DRAFT: Confidential and Commercially Sensitive Advice to the Minister

MINISTER OF ENERGY REQUEST FOR SECTION 28 APPROVAL FOR INDEMNITY AGREEMENTS IN FAVOUR OF OPG AND IESO FOR THEIR PARTICIPATION UNDER THE ONTARIO FAIR HYDRO PLAN ACT

ISSUE

The Minister of Energy is requesting approval from the Minister of Finance, pursuant to Section 28 of the *Financial Administration Act ("*FAA"*)* to enter into Indemnity Agreements ("Agreements"), on behalf of the Crown, in favour of Ontario Power Generation ("OPG"),and its subsidiaries and the Independent Electricity System Operator ("IESO") with respect to their respective roles in carrying out the implementation of the Ontario Fair Hydro Plan ("OFHP") under the *Ontario Fair Hydro Plan Act, 2017* (the "OFHP Act"). The indemnities would extend to the directors, officers and employees of these entities as well as the agents of the IESO.

Section 28 of the FAA requires that all ministries and public entities request the prior written approval of the Minister of Finance or the President of the Treasury Board for any transaction or commitment that would directly or indirectly increase the indebtedness or contingent liabilities of Ontario.

- The Minister of Energy would sign an Indemnity Agreement in favour of OPG and in favour of IESO.
- The Ministry of Energy indicates both OPG and the IESO expect to carry out activities that fall outside the scope of their pre-OFHP typical business activities and corporate mandate. This creates the risk that such activities could be perceived as not being carried out in "good faith" or in the best interest of the corporation thereby exposing OPG and/or the IESO to increased liability (pre-existing statutory protections from liability only extend to "good faith acts").
- In addition, statutory protections do not indemnify for costs relating to defending a claim.

RECOMMENDATION

- IESO and OPG have stated that these indemnities are required for their participation in the implementation of the OFHP Act.
- In order for the OFHP Act to be successful, it is recommended by the Minister of Energy that the Minister of Finance approve this request.
- [The requirement for indemnities was referenced in the recent Cabinet Submission by Minister of Energy, dated ___________.]

WHAT IS THE MINISTER BEING ASKED TO SIGN?

- The Minister is being asked to sign the section 28 approval forms and the transmittal letter to Minister Thibeault.

FISCAL IMPACT

Commented [A1]: Would Energy think it fair to add this wording to its business case?

Commented [OPCD2]: For accounting purposes, doesn't OPG have to demonstrate that they are making the decision to participate at their own discretion? This clause would appear contradictory.

Commented [OPCD3]: See note above. Involvement by OPG was supposed to be based on a 'business case'

Commented [OPCD4]: These indemnities will not guarantee the success of the OFHP.

Commented [A5]: This is placeholder language. TBD/TBC

Commented [OPCD6]: Timing consideration are not noted in the briefing note. When does it have to be signed by? When does OPG anticipate borrowing?

- The fiscal impact of a future indemnity claim is unknown. Ministry of Energy ("MENE") states that the likelihood of this indemnity being called upon is low and that the fiscal exposure is unquantifiable at this time.
- An line item or an appropriation for the contingent liability is not required by the Ministry of Energy at this time. Disclosure on contingent liabilities would have to be reported in the Province's financial statements.
- An approval would be required for a voted appropriation for the Ministry of Energy to make payments if indemnity was called upon.
- MENE has confirmed in its [draft] request letter that it bears responsibility for funding, within its approved allocation, for payments associated with the indemnities provided under the Agreements.

Commented [A7]: Is this statement in the business case? P. 5 says "The risk to the Province of giving the indemnities is undeterminable at this time." Whereas the contingent liability table says it is low.
Can we have MENE to put this right up front. Need a bit of a narrative – what we [Energy] believe and why.

Commented [OPCD8]: Some reference to the amount likely being material with reference to components would be relevant to the decision maker…under what circumstances might the indemnity be called up, and what would have to be covered? All legal claims? Are there any limitations/scopes/timing considerations?

Commented [OPCD9]: Expenses and related fiscal impact would be reported on an 'accrual' basis (e.g. for a lawsuit with likelihood of success and reasonably estimable – would have to accrue.

Commented [BA10]: We need to make clear what this means. Is it meaningful to claim to be responsible for funding if amount is unknown? And bullets above note ministry would need an approval for an appropriation. (This could include no approval and instruction to manage).

SUMMARY OF PROPOSED INDEMNITIES

This summary of the OPG/IESO Indemnity Agreement sets out who is being indemnified, for what, and also addresses the proposed waiver of claims, whereby the Province agrees not to bring certain claims against the indemnified parties.

