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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"),[1] 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 leading the negotiation of 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.

- OPG provided the OFA with a draft of a proposed term sheet dated May 12, 2017 (the "May Term Sheet"). The May Term Sheet included a number of features that were unacceptable to Ontario, including, most notably, a performance guarantee covering obligations of the Independent Electricity System Operator (the "IESO") and a liquidity guarantee that would be triggered in the case of financial market disruption.

- In a meeting on July 12, 2017, the OFA communicated Ontario's concerns about the May Term Sheet and indicated that the province would be willing to provide financial assurance to prospective investors in respect of only two kinds of risk:

    - the possibility of future legislative by the government of Ontario compromising the economic rights of investors; and

[1] S.O. 2017, c. 16, Sched. 1.

- the possibility that the Fair Hydro Plan is ultimately found to be invalid from a constitutional perspective by a court of competent jurisdiction.

- The OFA accepted that it was fair and reasonable for the province to provide a guarantee in respect of these two risks because they would be a consequence of the government`s past and future policy decisions. However, the OFA indicated that investors would need to assume the risk associated with other aspects of the Fair Hydro Plan and the risk of future market disruption.

C. Current Status

- The OPG took Ontario's position back to the investment dealers and worked with them to develop a revised term sheet that better reflected this more limited form of provincial guarantee (the "August Term Sheet").

- Ontario's external counsel (Blake, Cassels & Graydon LLP ("Blakes")) provided a mark-up of the August Term Sheet identifying a number of continuing concerns arising out of the draft provisions and to propose further amendments intended to address those concerns.

- On August 22, 2017, counsel from the Ministry of Energy, the Ministry of Finance ("MOF-LSB") and Blakes met with representatives from the OFA to discuss a number the issues identified by Blakes, as well as a number of further concerns identified by counsel in MOF-LSB.

D. Analysis

Purpose of Term Sheet

- As a preliminary matter, it is important to recognize that the purpose of the proposed Term Sheet is not to create enforceable rights or obligations. Section 5(3) of the Act makes it clear that any guarantee provided by the province must be agreed to by the Minister of Energy and the Minister of Finance (acting together) as authorized by order of the Lieutenant Governor in Council (the "LGIC"). The LGIC has not yet made an OIC authorizing the responsible Ministers to enter into any guarantee and therefore the Ministers do not yet have any legal authority to do so.

- Against this backdrop, it is clear that the purpose of the Term Sheet is to outline, in a general way, a high level understanding of the type of financial assurance that the province might be willing to provide to prospective investors in appropriate circumstances. The actual terms and conditions of any future assurance agreement entered into by Ontario will need to be fully negotiated in the context of a specific transaction and would necessarily be subject to LGIC and Ministerial approval.

Continuing Legal Concerns

- Attached to this briefing note as **Appendix "A"** is a revised draft of the August Term Sheet reflecting the consolidated legal comments of Blakes, MOF-LSB and ENE-LSB. The revisions are broadly intended to address the following concerns:

  - **Title** – Blakes is of the view that the proposed provincial assurance agreement is more accurately characterized as an indemnity arrangement, than a guarantee. There are highly technical reasons underlying this position and we note that OPG's external counsel (Torys LLP) does not agree with this concern. Rather than engaging in this debate, we have simply re-titled the proposed agreement as a "Change of Law Assumption Agreement," which more specifically reflects the substantive nature of the assurances that the province intends to provide.

  - **Preamble** – We have added a provision to the preamble to more explicitly confirm that the arrangements contemplated in the Term Sheet are subject to further government approvals and that the document is not intended to create any legally binding obligations.

  - **Beneficiaries** – Torys has indicated that the provincial guarantee must be given directly in favour of the Indenture Trustee, rather than the Financing Entity. The purpose of this change is to ensure that bondholders would have a direct remedy against Ontario. We have revised the draft Term Sheet to reflect this intention on the basis that it would not materially increase the scope of Ontario's legal or financial liability under the guarantee. However, we note that one consequence of this change is that Ontario would be considered a separate issuer for U.S. securities law purposes.

