment vehicle would purchase the shares with a 25-year loan provided by Ontario. The interest rate for the loan would be the Province's relevant borrowing rate, plus 15 basis points.**

- **The purchase would be at $18 per share, which is above the Province's book value for the shares.**

- **This would be a 25-year deal that can provide meaningful opportunities to First Nations for collective wealth creation and reduce barriers to accessing capital so that First Nations can advance their economic development initiatives. In addition to the benefit of investing collectively in Hydro One, the Province would also provide seed capital of up to $45 million in cash to the First Nation investment vehicle, depending on the level of First Nation participation.**

- **A minimum approval threshold of at least 80% of First Nation participation must be achieved by the end of 2017.**

- **I am pleased that the negotiating teams for the Chiefs Committee on Energy and the Province haves reached a form of agreement for the Hydro One share transaction that they have recommended to their decision makers for approval, subject to First Nations settling their holding structure, which I understand may happen next spring.**

- **I understand the goal is to work towards closing the transaction by the end of 2017 and the Province is committed to supporting this objective.**

BACKGROUND:

1. BROADENING HYDRO ONE OWNERSHIP

General/Proceeds

- The government continues to hold approximately 70% of Hydro One and plans to continue with subsequent share sales in the future, ultimately selling down to approximately 40 per cent ownership.

- Net revenue gains from the Province's sale of Hydro One common shares will be dedicated to the Trillium Trust to help fund infrastructure projects that will create jobs and strengthen the economy. These net revenue gains will help fund priority projects such as GO Transit Regional Express Rail, Light Rail Transit projects in communities across Ontario through the Moving Ontario Forward initiative, and natural gas network expansion in rural and northern communities.

- On August 25, 2016, the Ministry of Finance announced that Ontario has dedicated $3.2 billion from the sale of Hydro One shares to the Trillium Trust. The $3.2 billion reflects the net revenue gains in connection with broadening Hydro One ownership in 2015.

- The $3.2 billion credit to the Trillium Trust comes from:

    - About $0.8 billion in gains on sale from the sale of Hydro One shares in November 2015

    - The net benefit to the Province of about $2.4 billion from Hydro One's recognition of the deferred tax benefit.

- Ontario is making the largest investment in public infrastructure in the province's history -- about $160 billion over 12 years, which is supporting 110,000 jobs every year across the province, with projects such as roads, bridges, transit systems, schools and hospitals. In 2015, the Province announced support for more than 325 projects that will keep people and goods moving, connect communities and improve quality of life.

IPO

- The Initial Public Offering (IPO) closed in November 2015, at which point Hydro One common shares began trading on the Toronto Stock Exchange under the symbol "H"
    - 89,250,000 shares, or 15% of Hydro One, was offered at a share price of $20.50, for total gross proceeds of approximately $1.83 billion, including the over-allotment option
    - The Province also sold, by way of private placements, an additional aggregate amount of approximately 0.9% of Hydro One shares to separate trusts established by the Power Workers Union (PWU) and the Society of Energy Professionals (Society)

- Scotiabank and RBC Capital Markets were selected to act as the active bookrunners for the IPO

- The fees for underwriters were 1 per cent for institutional investors and 3 per cent for retail investors, significantly lower than industry norms

<u>April 2016 Secondary</u>

- In April 2016 the Province completed a secondary offering of Hydro One shares, raising approximately $2 billion in gross proceeds.

    - On April 5, the Province sold 72,434,800 common shares at $23.65 per share, generating $1.7 billion in gross proceeds.
    - The Province granted an over-allotment option to the underwriters to purchase up to an additional 10,865,200 common shares. The underwriters elected to exercise this over-allotment option in full.

- Approximately 53 per cent of the offered Hydro One common shares were sold to retail investors, reflecting a strong demand by individual retail investors across the province.

- The offering price was $23.65 per share, representing a 2.1 per cent discount to the market closing price on the day of launch. This is lower than the typical discount provided on a firm commitment offering.

- The underwriters agreed to buy the offered shares at a fixed price in advance of conducting any marketing, with a firm commitment offering. This type of transaction transfers market risk to the underwriters from the selling shareholder. As a result, underwriters in a firm commitment offering negotiate an offering price at a discount to the prevailing market price, where the underwriters judge investor demand will be sufficient to place the offering.

