Ontario

Implementing the Premier's Advisory Council Recommendations Related to Hydro One

April 15th 2015

CONFIDENTIAL ADVICE TO CABINET

Minister

Deputy Minister

Commercial Sensitivity

- The following submission contains confidential and commercially sensitive information
- Dissemination of this submission could have significant commercial impacts to the Province
- Information in this submission may have impact on market expectations and / or assessment of value. Any communication on these matters should be restricted to publically available information or government guidelines on the topic

Purpose

- The Premier's Advisory Council on Government Assets has provided the government with its final recommendations regarding Hydro One
- The government has been working with the Council to develop a plan for the implementation of these recommendations, including:
  - Regular meetings with the Premier, Ed Clark, and Ministers Chiarelli, Matthews, Sousa, and Duguid
  - Regular meetings with staff from the Council, Energy, Finance and Treasury Board Secretariat
- The purpose of this submission is to seek Cabinet policy and legislative approval for the proposed Initial Public Offering (IPO) of Hydro One and proposed merger of Hydro One Brampton

Premier's Advisory Council Recommendations

- In April 2014, the Premier's Advisory Council on Government Assets was engaged to review options for maximizing the value of government assets, including Hydro One
- The Council divided its process into two phases: Phase 1 focused on initial assessments and recommendations, while Phase 2 focused on due diligence and implementation planning
- The Council presented the government with its initial report, *Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers*, in November 2014
  - The report included a recommendation to divest Hydro One's distribution business and retain its transmission business
- The Council's Phase 2 due diligence included undertaking an extensive market sounding, financial, legal, and accounting analysis. As a result, the Council concluded that:
  - Hydro One as an integrated entity is worth more than the sum of two split businesses
  - There would be costs to separating Hydro One's distribution and transmission businesses, and that the process of separation would take considerable time during a period where the market is particularly attractive
  - All distribution or transmission policy objectives can be achieved through regulatory oversight; ownership is not required to achieve good energy policy outcomes
  - The Province should proceed with a partial sale of its interest in Hydro One through an IPO, including the transmission business, so that the company would be widely held, predominantly by Canadians
  - There is a potential for accelerated Local Distribution Company (LDC) consolidation from merging Hydro One Brampton with other Greater Toronto and Hamilton Area (GTHA) LDCs to drive efficiencies and benefit ratepayers by increasing the capacity of LDCs to drive further consolidation

Premier's Advisory Council Recommendations (*cont'd*)

- The Council's specific recommendations include:
  - An IPO of approximately 15 percent of Hydro One targeted for fall 2015 / winter 2016 with the Province indicating its intention to retain its remaining shares after selling down to 40 percent of its initial number of shares in subsequent secondary offerings
  - A merger of Hydro One Brampton with Enersource, PowerStream, and Horizon in order to catalyze LDC consolidation for either shares in the new entity or cash
- In taking Hydro One public, the government would free up resources that could be invested in provincial priorities such as public transit and transportation infrastructure
  - The economic benefits of provincial infrastructure investments in public transit and transportation would enable the next generation of economic growth – investments that otherwise would not occur
  - Taking Hydro One public would turn it into a growth-oriented Canadian company and allow it to expand beyond its current role to become one of the largest Ontario-based publicly-owned companies, allowing it to expand its business opportunities and increase its returns to all Ontarians
- To further incent LDC consolidation, as was recommended in the 2012 Ontario Distribution Sector Review Panel report that identified a potential for $1.2B in savings over a 10-year period, the Council also recommends the following time-limited tax changes:
  - Reduce the current transfer tax rate for all LDCs from 33 percent to 22 percent
  - Exempt small LDCs with less than 30,000 customers from the transfer tax rules
  - Exempt LDCs from the capital gains portion of departure tax rules in the *Electricity Act, 1998*
- The Province, Hydro One management, and unions should reach an agreement on pensions and labour costs in advance of the Hydro One IPO

Overview: Hydro One Initial Public Offering (IPO)

- An IPO is the first sale in publicly-traded equity markets of shares from a company that is privately held. In the case of Hydro One, owned by the Province, an IPO would allow the general public and institutional investors to buy shares of the company
  - An allocation of at least 25 to 30 percent of the IPO would be set aside for the general public
  - An IPO will allow Canadian investors to participate in the creation of a large, growth-oriented, Canadian company
- According to the Council, the market could accommodate ~$3B of Hydro One shares at any one time, which would more than allow for an initial offering of approximately 15 percent
- The stages of the IPO process are outlined below

IPO Preparation
(April – July 2015)
IPO prep with leadership & legislative changes

IPO Process
(June – Sept 2015)
Draft and File Documents & bookrunner engagement

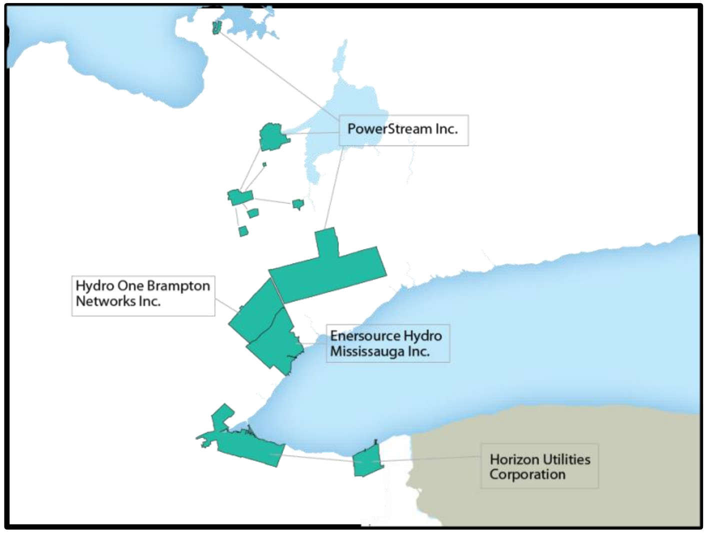
IPO Marketing/ Closing
(Fall 2015 / Winter 2016)
Investor road show, IPO pricing and closing