  - **Specified Claims** – The August Term Sheet purported to extend to all of the "rights and interests of the Financing Entity", including, but not limited to, the right to receive the payments contemplated under the Fair Hydro Plan. The OFA has previously indicated to OPG that the province is only willing to be responsible for the payment of *principal* and *interest* on Senior Debt Obligations. This would exclude other costs and fees incurred by the Financing Entity related to the Fair Hydro program such as payments to service providers (*e.g.*, law firms, accountants) and other types of claims that might be advanced by Beneficiaries in connection with the proposed guarantee. Limiting the province's liability to "senior" debt holders excludes OPG (who is a subordinated debt holder) on the basis that the province has already funded OPG's contribution by way of a liquidity injection. We have revised the Term Sheet to reflect these more limited concepts (primarily by way of a new definition of "Specified Claims").

- **Materiality Threshold** – The August Term Sheet included a series of "Guarantee Activation Events" that would trigger Ontario's obligations under the provincial assurance agreement. Although the enumerated list of events substantially reflected the limited form of guarantee proposed by the OFA, the August Term Sheet removed the "materiality" threshold for guaranteed claims. The intent of this change is to make the province liable in any case where the obligations of bondholders are not paid in full. However, this strict form of guarantee would expose the province to any unreasonable degree of risk. Beneficiaries 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). For this reason, we have reintroduced the concept of "materiality" in the list of Guarantee Activation Events (now described as "Assumption Events").

- **Right of Subrogation** – We have added a provision to the Term Sheet making it clear that Ontario will be subrogated to the rights of Beneficiaries who receive payments under the guarantee. This ensures that the province will be entitled to pursue any civil remedies against third parties that may have been available to the Beneficiary in respect of such amounts.

- **"Assumption" of Obligations** – The provisions of the August Term Sheet stated that, upon the occurrence of a Guarantee Activation Event, Ontario "assume and pay" all of the obligations of the Financing Entity. This language seems to intend that the province would directly assume all of the Financing Entities obligations to the Indenture Trustee and bondholders. The OFA has previously indicated that Ontario is only willing to commit to pay the principal and interest obligations of the Financing Entity as they come due, and not to replace the Financing Entity and become directly liable for all its obligations (except at its own option as discussed below). We have revised the Term Sheet to reflect this more limited commitment.

- **Optional Replacement** – We have added to the Term Sheet an optional right on the part of the province to assume all of the rights and liabilities of the Financing Entity, without the need for any further consent or approval of the Indenture Trustee. This would provide Ontario with greater flexibility in determining how to deal with any claims arising under the guarantee, without imposing this more onerous obligation on the province.

- **Approval Requirements** – We have revised the approval requirement section of the Term Sheet to modestly strengthen Ontario's rights associated with the process for approving future transactions that will be covered by the provincial assurance agreement.

- **Warehousing/Commingling Risks** – The August Term Sheet included a series of provisions dealing with ongoing business concerns associated with debt warehousing risks and LDC credit rating commingling. As far as we are aware, the arrangements contemplated in these sections have not been agreed to by Ontario and it is not helpful to link them in this way to the ongoing negotiations around the proposed guarantee. For this reason, we have deleted them from the Term Sheet.

E. Recommendations and Next Steps

- MOF-LSB will be arranging a meeting with the OFA as early as practicable next week to discuss the communication of these comments and the revised draft Term Sheet to OPG.

Date: August 31, 2017

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APPENDIX "A"

<u>Change of Law Assumption Agreement</u>

<u>Indicative Term Sheet</u>

<u>Ontario Fair Hydro Plan Act, 2017</u>

*This indicative term sheet (the "**Term Sheet**") relates to transactions contemplated to be undertaken under the Ontario Fair Hydro Plan Act, 2017 (the "**Act**") and the regulations made thereunder (the "**Regulation**"). This Term Sheet is to be held confidential. Unless otherwise specified, defined terms used herein have the meanings ascribed to them in the Act. The provincial protection and assurance arrangements contemplated in this Term Sheet will include such terms and conditions as the Minister of Energy and the Minister of Finance determine to be appropriate. This Term Sheet is not intended to create any obligations or be binding on the parties.*

Change of Law Assumption Agreement:	A Change of Law Assumption Agreement will be among the Obligor, a Financing Entity and an Indenture Trustee, acting for and on behalf of the Beneficiaries in accordance with a Trust Indenture.
Obligor:	The Province of Ontario, by the Minister of Energy and the Minister of Finance acting together.
Indenture Trustee:	An indenture trustee, acting for itself and on behalf of other persons entitled under an applicable Trust Indenture.
Beneficiaries:	The Indenture Trustee, acting for itself and on behalf of other persons entitled under Specified Claims.
Specified Claims:	Payment obligations of the Financing Entity that are secured under the Trust Indenture and that are approved as contemplated below under Obligor Approval. Specified Claims are expected to include principal and interest on senior debt obligations issued by the Financing Entity [and any other monetary obligations of the Financing Entity that rank ahead of or equally in priority of payment with the senior debt obligations of the Financing Entity pursuant to the Trust Indenture].
Assumption Events:	Any of the following would constitute an Assumption Event: (A) (1) the Legislature repeals (and does not replace on an equivalent basis) or amends the Act or any portion thereof; (2) the Legislature enacts or amends any other statute;