- Underwriting fees earned by underwriters for the secondary offering are 1 per cent for sales to institutional investors and 3 per cent for sales to retail investors, subject to a maximum of 2 percent. This is significantly lower than what underwriters have typically earned on firm commitment offerings.

2. HYDRO ONE GOVERNANCE & OVERSIGHT

Legislative Requirements Around Ownership Level

- The government has put in place protections that enable the Ontario government to remain the largest shareholder after the IPO and, by law, no other shareholder or group of shareholders acting jointly is allowed to hold more than 10 per cent of the voting shares.

- The Province is also prohibited by law from diluting its ownership below 40 per cent of the voting securities of the company. If the Province's ownership drops below 40 per cent, the Minister is required by law to take steps to acquire additional voting shares to restore 40 percent, subject to necessary government approvals.

Appointing of the new Chair, Board & CEO

- David Denison took over as Chair of Hydro One effective April 16, 2015 to lead the company through the IPO process. Mr. Denison has extensive experience leading major companies in Canada and elsewhere. He served as President and CEO of the Canada Pension Plan Investment Board from 2005 to 2012.

- On July 17, 2015 the Province appointed a new board of directors for Hydro One Inc., to oversee the company as it prepared to become publicly traded, with a renewed focus on customer service excellence and improved performance and reliability.

- Mayo Schmidt took over as President and CEO from Carmine Marcello effective September 3, 2015. Mr. Marcello remained as an advisor to both Mr. Schmidt and Mr. Denison to provide support in the transition.

- The Hydro One Board of Directors includes:

- David Denison (returning Director and Chair), former President and CEO of the Canada Pension Plan Investment Board
- Ian Bourne, Chair of Ballard Power Systems Inc.
- Charles Brindamour, CEO of Intact Financial Corporation
- Marc Caira, Vice Chairman of the Board of Directors of Restaurant Brands International Inc.
- Christie Clark, former CEO and Senior Partner of PricewaterhouseCoopers LLP
- George Cooke, (returning Director), Chair of the Board of Directors of the OMERS Administration Corporation
- M. Marianne Harris, former Managing Director at Bank of America Merrill Lynch Canada
- James Hinds, former Chair of the Independent Electricity System Operator (IESO) Board
- Kathryn Jackson, Senior Vice President and Chief Technology Officer of RTI International Metals, Inc.
- Roberta Jamieson, President and CEO of Indspire, former Board Member of Ontario Power Generation, and former Ombudsman of Ontario
- Frances Lankin, a member of the Board of Directors with the Ontario Lottery and Gaming Corporation; former President and CEO of United Way Toronto; and former member of the Premier 's Advisory Council on Government Assets
- Mayo Schmidt, President and CEO of Hydro One Inc.; former CEO, President, Board Member of Viterra Inc.
- Philip Orsino, former President and CEO of JELD-WEN Inc.
- Jane Peverett, former President and CEO of British Columbia Transmission Corporation
- Gale Rubenstein, (returning Director), Partner at the law firm Goodmans LLP

Ontario Energy Board Enhancements

- On December 1, 2015, Ontario passed *Bill 112 - Strengthening Consumer Protection and Electricity System Oversight Act, 2015*, to further protect Ontario's energy consumers and strengthen the role of the Ontario Energy Board (OEB). Amendments to the Ontario Energy Board Act, 1998 (OEBA), included as part of Bill 112, were proclaimed into force on March 4, 2016.

- The amendments to the OEBA included measures to:
  - Reinforce the OEB's ability to ensure reliability and continuity of service to all customers in Ontario in the event of a failing transmitter or distributor;
  - Enhance the OEB's ability to levy penalties for non-compliant activities by:
    - Increasing the cap on the amount of administrative penalties that the OEB may impose on a non-compliant entity (up to $1,000,000 per day).
    - Empowering and provide flexibility to the OEB in determining an administrative penalty equal to the amount the entity gained as a result of the non-compliant behaviour.
    - Removing the penalty matrix prescribed in regulation to provide flexibility to OEB to enforce penalties for non-compliant behaviour.
    - Increasing the maximum amount of fines (up to $2 million) that a court may impose on entities convicted of an offence under the OEBA.
  - Strengthen the OEB's oversight of utility transactions and structures;
  - Clarify relationships among local distribution companies and their affiliates; and
  - Provide tools to Cabinet to ensure that critical transmission infrastructure is built.