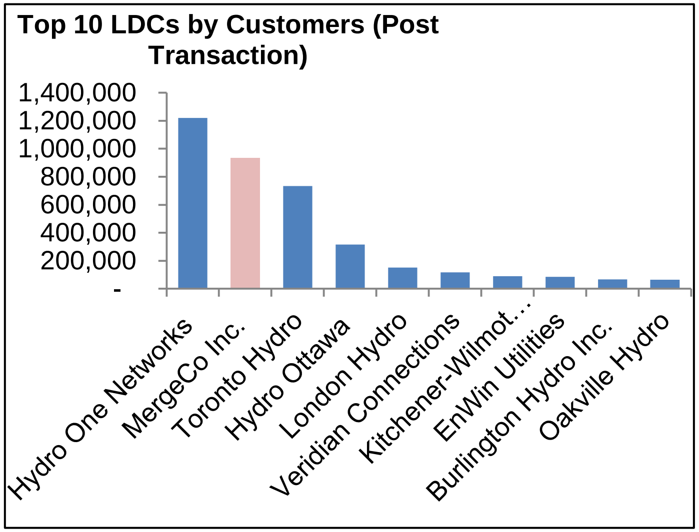
Overview: Hydro One Brampton Merger
Rationale

- The Council was initially inclined to recommend an open auction to divest its interest in Hydro One Brampton. An auction offers a transparent process and could deliver a value premium over a negotiated merger
- However, in the course of the Council's Phase 2 consultations, the Restructuring Secretariat received a strong pre-emptive bid from a consortium of GTHA-area LDCs that envisaged a merger of Hydro One Brampton with Enersource, PowerStream, and Horizon
- The quantum of the cash option was at the higher end of the indicative values identified in the Council's market soundings, and the equity option appeared to be equally attractive
- The Council considered that this bid offered an ideal base for creating a strong consolidator in the GTHA at a value that was as high as could be achieved in an auction. Accordingly, it is the option that the Council believes the government should pursue.
- The public interest benefits of such a merger are many, including the potential to:
  - Improve efficiency
  - Open the door to new capital investment from the private sector
  - Encourage modernization of the distribution system, and
  - Help to catalyze further consolidation in the sector by demonstrating the merits of such an approach
- In light of this, the Council believes that the Province should not conduct an open auction or procurement process for Hydro One Brampton, but instead should immediately proceed to negotiate a sale or merger of Hydro One Brampton to Enersource, PowerStream, and Horizon on the basis noted above

Overview: Hydro One Brampton Merger
Implementation

- The Council and Hydro One have negotiated a non-binding letter of intent (LOI) to merge Hydro One Brampton with PowerStream, Enersource and Horizon
  - The Province would receive 17 percent of the shares in the new company or $607M in cash at the option of the partners to be determined by July 31, 2015
  - These terms are highly competitive, based on the Council's market sounding
- The proposed Hydro One Brampton transaction represents a major step forward in catalyzing LDC consolidation in Ontario by creating
  - The second-largest LDC in the Province by customer size; and
  - A platform for further LDC consolidation in the Greater Toronto and Hamilton Area (GTHA)
- The public interest benefits of greater LDC consolidation include:
  - Improved efficiency and ratepayer savings
  - Strengthened service and reliability
  - Modernization of the distribution system





Key Implementation Elements

- Implementation of the Premier's Advisory Council recommendations will require action in the five areas outlined below, each of which is described in greater detail in the following slides

1. Proceeds re-invested in infrastructure	• Net proceeds (gain under Trillium Trust Act) would flow to Trillium Trust to invest in transit/transportation • Swapping legacy transmission and distribution assets for new public infrastructure, economic development and jobs
2. Electricity ratepayers protected	• The Ontario Energy Board (OEB) is a strong regulator, and its powers would be further enhanced to ensure customers are protected • The Province would continue as the single largest shareholder
3. Changes to control and oversight	• Allow Hydro One to operate like other publicly traded companies • Government would appoint some Hydro One Board members and ensure head office and grid control centre remain in Ontario
4. Sale processes maximize value	• IPO allows the Province to gradually sell down its stake in Hydro One while creating a widely held, Ontario-based champion • Brampton merger competitively priced and drives LDC consolidation
5. Labour negotiations underway	• OPG and Hydro One were provided with negotiating mandates from Treasury Board • OPG and Hydro One are in active negotiations with the PWU

1. Proceeds Re-Invested in Infrastructure
Mechanics

- The 2014 Spring Budget Bill included the *Trillium Trust Act, 2014 (TTA)*, which provides for Treasury Board to make regulations specifying qualifying assets and the net proceeds (defined by the TTA as the gain realized) from a sale of those assets to be deposited into the Consolidated Revenue Fund (CRF) and the Trillium Trust (TT) credited for that amount
    - Funds credited to the TT would be used to build new transit, transportation and other infrastructure as part of the Moving Ontario Forward initiative
- Under section 50.3 of the *Electricity Act, 1998 (EA)*, proceeds net of certain costs and other obligations (as determined by the Minister of Finance) from a Hydro One divestment are to be paid to the Ontario Electricity Financial Corporation (OEFC) to pay down the stranded debt of the old Ontario Hydro, not the CRF or the TT
    - It is proposed to amend section 50.3 of the EA to have proceeds paid to the CRF and require the Province to pay OEFC an equivalent amount by way of cash or granting a debt remission, issuance of securities or debt obligations by the province to OEFC, or another form as determined by the Minister of Finance
- The proposed amendment would allow the government to pay proceeds into the CRF and credit the sale net gain to the Trillium Trust to contribute funding to Moving Ontario Forward, while also fulfilling its commitment to OEFC/ratepayers towards stranded debt
    - If OEFC, which manages the stranded debt, were not kept whole, industrial and non-residential ratepayers would continue to pay the debt retirement charge for a longer period
- A further technical amendment to section 50.3(2), with respect to the various deductions from proceeds such as acquisition costs and other costs and obligations, would specifically allow for the deduction of the amounts already allocated by the Province to OEFC in respect of Hydro One's income over time. OEFC has already recognized these amounts of "Electricity Sector Dedicated Income" as revenue