Who the Indemnity Applies to

- The indemnity is being given in favour of "Protected Persons" which comprises OPG, each of OPG's subsidiaries [NTD: We have not received confirmation of whether the financing entity is a subsidiary of OPG] and each of their respective directors, officers and employees.

- Protected Persons are being indemnified against all losses, costs, damages and other expenses for any amount for which they incur damages in relation to any civil, criminal, administrative, investigative and/or other claim, including a broad range of types of damages. This also includes punitive and a broad range of types of damages that are not always included in an indemnity, such as consequential damages and economic losses. The indemnity also covers costs and expenses for defending themselves. These indemnities are for any act or omission and activity that relates to the Fair Hydro Plan.

Commented [OPCD11]: If exercised in good faith? Has OPG and it's external auditors commented on potential risks of the request to the accounting treatment? Feedback should be in writing, and taken together with other terms and conditions that may impact an assessment of 'provincial' control.

What indemnities are being provided?

- The Indemnity Agreement provides that the Protected Person shall not benefit from the indemnity to the extent that the losses are already covered by an insurance policy or another indemnity.
- The indemnity also does not apply where the loss relates to the gross negligence or willful misconduct of the Protected Person. It is also explicitly carved out of this exception that a failure to conduct reasonable due diligence investigation will not in itself constitute gross negligence or willful misconduct, which narrows the exception in the context of disclosure and activities relating to issuing securities in public markets such that failing to conduct due diligence will not necessarily invalidate the Indemnity.

- The indemnity also applies where, in the case of a criminal or administrative proceeding, the Protected Person had a reasonable belief that their conduct was lawful.
- The Indemnity Agreement sets out how the Protected Person should notify the Province of any claims, and how any proceedings should be dealt with amongst the parties, as well as how any expenses and amounts should be paid during the determination of the claim.

The Indemnity Agreement includes a waiver of claim provision, which is not a normal provision for an indemnity agreement.

- This additionally provides that the Province will not make a claim against a Protected Person who is an individual (i.e., does not apply to OPG/IESO or subsidiaries) relating to any activities associated with the Fair Hydro Plan. This does not apply to claims for willful misconduct, dishonesty or gross negligence.

The Indemnity Agreement includes a warranty section given by the Province. In this section the Province Warrants that it has the authority and capacity, and has taken all necessary steps to enter into the Indemnity Agreement.

- This is an unusual provision, but likely relates to the fact that the Province is not the employer of the indemnified party, or the officers and directors are not the officers and directors of the Province.

ANALYSIS

Scope of liability from Indemnities

The IESO and OPG are asking the Province to agree to indemnify, defend and hold harmless the IESO (and its agents) and OPG (and its subsidiaries), as well as their respective directors, officers and employees, from all claims, liabilities, costs, losses, taxes, fines, penalties judgments (including indirect and consequential damages/loss of profits, economic loss/loss of opportunity) that might, directly or indirectly, be incurred by any of the indemnified entities and individuals in relation to any civil, criminal administrative investigative or other claims or proceedings arising directly or indirectly as a result of the entities or individual's activities, acts and/or omissions in the implementation of or otherwise relating to the OFHP (including where an individual is acting at the request of OPG or IESO in a different capacity than as a director, officer or employee of OPG or a subsidiary).

- The indemnity would also include coverage for the financing entity (SPV), created by OPG, (as a subsidiary of OPG) to facilitate the purchase of the deferred assets ("regulatory assets") under the Global Adjustment ("GA").

MENE states that the OFHP Act activities of both OPG and the IESO would otherwise fall outside the scope of their typical business activities and corporate mandates. According to MENE, this creates the risk that such activities could be perceived as not being carried out in "good faith" or in the best interest of the corporation, thereby exposing OPG and/or the IESO to increased liability.

Commented [OPCD12]: In the case of a market disruption, can the government guarantee that it will be able to indemnify, for what amounts and for how long?

Commented [A13]: s.28 notes usually talk about mitigation, as does the contingent liability table. Anything we can add here?

Commented [OPCD14]: What does this mean?

Commented [A15]: Has the scope of this indemnity been compared to the proposed Provincial guarantee related to the financing? Is there overlap or duplication?

Commented [A16R16]: Comments from MOF Legal:

Even if Board has indemnities from OPG, wouldn't be able to cover as is not in the best interest of corporation.

MOF Legal: up to Energy to tell us. OPG must have given Board members the normal indemnities.