- *For more information, please see the E02- Energy Consumer Protection Housebook note.*

OBCA and Canadian Securities Law Requirements

- As an OBCA company subject to Canadian Securities law, Hydro One continues to comply with rigorous governance requirements that include:

- Disclosure of board-approved annual financial statements with management discussions and Analysis (MD&A), along with quarterly updates;
- CEO and CFO Certifications and Associated Controls certifying the quality and reliability in the annual and quarterly materials;

- Shareholders' meetings requirements and rules;

- Annual Information Form providing material information about the company and its business in the context of its historical and future development. It describes the company and its operations, prospects, risks and other factors that impact its business.

- Disclosure requirements with respect to management circulars (including information about senior management, such as share ownership, any indebtedness to the company and any interest in material transactions) as well as compensation circulars (executive compensation disclosures including shares awarded, perks and incentives); and

- Event-driven disclosure requirements to issue material change reports.

***Securities Act* (Ontario) Requirements**

- Hydro One is a reporting issuer of debt securities in Ontario and is subject to the continuous disclosure standards and requirements of the *Securities Act* (Ontario). It is required to make information about its financial, management and compensation available to the public.

- The Ontario Securities Commission conduct ongoing reviews of the disclosure documents.

Hydro One Ombudsman

- The province has required by law that Hydro One create a dedicated Ombudsman, similar to those found at other public companies to address and resolve complaints from its customers and affected groups. Hydro One has appointed Fiona Crean as the Ombudsman of Hydro One.

- The Office of the Ombudsman is now operative.

OEB Rate Filing Process

- The OEB's objects are set out by the *Ontario Energy Board Act, 1998* (OEBA).

- One of the OEB's objects is to protect the interests of consumers with respect to prices and the reliability and quality of electricity and natural gas service across Ontario.

- It fulfils this mandate by, among other things, reviewing and approving the rates charged by local distribution companies (LDCs). LDCs, including Hydro One, must submit a rate application to the OEB in order to change any approved distribution rate, or apply for a new rate. The OEB must also approve any changes to transmission revenue requirement and sets uniform transmission rates for the province. In reviewing costs and setting rates, the OEB uses an open and transparent process that allows the public and interveners to review and provide input to the rate approval process.

3. <u>HYDRO ONE FINANCIAL RESULTS</u>

- On November 11, 2016, Hydro One Ltd. (TSX:H) announced its financial and operating results for the second quarter ended September 30, 2016

		Three months ended September 30, 2016			
Key Metrics		**2016**	**2015**	**$∆**	**%∆**
Revenues	M	1,706	1,645	61	3.71%
OM&A	M	264	274	-10	-3.65%
EBIT	M	381	326	55	16.87%
Tax	M	44	36	8	22.22%
Net Income (Common)	M	233	188	45	23.94%
Adjusted EPS	$	0.39	0.32	0.07	21.88%
Capital Investment	M	424	438	-14	-3.20%
Tx Monthly 60 Min Peak Demand	MW	22,991	22,321	670	3.00%
Dx Units Distributed	TWh	6.6	7.1	-0.5	-7.04%

Key Financial & Operating Highlights

- Q3 adjusted EPS was $0.39 up from Q3 2015 ($0.32) and exceeded analyst consensus of $0.31 (range $0.28-$0.34)

- New senior executives installed to lead Customer Service, Operations, Legal, and Strategy functions

- Agreement reached to acquire Orillia Power Distribution in August

- Acquisition of Great Lakes Power Transmission completed in October following OEB approval

- Declared a quarterly dividend of $0.21 per share payable on December 30

- The OEB issued updated cost of capital parameters for rates effective in 2017, including updated 2017 ROE of 8.78%, 41 basis points higher than 2016 at 9.19%

- Capital investments of $424 million towards Ontario's electricity transmission and distribution systems

- Successfully completed the integration of Haldimand Hydro and Woodstock Hydro, including employees, operations and customers

4. HYDRO ONE'S RATES

2015-2019 Custom Cost of Service (CCOS) Distribution Application:

Summary of OEB Decision

The OEB denied Hydro One's request for five year rate setting (2015-2019), approving a framework to set rates for only a three year period (2015-2017). The implementation date for the decision was May 1, 2015. Rates for 2016 and 2017 will be set when certain update parameters, such as cost-of-capital parameters, become available.