2. Protecting Ratepayers

Overview

- Any change in ownership of Hydro One would not impact projected transmission or distribution rates
- The OEB would ensure on-going rate protection and reliability standards for all Hydro One customers
- The current Rural or Remote Rate Protection (RRRP) subsidies would remain in place for Hydro One customers following an IPO
- Hydro One transmission corridor lands would continue to be owned by the Province
- Bringing in private sector capital and putting Hydro One on a level playing field with other publicly traded entities would lead to cost savings and benefits to ratepayers
    - There could be some downward pressure on forecasted rates in the event of concessions on labour and pension costs, subject to the outcome of collective bargaining
    - Efficiencies would benefit ratepayers, as per OEB rate-filing requirements

2. Protecting Ratepayers

Ontario Energy Board (OEB) Enhancements

- The OEB is an effective regulator with experience overseeing private entities
- A Hydro One transaction could provide an opportunity to further enhance the OEB by proposed legislative changes that may include (see appendix 6 for more detail):
  - Implementing the OEB's recommendations on enhancing the *Energy Consumer Protection Act* with respect to energy retailers by, among other things:
    - Exploring options to eliminate or limit door to door sales by energy retailers
    - Enhancing the OEB's enforcement powers and compliance tools
    - Providing the OEB with more consumer education tools
    - Ensuring the OEB has the ability to determine if green retail products are providing consumers with the claimed environmental benefits
  - Ensuring reliability / continuity of service to customers
    - Extending current OEB emergency provisions to transmission
    - Giving the OEB greater tools to appoint supervisors or requiring a third party to take over the operations / management of distributors if a distributor is unable to continue to provide services to its customers for financial or other reasons
    - Propose amending legislation to allow for the sharing of safety-related information between the OEB, Technical Standards and Safety Authority (TSSA) and Electrical Safety Authority (ESA)

2. Protecting Ratepayers

Ontario Energy Board (OEB) Enhancements (cont'd)

- Key proposed legislative enhancements would include (cont'd):
  - Providing further OEB compliance tools for distributors and transmitters
    - Increasing penalties for non-compliant activities
  - OEB oversight of utility transactions and structure
    - Reducing the threshold for OEB review of share purchases where an individual/entity would own more than 10 percent (down from the current threshold of 20 percent)
    - Maintaining head offices, key personnel, and records in Ontario
    - Ensuring all corporate / transaction structures are appropriately reviewed / defined
  - New / enhanced tools to ensure that critical transmission infrastructure is built
    - Creating an LGIC OIC mechanism to identify public interest priority transmission projects that are needed
  - Clarify / amend LDC and affiliate relationships
    - Creating a level playing field between utilities regardless of ownership
    - Providing greater clarity regarding utility and non-utility business activities
  - Amend legislation to allow the OEB to appoint a consumer advocate, or where the OEB has not already done so, allow the appointment of a consumer advocate through an LGIC OIC
  - Administrative amendments
    - Adding consumer protection / education to the OEB's objects
- ENERGY will work with MAG and others in the development of these proposed legislative changes

2. Protecting Ratepayers

Rural or Remote Rate Protection Continues

- In 2001 the Rural or Remote Rate Protection (RRRP) framework was put in place to ensure that all Ontario residents pay similar prices for electricity distribution and in particular protect those in rural and northern communities
- With respect to Hydro One customers, the RRRP subsidy would continue post-IPO and includes the following:
  - $127M to about 350,000 rural residential Hydro One customers across the Province who receive approximately $30 monthly or about $350 annually
  - ~$34M to 3,500 off-grid remote customers served by Hydro One Remote Communities (RemoteCo)
- The cost of the RRRP is recovered from all electricity customers in Ontario and is currently set by the OEB at 0.13 ¢/kWh representing a cost of about $16 per year for a typical residential customer

2. Protecting Ratepayers

Province Continues to Own Transmission Corridor Lands

- Hydro One's transmission corridor lands are owned and managed by the Province and would continue to be owned and managed by the Province post-IPO
  - These lands were transferred to the Province in 2002 and include some 50,000 acres

- In managing these lands, while their primary purpose is the transmission of electricity, the Province's Secondary Land Use Program (PSLUP) allows secondary use access to transmission corridors
  - Public uses are given priority over private uses, and typical compatible secondary uses include parks and trails, soccer fields, road crossings, water / sewer pipelines, open storage, agriculture and parking lots for transit and commercial facilities

- Roles and responsibilities for the PSLUP include
  - *Hydro One*: reviews proposals to make sure they will not impact transmission safety, maintenance, restoration, reliability or system expansion
  - *Ministry of Economic Development, Employment and Infrastructure*: owns the transmission corridor lands on behalf of the Province and manages the PSLUP
  - *Infrastructure Ontario*: executes any secondary land use agreements on corridor lands on behalf of the Ministry of Economic Development, Employment and Infrastructure

- A key operating principle of the PSLUP program is to ensure that all secondary land uses are compatible with Hydro One's existing and planned transmission and distribution installations, so proposals will not move forward unless Hydro One provides technical clearance of them

3. Changes to Control and Oversight Post-IPO

Overview

- To allow Hydro One to operate in the same way as other publicly traded companies and to maximize proceeds, the Council recommends that the oversight and control of the company must be modified
- The proposed changes, described in the following slides, include:
  - Hydro One, post IPO, will face all the restrictions and disclosure requirements as other publicly traded, regulated utilities in Ontario, plus additional enhancements. These changes would allow the company the flexibility to compete and grow
  - For example, the following protections and restrictions would apply:
    - Ratepayers would continue to be protected through a strong and strengthened OEB
    - As the single largest shareholder the Province would continue to nominate a portion of the board of directors and as a 40 percent (or greater) shareholder would be able to remove the entire board if necessary
    - The head office, senior executive and decision making functions and grid control centre would all remain in Ontario
    - A new ombudsperson would oversee the company and its customer interactions
    - Hydro One would continue to be subject to Ontario Securities Commission and other financial disclosure requirements