Bruce Lease one covers the not in the best interest of corporation.

OBCA indemnity: immunity from suit. May indemnity corp. directors and officers. Limited to indemnity in good faith. Other specific provisions exist in EA and FHA.

IESO covers quite a bit. Including Board, directors, employees.

Commented [OPCD17]: These will be reported as intangible assets by OPG Trust. Should that terminology be used instead?

Commented [A18]: Fair to insert?

Commented [A19]: Would Energy change this to "historical" in its business case?

Commented [A20R20]: MOF Legal: OPG Board appears to be concerned some would say not in good faith despite objects being changed.

Commented [OPCD21]: Wherever IESO or OPG undertake activities outside of their mandate, have such indemnities been obtained?

Examples of specific risks to OPG include, without limitation,

- liability as a promoter under Canadian securities laws (or the equivalent, if any, under other applicable securities laws),
- secondary market liability under Canadian and/or other applicable securities laws,
- liability that the signatories to the prospectuses will have (i.e., the individuals signing the prospectus), and
- liability of OPG as the Financial Services Manager under any of the transaction agreements (e.g., the Financial Services Management Agreement, the Administration Agreement, the MSSA, the Master Trust Indenture and any Supplemental Indentures).

Examples of specific risks to the IESO include, without limitation, liability for its role in potential securities offerings of OPG's financing entity, which may come with heightened exposure to liability for the IESO, particularly for offerings into the U.S. market. It is not clear whether the statutory protections would apply federally or in the U.S. context. If they would not extend to a U.S. claim, for example, it would support the need for a separate indemnity for the IESO.

If the indemnities are not provided, ENE indicates that this could affect OPG and IESO's willingness to undertake such activities, jeopardizing the successful implementation of the OFHP Act. Both the IESO and OPG have specifically asked for these Indemnities in order to allow them to carry out their roles in implementing the OFHP Act.

Commented [A22]: Can we know this in advance, or is this only to be known if tested in the courts?

Commented [A23R23]: IESO is indirectly involved. Not clear EA 19(1) for IESO. Unclear whether it'd protect from US suit. OFA Board also raised. MOF Legal: this is a valid point.

Commented [OPCD24]: As written, or at all?

Commented [A25]: The business case is somewhat inconsistent on specifically citing directors, or being broader. Which is it?

Key Comments:

In providing the approval under Section 28 of the FAA, it is important to flag the following key items that arise from the Indemnity Agreements that the Minister of Energy is proposing to sign [subject to finalising drafting – TBC].

1. Acting in "Good Faith"

Without duplication of the coverage for liabilities that could arise for OPG and IESO, both are requesting to be indemnified for their activities that may be found to have not been conducted in "good faith" and/or in the best interests for their respective corporations.

Commented [OPCD26]: Should their MOUs be modified instead?

Since IESO and OPG are expected to carry out activities under the OFHP that fall outside the scope of their typical business activities and corporate mandate to date, management in IESO and OPG are of the view that this creates the risk that such activities could be perceived as not being carried out in "good faith" or in the best interest of the corporation thereby exposing OPG and/or the IESO and their directors, officers and employees to increased liability.

- The concern seems to be that carrying out activities to implement the OFHP Act, even if in some cases required by the Act would not be considered to be in the best interest of the respective corporation.

  - Is there a difference between acting in good faith in the best interests of the corporation versus acting in good faith in the exercise or performance of powers or duties under the Act?
- Statutory protections from liability only extend to "good faith acts as set out below for IESO directors, officers, employees and agents and for OPG employees".
  - Since OPG is falls under Ontario's *Business Corporations Act* (OBCA), directors and officers of OPG are subject to the standard set out in that Act which includes a limitation on indemnities from corporations, whereby indemnities can only be given to the extent that the directors and officers carried out their activities in good faith and in the best interest of the corporation. The proposed Provincial indemnity, however, would not be restricted to that standard.
  - The standard applicable to directors of IESO is set out in s. 12 of the *Electricity Act, 1988*, i.e., to act honestly and in good faith in the best interests of the IESO and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
  - So the standard is similar for both OPG and IESO directors.

Commented [OPCD27]: Good point.

Commented [A28]: There is no statutory protection for directors and officers of OPG. Most likely OPG has provided them with a typical indemnity consistent with OBCA provisions

Commented [OPCD29]: Does it only cover them during their terms, or does it carry once they leave for any past activities/transactions?