  - The OEB found that Hydro One's "Custom Cost of Service" application was not sufficiently aligned with the objectives of the OEB's Renewed Regulatory Framework for Electricity (RRFE) and therefore did not approve the application as presented.

- The OEB decision will result in an increase in Hydro One's distribution revenues of about 19% between 2014 and 2017. This compares with Hydro One's request for a 29% increase over its proposed five year rate-setting period.

- The OEB reduced Hydro One's OM&A budget by 4%, 3.7% and 3.7%, respectively, for 2015, 2016 and 2017. In 2017, Hydro One will have an approved OM&A expense of $592.3M compared to $614.0M as applied for, representing a reduction of $22M.
  - The OEB has determined that Hydro One's capital spending plan is justified over the 2015-2017 period.
  - However, the OEB has not accepted Hydro One's proposal on OM&A, especially with respect to compensation, vegetation management, and CDM.

SUMMARY OF HYDRO ONE'S APPROVED OM&A BUDGET			
	2015 ($ million)	2016 ($ million)	2017 ($ million)
Requested OM&A	564.3	610.2	614.0
Less, compensation reduction	7.7	7.7	7.7
Less, vegetation management reduction	13.0	13.0	13.0
Less CDM reduction	1.0	1.0	1.0
OEB approved OM&A	542.6	588.5	592.3
Percentage reduction as a result of Decision	4.0%	3.7%	3.7%

- In its 2015 decision, the OEB determined that the seasonal customer class is no longer justified and directed Hydro One to prepare a plan by August 4, 2015 for the elimination of this rate class commencing January 1, 2016.

  - Subsequently on September 30, 2015, after reviewing the plan prepared by Hydro One, the OEB issued an order to Hydro One that it expects the Board's policy on moving residential customers to fully fixed rates over time would apply to Hydro One's Seasonal customers, starting in January 1, 2016.

    - The Order stated that in the OEB's view, such a change constitutes the initial steps in the execution of the OEB's direction to eliminate the Seasonal class by aligning rates for these customers' premises with a density-based rate structure applicable to other residential customers.

    - At the time, the OEB indicated it would initiate a further proceeding in the future to consider the remaining steps for the elimination of the seasonal class.

    - In November 2016, the OEB initiated a proceeding to implement the OEB Decision to eliminate the Hydro One Networks Inc Seasonal distribution rate class. In its Procedural Order, the OEB required Hydro One to file an updated report on the elimination of the seasonal class no later than December 1, 2016. It also required Hydro One to file a draft notice to inform seasonal customers of the upcoming proceeding and an estimate of how the elimination of the seasonal class would affect customers.

    - On December 1 2016, Hydro One filed an updated report on eliminating the seasonal rate with the OEB. This updates the original report, filed in August of 2015. The report indicates that the move to all-fixed rates alone addresses the key concern of some seasonal customers that low consumption customers are not paying their fair share of costs. The analysis also shows that from a customer's perspective, very little incremental benefit is gained by the elimination of the Seasonal Class and that the elimination of the Seasonal class combined with the move to all-fixed residential distribution rates results in only a small benefit to the 70,000 seasonal customers moving to the R1 class and a very large negative impact on the 84,000 seasonal customers that would move to the R2 class.

  - The report also detailed options for mitigating bill impacts associated with the elimination of the seasonal class, discusses and assesses options for billing and meter reading frequencies, identifies areas of Hydro One's Conditions of Service that require revision as a result of the elimination of the seasonal class, and identifies a number of significant implementation and ongoing administrative issues associated with eliminating the seasonal class, including the need for extensive customer information system (CIS) changes, annual monitoring of formerly seasonal customers' consumption and customer communication challenges, among others.

  - The updated report suggested that the elimination of the seasonal class represents a significant change to Hydro One's distribution rates structure that will impact the rates for all customer classes. As such, Hydro One is proposing that any changes related to eliminating the Seasonal Class should be coordinated to coincide with the next planned rebasing of distribution rates on January 1, 2018.