3. Changes to Control and Oversight Post-IPO

Government Retains Certain Controls

- To allow Hydro one to operate as a commercial entity and maximize proceeds, current government restrictions on Hydro One would need to be removed:
  - Minister of Energy would no longer be able to issue sole shareholder Declarations and Resolutions allowing the Minister to assume powers of the Board of Directors
  - Hydro One would no longer be required to submit annual business plans to Energy and Finance for concurrence
  - Hydro One would no longer be subject to most government oversight measures:
    - Regular scrutiny from Ontario's Ombudsman, Financial Accountability Officer (FAO), Integrity Commissioner, and Information and Privacy Commissioner
    - Value for Money audits by the Auditor General of Ontario
    - *Freedom of Information and Protection of Privacy Act*
    - *Broader Public Sector Executive Compensation Act, 2014*, which would enable LGIC to set compensation frameworks
    - Various TB/MBC Directives (e.g. Procurement, Travel, Meal and Hospitality, etc)
- This is necessary in order to provide clarity and comfort to investors that the government would have limited interference so that it can operate as a normal commercial entity
- These powers and oversight mechanisms would fall away to enable the IPO, despite the government maintaining 85 percent ownership in the company in year one after the IPO
- The rights of the Province and the Auditor General to obtain information for preparing and auditing financial statements would remain in place until a future date (expected to be when Hydro One is no longer consolidated)

3. Changes to Control and Oversight Post-IPO

Government Controls Retained Via Legislation, Agreements and Constating Documents

- **Government could remove the Board:** Government could vote to remove all, but no less than all, of the members of the Board (with or without removing the Chair) as long as the Province is the majority shareholder
- **Post-IPO, Government could nominate 40 percent of Board:** Government could nominate 40 percent, or 4 out of 10 of the members of the Board, or its pro-rata interest, whichever is less
  - Once elected, these members have a fiduciary duty to act in the best interests of the company
  - Board members must meet pre-defined qualifications that include independence, commercial experience, and expertise commensurate with this role
  - In addition, Board members cannot be government officials (either current or during prior three years)
- **Government could reject other Board nominees:** Government, acting reasonably, would be entitled to reject non-provincial nominees if it determines they do not meet the qualifications and it provides written reasons for that determination
- **Confirmation of the Chair and CEO:** Confirmation of the Chair and CEO would require annual approval of two-thirds of the Hydro One Board
  - In practice, this means provincial appointees could block any nomination
- **Government as shareholder on other matters:** the government would be free to vote its shares on any other matter (e.g., substantive changes to corporate documents)
  - However, government cannot initiate certain fundamental changes (e.g., amendment to articles, amalgamations, arrangements and continuance)

3. Changes to Control and Oversight Post-IPO

Government Retains Certain Controls

- **Government controls depend on ownership stake:** The proposed legislation would prevent the Province from taking active measures to fall below a 40 percent stake in Hydro One. The Province would also have a pre-emptive right enshrined in the governance agreement, to purchase up to 40 percent of any new issuances except shares issued for acquisitions by Hydro One
- However, there are instances in which the Province's interest in Hydro One could be diluted below 40 percent, which would change the governance relationship between the Province and Hydro One
  - If, for example, at the time of IPO there are 1 million outstanding Hydro One shares, as per the proposed legislation the Province must hold at least 400,000 shares
  - However, if Hydro One is growing and issues another 1 million shares, the Province would be diluted down to 20 percent. If Hydro One issues shares for cash, the Province would have the option but not the obligation to purchase shares to maintain its 40 percent ownership stake
  - Hydro One would generally issue new shares in order to meet the growing needs of its existing businesses (capital expenditures for new transmission lines, new transformers etc.) or as a result of the acquisition of new businesses
  - In either of these scenarios, assuming the Province was diluted, the Province would hold a smaller portion of a growing company and would continue receive a direct financial benefit as well as indirect benefits from greater economic development and jobs growth
  - Government's powers would change as the company moves farther away from 100 percent provincial ownership:
    - *Greater than 40 percent:* the Province has the right to nominate board members in relation to its ownership rights, to a maximum of 40 percent and can block certain fundamental changes
    - *Less than 40 percent*: the Province would have the right to nominate board members in relation to its ownership stake below 40 percent (e.g. 3 out of 10 if owns 30 percent), and while it owns at least one-third of the shares, can block certain fundamental changes
    - *At or below 10 percent*: the Province would be no different than any other Hydro One shareholder (including being subject to the 10 percent ownership restriction)

3. Changes to Control and Oversight Post-IPO

Government Secures Certain Restrictions Post-IPO

- The following restrictions / requirements would be imposed in anticipation of a Hydro One IPO
  - No single shareholder could own more than 10 percent of Hydro One, except for the Province
  - Head office, CEO, and substantially all strategic decision-making management and functions maintained in Ontario
  - Grid Control Centre for Ontario operations maintained in Ontario
  - At least 25 to 30 percent of the IPO would be made available to the general public (the remainder would be for institutional investors)
  - Hydro One could not sell substantially all of either the transmission or distribution assets regulated by the OEB
  - Province would elect the initial Board of 10 directors, and post-IPO would nominate 4 Board seats or its proportionate amount based on its share ownership, whichever is less
  - As described in the previous slide, government would be able to vote to remove all, but no less than all, of the members of the Board (with or without removing the Chair) as long as the Province is the majority shareholder and effectively if it maintains a 40 percent or greater ownership
  - Government would be required to return to the Legislature in order to actively reduce its ownership to less than 40 percent of the initial outstanding shares of Hydro One