	(3) the Lieutenant Governor in Council repeals (and does not replace on an equivalent basis) the General Regulation made under the Act or any portion thereof; or (4) the Lieutenant Governor in Council, a minister of the Crown, an official of the government or a board or commission all the members of which are appointed by the Lieutenant Governor in Council makes or amends any "regulation" (as defined in Part III of the *Legislation Act, 2006*), in each case, that materially and adversely affects (a) the ability of the Financing Entity to receive amounts on its investment interest so that it can pay Specified Claims or (b) the Change of Law Assumption Agreement or any of the agreements under which Specified Claims arise without the agreement of the Indenture Trustee; or (B) a court of competent jurisdiction in a final and non-appealable judgement determines that all or a portion of the Act or the Regulation is *ultra vires* in a way that materially and adversely affects the ability of the Financing Entity to receive amounts on its investment interest so that it can pay Specified Claims.
Obligation to Assume Specified Claims:	Upon the occurrence of an Assumption Event, the Indenture Trustee will have the right to require the Obligor to pay the amount of Specified Claims on behalf of the Financing Entity when they become due and payable (without acceleration). The exercise of such right by the Indenture Trustee in accordance with the Trust Indenture shall constitute the only remedy available under the Change of Law Assumption Agreement. Under no circumstances shall the Obligor be obligated to pay or indemnify a Beneficiary for consequential, special or punitive damages, or for economic loss or loss of profits.
Subrogation:	Upon paying an amount to a Beneficiary in respect of a Specified Claim, the Obligor shall become entitled to all of the applicable Beneficiary's rights and interests under and in respect of the Specified Claim, including the security interest in each related investment interest and related property of the Financing Entity and the obligations of the Financing Entity owing under the agreements under which the Specified Claim arises. The Financing Entity may not change or consent to any change in such rights and interests without the Obligor's prior written consent.

Optional Replacement:	At any time following the exercise by the Indenture Trustee of its right to require the Obligor to pay Specified Claims when due and payable, the Obligor shall be entitled (but not obligated) to replace the Financing Entity as obligor and debtor and directly assume all of the Financing Entity's outstanding obligations and liabilities. The Financing Entity (including through the Financial Services Manager) will ensure that any obligation and liabilities undertaken or assumed by it will by their terms permit such a replacement and assumption (or, if applicable, satisfaction and termination) by the Obligor without additional cost or penalty and without any requirement for further consent, approval or agreement.
Term:	The Change of Law Assumption Agreement will continue for as long as any Specified Claim remains outstanding.
Obligor Approval:	The Change of Law Assumption Agreement will become effective in respect of a Specified Claim (including any modification) only after the Obligor has confirmed in writing that the Change of Law Assumption Agreement applies to such Specified Claim. The Change of Law Assumption Agreement will annex the applicable forms of program and series documents under which obligations of the Financing Entity may arise (e.g., including the form of trust indenture and series supplemental indenture) and set out the terms and conditions and process for obtaining the Obligor's approval and confirmation that the Change of Law Assumption Agreement will apply to Specified Claims. Such approval may be made conditional on such matters as may be specified by the Obligor, including a maximum amount applicable to Specified Claims. The Province's approval of the form of any IESO/Financing Entity transfer agreement and any amendments will also be required.
FIPPA:	The Change of Law Assumption Agreement will acknowledge that the Obligor will be bound by the *Freedom of Information and Protection of Privacy Act* (Ontario) and that any information provided to the Obligor, or any agent or representative of the Obligor in connection with the Change of Law Assumption Agreement, may be subject to disclosure in accordance with the act or as otherwise required by law.
Representations and Warranties:	To be determined by the Minister of Finance and Minister of Energy in negotiation with the Financing Entity.

Confidentiality Obligations:	To be determined based on what would be customary and appropriate for similar types of arrangements and is acceptable to the Obligor and the Financing Entity.
Governing Law:	Province of Ontario.