  - Hydro One informed the Board that it anticipates it will need 30 business days to develop and issue the notice, once it is finalized by the OEB. Hydro One informed the OEB that given the work required to implement distribution rate changes for 2017 and the 8% rebate, it is not in the position to develop notice until after the New Year.

  - The proceeding is currently underway.

- The OEB accepted the results of Hydro One's Rate Class Review and its underlying assumptions for the reclassification of some customers' rate classes to match their local population density.

- The OEB expects a rate impact mitigation plan to be implemented with respect to rate reclassification. The OEB directed Hydro One to apply rate mitigation to those customers who experience a total bill impact greater than 10% from all causes at a typical consumption level for every class.

- Hydro One proposed to move all customer classes (eg. residential, general service, industrial) to a revenue-to-cost ratio range of 98%-102% over the five year plan. The OEB directed Hydro One to move its ratios to 90%-110% over the three year period.

- Hydro One sought to smooth the rate impacts over its proposed 5 year plan, by way of rate riders, resulting in an annual average distribution rate increase of 6.3%. The OEB did not approve this rate smoothing plan, concluding that rate smoothing would only have a minor effect on rates over the approved three year period.

- Recognizing the unique challenges in implementing the Smart Meter program faced by Hydro One, the OEB approved the recovery of costs as submitted.

- The Ontario Energy Board, in deciding on compensation costs, decided not to adjust pension costs or pension accounting methodology, but is encouraging Hydro One to drive towards a 50/50 employee/employer pension contribution ratio.

2016 Custom IR Year 2 Update

- Hydro One applied to the OEB for 2016 distribution rates based on the framework approved for its 2015-2017 multi-year rate setting plan. In the 2015-2017 framework decision, the OEB approved distribution rates for 2015 and a framework for setting rates in 2016 and 2017, subject to specific annual adjustments.

    - The annual adjustments include: cost of capital updates, cost allocation model updates, revenue-to-cost ratio changes, certain rate rider and service rate updates.

    - In addition to the annual adjustments, Hydro One proposed changes to its 2016 rates to comply with new OEB policies: the Cost Allocation Policy for the Street Lighting Rate Class and the Distribution Rate Design for Residential Electricity Customers

        - In April 2015, the OEB released a new policy requiring electricity distributors, including Hydro One, to structure residential rates so that all the costs for distribution service are collected through a fixed monthly charge. The fixed monthly charge is to be fully implemented by 2019 with initial implementation starting in 2016.

        - Hydro One's Final Rate Order for 2016 rates was approved by the OEB on January 14, 2016. As part of the approval, the OEB accepted a modified rate design for the R1, R2 and Seasonal classes based on an eight year transition period to fully fixed monthly distribution charges (see section below on OEB Rate Redesign Initiative). The UR class has a five year fixed rates transition period.

- The overall impact of the Decision for Year 2 Updates is a reduction of the proposed 2016 revenue requirement from $1,473.8 million to $1,409.8 million.

- As a result of the rate order, a typical urban residential (UR) customer consuming 750 kWh per month will see a $0.13 increase in total bill (roughly 0.1%)
    - A typical medium density (R1) residential customer will see an increase of $1.05 in total bill (roughly 0.7%)
    - A typical low density (R2) residential customer will see an increase of $2.59 in total bill (roughly 1.4%)[1]

2017 Custom IR Year 3 Update

- The OEB has approved Hydro One's Rate Order for 2017 distribution rates, effective January 1, 2017, based on the framework approved for its 2015-2017 multi-year distribution rate setting plan, which was approved in March 2015. This is the final adjustment under the current multi-year arrangement.
    - To set 2017 distribution rates, the OEB approved annual updates to cost of capital, cost allocation, revenue-to-cost ratio changes, and certain rate rider and service rate updates.
    - In addition to the annual adjustments, Hydro One proposed changes to its 2017 rates to comply with new OEB policies: the Cost Allocation Policy for the Street Lighting Rate Class, the continued implementation of the new Distribution Rate Design for Residential Electricity Customers and the increase in the funding for the Rural and Remote Rate Assistance Program (RRRP).

- In setting Hydro One's 2017 distribution rates, the OEB approved an increased monthly Rural and Remote Rate Protection (RRRP) amount to offset the cost of delivery to Hydro One R2 residential customers. This monthly amount increases from $31.50 per month to $60.50 per month, effective January 1, 2017, a monthly increase of $29.00. This reflects

[1] Bill impacts using OEB typical customer of 750 kWh/m and RPP rates effective May 1, 2016.

the implementation of the Government's changes to O.Reg. 442/01 to provide rate relief to eligible low-density residential customers.