3. Changes to Control and Oversight Post-IPO

Ontario Securities Commission and Other Requirements Apply

- As with all publicly traded companies incorporated under the Ontario *Business Corporations Act* (OBCA), Hydro One will continue to face rigorous governance and disclosure standards
- Hydro One will continue to be subject to the continuous disclosure standards and requirements of the *Securities Act (Ontario)*. Under this Act, Hydro One will be required to file financial, management and compensation information with the Ontario Securities Commission
  - These disclosure requirements include: annual information forms, financial statements, management information circulars, compensation disclosure (the salary of the top 5 earners in the company), management's discussion and analysis (MD&A)
- Publicly traded companies are subject to additional requirements and disclosure obligations against best practices around the composition of the Boards, the qualifications of Board members, and the establishment of a code of conduct for Board members
- Hydro One must also continue to follow the rules and requirements established by stock exchanges, the US Securities and Exchange Commission, the Electrical Safety Authority, the Independent Electricity System Operator, and the National Energy Board
- See appendix 7 for more detail on on-going disclosure requirements

4. Hydro One IPO Implementation

Stages of Work

- An IPO is a multi-staged process that requires the knowledge and advice of specialised professionals who not only understand the process but are also able to provide advice on all issues such as legal, pricing, marketing, timing the sale and conducting due diligence

IPO Preparation

April-July 2015

- Appoint "public company ready" Board, Chair and senior management
- Select key parties involved including lead bookrunner to support the process (more on next slides)

IPO Process

June-Sept 2015

- Determine exchange listings and conduct due diligence
- Develop the preliminary prospectus to provide details about the investment offering to assist potential investors in making informed investment decisions and
- File the preliminary prospectus with the Ontario Securities Commission (OSC)

IPO Marketing/ Closing

Fall 2015 / Winter 2016

- Conduct investor road shows where the senior management and bookrunners provide presentations to analysts, fund managers and potential investors across Canada and in other jurisdictions
- IPO is expected to close in late fall 2015 / winter 2016. Following closing, the securities are listed and trading will commence on the exchange