Both the *Electricity Act, 1998* and the *Ontario Fair Hydro Plan Act, 2017*, provide coverages for such liabilities as long as those activities are done in "good faith".

- Subsection 19(1) of the Electricity Act, 1998 already provides IESO directors, officers and employees with the following protection from liability:

> *"No action or other civil proceeding shall be commenced against a director, officer, employee or agent of the IESO or a member of a committee or panel established by the board of directors of the IESO for any act done in good faith in the exercise or performance or the intended exercise or performance of a power or duty under any Act, the regulations under any Act, the IESO's licence, the IESO's by-laws or the market rules, or for any neglect or default in the exercise or performance in good faith of such a power or duty."*

- Subsection 39(1) of the *Ontario Fair Hydro Plan Act, 2017* also provides similar protection from liability for OPG:

> *"No action or other civil proceeding shall be commenced against any employee of the Province or Ontario Power Generation Inc. for any act done in good faith in the exercise or performance or the intended exercise or performance of a power or duty under this Act, the regulations or for any alleged neglect or default in the exercise or performance in good faith of such a power or duty."*

Commented [BA30]: Does this mean
- employee of the Province or employee of OPG, or
- employee of the Province or OPG (i.e., the corporation itself)?

2. <u>Potential for Fiscal Exposure of the OFHP Act</u>

In addition to the potential fiscal impact due to a call on the indemnity, there may be a risk associated with the anticipated accounting treatment of the GA Financing portion of the OFHP. With the Province providing guarantee agreements, financial support through credit facilities and the proposed agreements to indemnify the IESO and OPG, the case for the anticipated accounting treatment of the GA structure could be weakened.

Commented [OPCD31]: Accounting related considerations should definitely be raised, but as discussed with John Kim,, it is OPG and it's auditors who need to provide an assessment of the accounting impacts of the proposed indemnity (fill scope), taken together with other potential risks associated with regulations, commercial agreement terms, etc. If the Trust is assessed as controlled for accounting purposes, then the fiscal impacts will be materially different.

Commented [A32]: Whether to include or not, or how to position it, we should see what OPG and E&Y say on the impact on the accounting opinion.

Commented [A33]: Need to get an update from OPCD on whether the proposed indemnities would have a significant impact on this analysis.

BACKGROUND

- On March 2, 2017, the government announced Ontario's Fair Hydro Plan (the "OFHP"), under which the government will take steps to lower electricity bills [on an after-tax basis] by 25 per cent on average for a typical residential customer, starting July 1, 2017, relative to what the bills would otherwise have been without the OFHP.
- Changes to refinance a portion of the Global Adjustment ("GA") are a component of the 25 per cent rate relief under the OFHP. This includes roles for both IESO and OPG:
  - IESO – legislation imposes certain obligations and requirements on IESO to carry out various activities to implement the OFHP such as the creation of a regulatory asset in relation to deferred costs and the GA financing component of the OFHP, the conveyance of that asset to a financing entity (expected to be established by OPG) and providing a servicing role in recovering the financing entity's funding costs from future ratepayers. IESO may also be required to play a role in potential securities offerings of OPG's financing entity. This may come with heightened exposure to liability for the IESO.
  - OPG – OPG is expected to finance the purchase of the regulatory asset, related to deferred costs, through a financing entity that OPG creates. OPG considers risks associated with these OFHP-related activities to be beyond OPG's usual business/operations. This is particularly true with respect to any securities offerings of OPG's financing entity. Products are expected to be offered into the Canadian and U.S. Markets. As a result, pre-existing indemnities and protections do not adequately protect OPG, its directors, officers and employees. Under the envisioned accounting treatment where OPG is assessed to control the SPV, the deferred asset would be reflected on the Trust's books as an intangible asset. The overall GA Smoothing part of the FHP would not have a negative impact on the Province's books. However, if the preponderance of evidence concludes that the trust is not controlled by OPG, but rather by the Province, then the anticipated fiscal impact will not result and the amount of any unrecovered GA payments to generators will immediately be reflected as an expense on the Province's books.
- The 25 per cent rate relief also includes the rebate amount equivalent to the 8 per cent Provincial portion of the HST that has been in effect since January 1, 2017 under the Ontario Rebate for Electricity Consumers Act, 2016, and the expected savings from the shifting of the Ontario Electricity Support Program ("OESP") and the Rural or Remote Rate Protection program ("RRRP") costs from ratepayers to being funded by the Province.
- The government introduced legislation, passed on May 31, 2017 and received Royal Ascent on June 1, 2017, to enable the implementation of the OFHP Act.

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