- As a result of the final rate order a typical medium density residential (R1) customer using 750 kWh per month will see a monthly bill decrease of $1.54;
  - a typical low density residential (R2) customer using 750 kWh per month will see a monthly bill decrease of $26.11;
  - a typical urban residential (UR) customer using 750 kWh per month will see a monthly decrease of $2.53;
  - a seasonal residential customer using 750 kWh per month will see a monthly decrease of $5.49.
  - All above impacts are resulting from distribution rates only, before tax.

- The OEB also approved changes based on the continued implementation of its new Distribution Rate Design for Residential Electricity Consumers (moving towards fully fixed distribution rates for these customers).

Transmission Rates:

- There are five rate regulated transmission companies that participate in the uniform transmission rate (UTR) pool, including Hydro One. Hydro One accounts for about 95% of the approved transmission revenue requirement in Ontario for 2016. Hydro One is currently before the OEB seeking approval of its 2017-18 transmission revenue requirement. As a result, the OEB has declared 2016 Uniform Transmission Rates (UTRs) interim for 2017, effective January 1, 2017.

- On October 13, 2016, the Ontario Energy Board granted approval of the acquisition by Hydro One Inc. of all issued and outstanding voting securities of Great Lakes Power Transmission Inc. (GLPT) The transaction closed on October 31, 2006. At the present time, Hydro One will continue to operate GLPT as a separate operating unit.

2017-18 Transmission Rate Application

- Hydro One is requesting OEB approval for Total Transmission Revenue Requirement of $1,619M for 2017 and $1,698M for 2018. The requested revenue requirements were developed by Hydro One using a cost-of-service methodology, similar to previous Hydro One revenue requirement applications. This reflects increases of 3.3% and 4.5% for 2017 and 2018, respectively

- Revenue Requirement for inclusion into rates (Rates Revenue Requirement) takes into account the removal of external revenues and other adjustments. The Rates Revenue Requirement requested is $1,517M and $1,596.6M for 2017 and 2018, respectively, reflecting increases of 2.5% in 2017 and 5.2% in 2018.

- Hydro One also takes into account the declining transmission load resulting from CDM and embedded generation. After taking this into account, Hydro One estimates the requested revenue requirement increases would result in transmission rate increases of 4.6% in 2017 and 5.2% in 2018.

- If approved, Hydro One estimates that these increases would result in a typical Hydro One R1 (medium density) residential customer using 750 kWh per month seeing a total bill increase of about 0.2% in 2017 and 0.3% in 2018.

- Hydro One states that the transmission component of the average total distribution bill is approximately 6.8%.

- Hydro One is also seeking approval to keep its Export Transmission Service ("ETS") rate at $1.85/MWh. This rate was approved in the last revenue requirement application. Ontario electricity consumers do not pay this rate.

Summary of Hydro One Tx Revenue Request 2017-2018
Revenue Requirement $M

	2016 Approved	2017 Proposed	2018 Proposed
Total Revenue Requirement	$1,567.6	$1,619.0	$1,692.2
% chg		*3.3%*	*4.5%*
$ chg		*$51.4*	*$73.2*
Rates Revenue Requirement	$1,480.5	$1,517.0	$1,596.6
% chg		*2.5%*	*5.2%*
$ chg		*$36.5*	*$79.6*
Load Impact		2.1%	0.0%
Tx Rate Increase		4.6%	5.2%
Typical R1 Residential Total Bill Impact		0.2%	0.3%

- The application is currently under review at the Ontario Energy Board (OEB). The OEB has a thorough and transparent process to assess cost-of-service applications, such as Hydro One's Transmission Application. The OEB process allows for interested parties, such as groups representing consumers and industry, to participate. The OEB is the independent regulator of electricity and natural gas utilities in Ontario, with a mandate to protect the interests of consumers, among other things.

Hydro One 2015-16 Transmission Rate Application:

- Hydro One initiated settlement discussions with intervenors in the summer of 2014, resulting in a complete settlement on all issues that was filed with the Board. The Board approved the settlement on December 2, 2014.