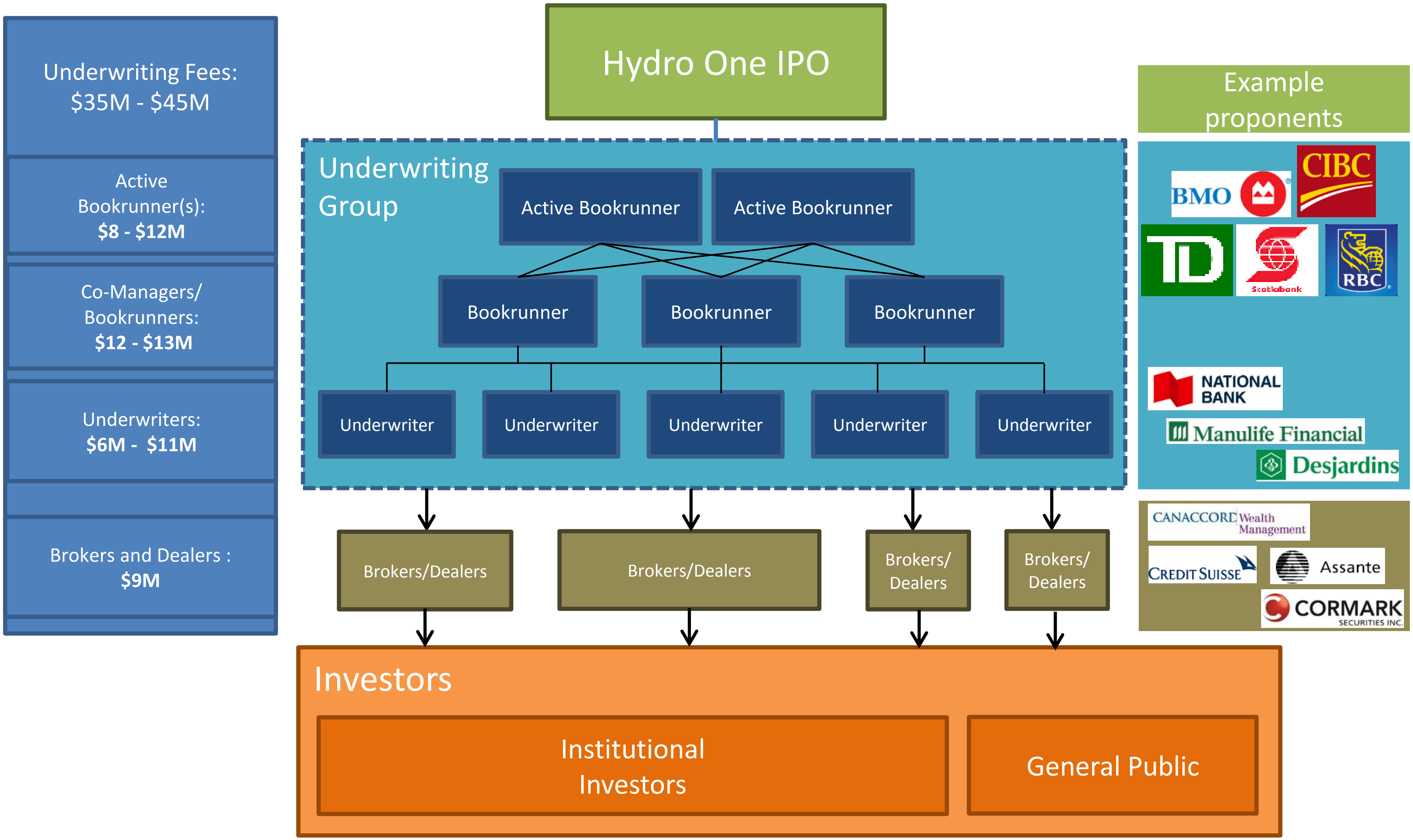
4. Hydro One IPO Implementation

Selection Process and Fees

- The total fees to be paid to the underwriting group would be less than industry standard and initially estimated to range from $35 to $45M (with a cap of $50M) which is at 3 percent for retail and 1 percent for institutional (or about 1.8 percent of the transaction value)
- This fee structure is considerably lower than the industry average of 4-5 percent (which if applied to Hydro One would amount to ~$100M). See appendix 2 for more detail
- Key parties to the IPO process include:
  - **Bookrunners:** A large Canadian bank would act as the lead bookrunner and would carry out most of the work relating to the IPO including creating a prospectus, organizing roadshows, marketing, and managing the other experts. Other bookrunners help build the "book" of investors and coordinate with the lead
  - **Underwriters:** Purchase shares and resell to investors through their networks of brokers and dealers (all bookrunners are also underwriters)
  - **Broker/Dealers:** Buy securities for their retail investors, and provide investment advice
- Given the scale of this transaction, prominence for the Canadian market and need for access to retail channels, all the five large Canadian banks will be asked to act as bookrunners
  - They are uniquely positioned for Canada, with access to capital, global investor networks, financial strength and Canadian marketing capabilities
- The five large banks would compete between each other, and the government will select 1 (or 2) to act as lead (or active) bookrunner(s) based on their skills, experience, previous IPOs completed, their reputation and relationships with institutional investors, transparency and research capabilities
- The Ministry of Energy also plans to engage a process advisor to provide advice, as needed, on the IPO process and its effective execution

4. Hydro One IPO Implementation

Illustrative Breakdown of Fees



4. Hydro One IPO Implementation

Comparison of Fees with Other Transactions

- The following table provides an overview of fees paid for large public sector company initial public offerings, and equivalent rate if applied to the Hydro One IPO:

IPO	Year	Fee Structure	Equivalent cost if applied to proposed 2015 Hydro One IPO
Air Canada	1988	5%	~$100M
Potash Corp.	1989	5%	~$100M
Petro-Canada	1991	5%	~$100M
Nova Scotia Power	1992	3.9% on instalment receipts, 4.5% on common shares	~$78M to ~$90M
CN Rail	1995	4%	~$80M
Manitoba Telecom Services	1996	3.9% on instalment receipts, 4.5% on common shares	~$78M to ~$90M
Information Services Corp. (Sask.)	2013	6%	~$120M
Hydro One (2015, proposed)	**2015**	**Less than 2% (1% for institutional investors, 3% for retail investors)**	**~$35M to ~$45M**

4. Hydro One IPO Implementation

IPO Preparation

- In addition to engagement of the lead bookrunner, underwriters and process advisor, Hydro One intends to engage several executive search firms to assist with leadership reviews needed to ready Hydro One for the IPO

- Executive search firms will be engaged to assist in seeking potential candidates for the following key positions:

  – Hydro One Board representatives

  – CEO

  – CFO

  – Head of regulatory affairs

- The aggregate, expected cost for these reviews ranges from $1.5M to $2M

4. Hydro One IPO Implementation

Fiscal and Accounting Considerations

- The table below illustrates the Council's estimated fiscal impacts of the proposed transaction and assumes 60 percent of Hydro One's equity be sold over 4 years for a total of approximately $9.0B (60 percent of $15B) (actuals subject to market conditions, final accounting)
  - The potential fiscal impacts shown are not necessarily incremental, as the 2014 Budget included targets from asset optimisation, that a Hydro One divestiture could help meet
- The Council's estimated fiscal impacts of the illustrative transactions between 2015-16 and 2018-19 include
  - The gain on sale (the difference between the proceeds raised and book value) would be dedicated to the Trillium Trust, subject to a Treasury Board regulation and changes to section 50.3 of the Electricity Act
  - An additional positive fiscal impact in 2015-16 related to the recognition of tax goodwill, this could also be dedicated to the Trillium Trust subject to necessary amendments to the *Trillium Trust Act, 2014*
    - These two amounts total the $1,530M shown in the Upfront Impact from Transaction row in the table below (See slide 58 for more detailed table)
  - Forgone net income and payments-in-lieu of taxes, which offsets part of the gain, as can be seen in the Estimated Fiscal Contribution line below
  - The potential interest savings as a result of using the proceeds raised to pay down debt / reduce provincial borrowing, temporarily until infrastructure spending affects interest costs
- With a sale of greater than 10 percent, Hydro One will become taxable and leave the payments-in-lieu of tax (PILs) regime and will have to pay about $2.6B in Departure Tax to OEFC. To prevent discounts on the valuation, the Council recommends that the Province does a capital contribution for up to the amount of the departure tax. The capital contribution would be fiscally neutral.
- There's a potential risk to the fiscal plan if there is pressure on the Province to end the Debt Retirement Charge (DRC) earlier than planned

Fiscal Impact ($M)*	2015-16	2016-17	2017-18	2018-19	2019-20/ Ongoing
Upfront Impact from Transaction (Dedicated to Trillium Trust)**	**$1,530**	**$990**	**$1,040**	**$1,130**	**-**
Loss of Net Income/PILs/Indemnity Payments	($140)	($350)	($480)	($640)	($740)
Estimated Fiscal Contribution	**$1,390**	**$640**	**$570**	**$500**	**($740)**
Potential Interest Savings***	$40	$130	$220	$330	$390
Total	**$1,430**	**$770**	**$790**	**$820**	**($350)**

*Based on PAC information as of February 20, 2015 and include Hydro One Brampton as part of the IPO. Numbers are based on Council analysis, and subject to change arising from new options. Numbers rounded to the nearest $10M. Numbers may not add due to rounding. On-going amounts forgone would change over time, depending on amount of forgone H1 growth and other changes in market conditions. Assumes mid-fiscal year transactions
** Subject to treasury Board regulations, and, for 2015-16 amount includes $770M in goodwill which is subject to legislative amendments to allow it to flow to the Trillium Trust
***Potential IOD savings would decrease and effectively be eliminated over the long-term as infrastructure projects materialize.

4. Hydro One Brampton Merger Implementation

Stages

- The Council and Hydro One have negotiated a non-binding letter of intent (LOI) to merge Hydro One Brampton with PowerStream, Enersource and Horizon
  - The Province would receive 17 percent of the shares in the new company or $607M in cash at the option of the partners to be determined by July 31, 2015
    - In the event the Province holds shares, it would need to engage an executive search firm to assist in identifying potential board nominees
    - A regulation under the Electricity Act may be needed to ensure Brampton Hydro and the new merged entity remains subject to the PILs regime
  - These terms are highly competitive, based on the Council's market sounding
- Details of the LOI have been reviewed and approved by the holding company boards of PowerStream, Horizon and Enersource, which include City Council representation
- The Minister of Energy intends to issue a sole shareholder Declaration and Resolution to the Board of Hydro One authorizing it to proceed with this transaction
  - The Declaration / Resolution would enable the Minister to require that Hydro One's interest in Hydro One Brampton be transferred directly to the Province in order to separate the IPO from this process
- The details of the agreement would be finalized in spring 2015 and the agreement would likely be signed in summer 2015
  - Partners would have until July 31, 2015 to determine whether to issue shares in the newly merged company or pay cash to the Province for its interest in Brampton
- Once the agreement is signed, it is likely that OEB approval will be required. This regulatory review could take as long as a year
- The transaction could close after OEB approval is secured

4. Hydro One Brampton Merger Implementation

Rationale

- A merger with these four companies would create the second largest LDC in Ontario by customer size that would serve as a platform for further LDC consolidation. The benefits of consolidation include:
  - Improved efficiency and ratepayer savings
  - Strengthened service and reliability
  - Modernization of the distribution system
- In 2012, the Ontario Distribution Sector Review Panel estimated that net cost savings from LDC consolidation would be $1.2B over ten years valued in present terms
  - Subsequent to the release of the Panel report, the Minister of Energy announced that government would not force consolidation, but was committed to finding these savings for ratepayers through voluntary LDC consolidation and partnerships
  - See appendix 3 for more details on the Panel's estimate of savings
- The Council is also recommending time-limited changes to the existing transfer tax regime to provide a further incentive to spur LDC consolidation over the next three years
  - A transfer tax, paid towards stranded debt, is currently 33 percent of the fair market value of any LDC assets sold to the private sector. The Council is recommending that the transfer tax rate be reduced to 22 percent for all LDCs, as well as an exemption for small LDCs with fewer than 30,000 customers
  - See appendix 8 for more detail on the Council's transfer tax recommendations

4. Hydro One Brampton Merger Implementation

Rationale (cont'd)

- In addition, as a stand-alone subsidiary of Hydro One Networks, implementing a Hydro One Brampton merger is relatively straightforward because its corporate structure, labour agreements, operations, licences and rate structures are separate and distinct
- Hydro One's other distribution assets would remain intact as part of the IPO process, for the following reasons:
  - During its market soundings, while the Council heard from some parties interested in purchasing Hydro One distribution assets, the value premium in the market for a partial sale of a combined transmission and distribution company is likely to be significant
  - Not splitting the company would avoid dis-synergies and separation costs, and labour agreements would continue to be negotiated with a single employer and avoid a split pension plan
  - Keeping Hydro One's distribution assets intact ensures that Hydro One's rural customers will not experience rate shocks resulting from the separation of Hydro One's lower-cost and higher-growth assets
  - Breaking up Hydro One's distribution assets would take considerably longer than an IPO process given the restructuring that would be needed (e.g. corporate structures, pension plan provisions), as well as the required approvals (e.g. new licenses, OEB approval of new rates and sale)
  - Selling Hydro One assets piecemeal, to existing LDCs would not act as a driver for further LDC consolidation and associated benefits

4. Hydro One Brampton Merger

Fiscal considerations

- The following table provides estimated fiscal impacts for the Province under a Hydro One Brampton merger scenario compared to the status quo of continuing to hold Hydro One Brampton
- Scenario 1, Province owns a share of MergeCo: An upfront (non-cash) fiscal impact in 15-16, and little net fiscal impact going forward
  - Assumes the Province is able to recognize its share of net income from its ownership in MergeCo under modified equity rules. If not possible, the Province would only be able to recognize the dividends received from MergeCo with the consequent reduction in annual contributions to the fiscal plan of about $8 to $10M per year
  - Also assumes that PILs would continue to be paid to OEFC, with MergeCo still tax exempt under the Income Tax Act
- Scenario 2, Province is bought out by the other partners: Greater positive fiscal impact in 2015-16 from a higher up-front gain on sale, followed by lower revenue in out years, as net income is forgone
  - If the sale price were about $607M or 1.5x ratebase, the Council has estimated the one time gain to be about $220M
  - Foregone net income in out years could be offset by potential interest on debt savings (from the up-front cash)
- The table below assumes a Jan. 1, 2016 transaction date.

Fiscal Impacts ($M)*	2015-16	2016-17	2017-18	2018-19	2019-20 / Ongoing
Scenario 1: MergeCo** Asset Revaluation & Share of Net Income/PILs in MergeCo	**$174********	**($3)**	**($0)**	**$1**	**($1)**
Scenario 2: Buyout Up-front Gain & on-going revenue impacts	$216	($18)	($17)	($17)	($20)
Potential Interest Savings for Scenario 2****	$5	$18	$19	$20	$21
Total	**$221**	**$0**	**$2**	**$3**	**$1**

* Based on PAC / KPMG information as of April 1, 2015. Numbers are based on Council analysis, and subject to change arising from new options. On-going amounts forgone would change over time, depending on amount of forgone growth and other changes in market conditions.