- Based on the settlement agreement, Hydro One's revenue requirement is as follows:

	Revenue Requirement Amount ($M)	% change
2013 Approved	$1,391	0.4%
Revised 2014 Approved[1]	$1,446	4.0%
2015 Approved[2]	$1,518	5.0%
2016 Approved[3]	$1,480	-2.5%

[1] The 2014 revenue requirement and the associated impacts were revised based on the Board's Cost of Capital update for 2014, which occurred in late 2013.
[2] This is inclusive of $40.6M allocated to B2M LP on an interim basis.
3 Excludes $32.97M approved revenue requirement for B2M LP.

Uniform Transmission Rates*				
		2015	2016	% change
Network	$/kW/Month	$3.78	$3.66	-3.2%
Line Connection	$/kW/Month	$0.86	$0.87	1.2%
Transformation	$/kW/Month	$2.00	$2.02	1.0%

*Transmission rates are pooled across all customers in Ontario through a mechanism known as the Uniform Transmission Rates (UTRs). This mechanism allows transmitters to charge the same rates for their service, while recovering their individually approved revenue requirements through proportional allocation of revenues.

5. FIRST NATIONS AGREEMENT-IN-PRINCIPLE FOR SALE OF HYDRO ONE SHARES

- The Chiefs of Ontario (COO) wrote to Minister Chiarelli on July 13, 2015 advising that First Nations recognize the partial sale of Hydro One as a "significant opportunity…to move past historic grievances and to…share resources and the benefits of the lands."
    - COO stated an expectation to own 10% of Hydro One and to work with the Minister and the Ministry to ensure that ownership of shares is transferred outside of the Initial Public Offering (IPO)

- Financial terms include:
  - Share price: $18 per share
  - Loan terms consistent with the union arrangement, except:
    i. Term: 25 years (versus 15 years under union arrangement)
    ii. Repayment: Interest and mandatory principal payments before maturity to be made only to the extent dividends are paid on the shares. Mandatory principal payments before maturity only if the value of the shares is or falls below an agreed margin of 150% on the outstanding value of the loan (versus 200% under union arrangement)
    iii. Release of Shares: Shares may be released for use by COO as long as an agreed margin of 150% is maintained (versus 200% under union arrangement)
  - Cash contribution of $45M (assuming 100% First Nations participation, reduced to $30M and prorated if less than 100% participation), which the Ministry of Energy will build into its future budgets
  - Cash contribution is offset by increasing the price of share sold from $16 (the floor of the TB/MBC mandate) to $18

- Non-Financial Terms include:
  - **Participation Thresholds and Incentives:** If all 133 First Nations do not approve the transaction within 2 years from the date of the definitive agreements (unless the only First Nation that has not approved by that time is the one that has been identified to the Province), then the Cash Contribution is stepped down by $15M and the shares and remaining cash are pro-rated to reflect actual participation
  - Minimum 80% threshold (by number and equity) required by December 31, 2017
  - **Release and Indemnification:** Each participating First Nation shall provide a binding certificate enforceable by the Province confirming that the First Nation shall not (i) initiate any court proceedings or take any other action seeking to prevent or interfere with any sales of common shares of Hydro One by the Province (not limited to 60% of Hydro One shares), (ii) seek damages relating to the IPO or any sales of Hydro One shares, or (iii) seek damages relating to the First Nations' fund vehicle
    i. Purchaser and the investment fund to provide an indemnity for any losses suffered by the Province as a result of First Nation claims relating to the foregoing, with recourse under the indemnity to the Purchaser's assets, including the pledged shares, and investment fund (the claim against the investment fund is unsecured)
  - **Voting Rights:** Agree to allow Purchaser to vote the pledged and released shares
  - **Reps and Warranties on Hydro One**: No representations regarding Hydro One (from Hydro One or Province)
  - **Due Diligence:** Allow COO to conduct diligence after announcement and before signing definitive agreements, provided advisors and Chiefs Committee on Energy enter into a confidentiality agreement with Hydro One that prevents disclosure beyond that group
  - **Outside Date**: Close by December 2017
  - **Standstill:** No First Nation may dispose of or monetize its interest for 5 years after closing
  - **Autonomy:** Purchaser will have full autonomy over its investments, without any requirements to report back to the Province on how funds are disbursed