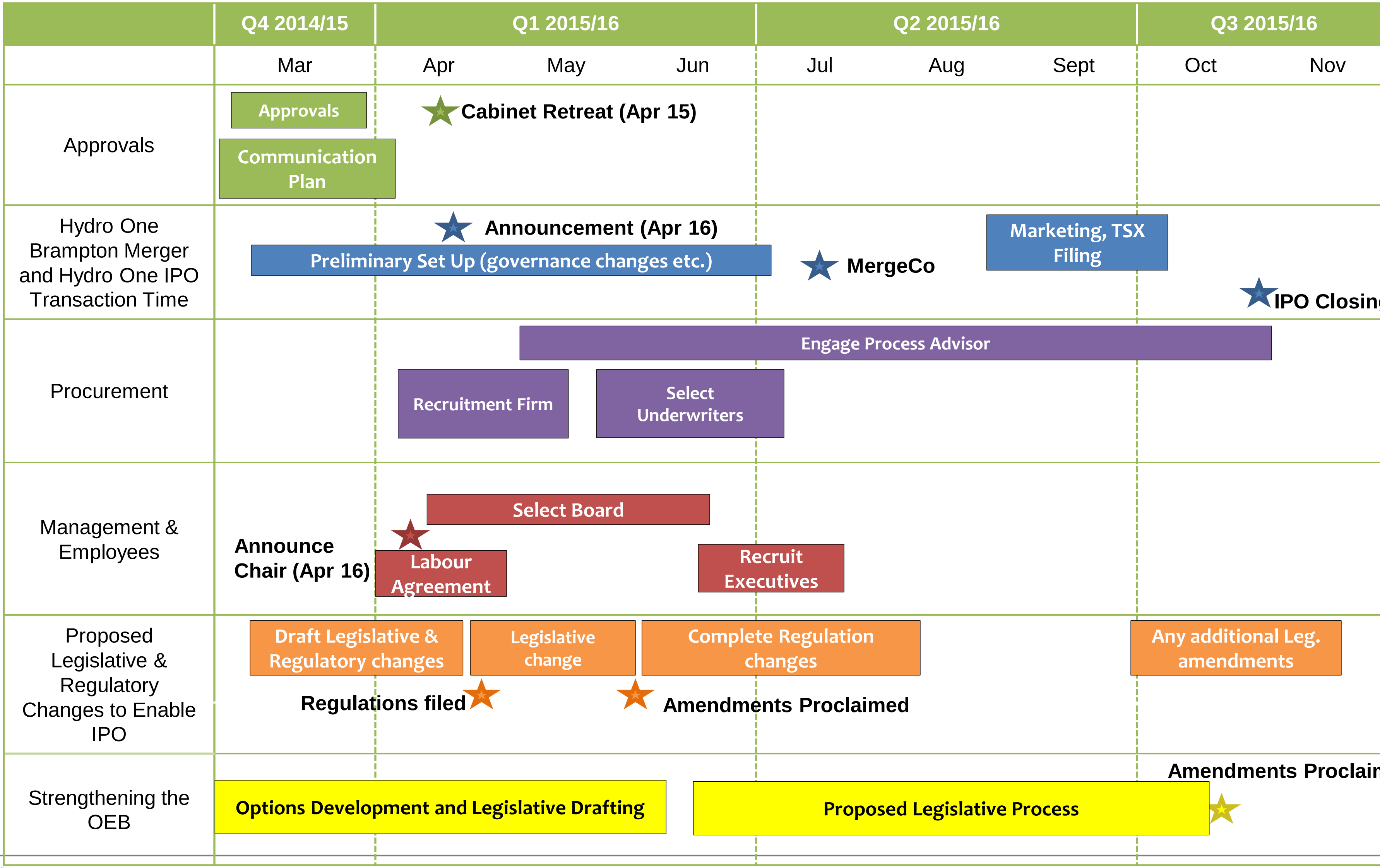
** Assumes that Province is able to account for its share of MergeCo income under modified equity accounting. There are risks that this method of accounting for share of income would be disallowed given Province would only have about 17% of MergeCo. This would reduce annual revenue by about $8-10M [TBC]

*** The fiscal gain on the step-up of the Brampton value due to the merger could also go to the Trillium Trust subject to necessary amendment to the *Trillium Trust Act, 2014*. Note that as this is not a cash amount. A buyout would provide cash.

**** Potential IOD savings would decrease and effectively be eliminated over the long-term as infrastructure projects materialize.

4. Illustrative Timeline

Hydro One IPO and Brampton Transactions



Ontario

Communications Plan

- Government intends to announce Advisory Council recommendations together on April 16th
- The announcement will combine a Council-led technical briefing for media and stakeholders with a media event and availability with Premier / Ministers
- Event will be supported by Province-wide news release, backgrounders
- Primary message: Supporting much-needed investment in infrastructure and transit across Ontario
- Post-announcement activities include:
  - MPP echo events highlighting infrastructure investment
  - Minister Chiarelli events across the Province in areas such as Brampton, Barrie, Hamilton, London, Sudbury and Peterborough
  - Ongoing media relations with business media and rural media, particularly in Hydro One service territory

Communication Plan (*cont'd*)

Key Messages

- The Advisory Council on Government Assets has recommended the best way of improving the long-term performance of Hydro One to free up significant capital that the Province can invest in new infrastructure
- Today's announcement will make the electricity system more effective. It will help create efficiencies and innovation that will benefit all electricity customers
- Ontario intends to move forward with an IPO of 15 percent share offering this year and over time would further reduce its ownership
- The Province would remain the largest shareholder in the new company. No other shareholder would be allowed to own more than 10 per cent
- Hydro One will remain regulated and will not be able to set its own rates. The independent Ontario Energy Board will continue to have oversight of the company and approve its rates
- We've taken a long-term perspective on this deal. By remaining a significant shareholder, every Ontarian would benefit from the future revenues from this reinvigorated asset and ratepayers will remain safeguarded through measured regulation
- We intend to introduce legislation later this spring that would strengthen and enhance the OEB's powers even further
- Ontario intends to bring forward time-limited tax changes to encourage private sector utility consolidation – such as reducing the transfer tax rate and exempting capital gains portion of the departure tax

Communication Plan *(cont'd)*

Audience	Key Issues	Response
General Public	▪ General public support for keeping the asset in public hands. The case for selling is not clear or strong ▪ Will expect details of how the proceeds will be invested. How much do we expect to raise? Will all funds flow to the Trillium Trust?	▪ Good business decision: Improves the long-term performance of Hydro One and frees up capital for the provincial priority of infrastructure ▪ Good for customers: H1 Brampton becomes part of a modern, effective distribution company. New model makes Hydro One more efficient, good for keeping rates down ▪ Good for public infrastructure: proceeds go to the Trillium Trust ▪ Commitment to OEFC and stranded debt maintained ▪ Protections are in place: Hydro One remains regulated, OEB will have new powers of oversight
Opposition Critics	▪ Accusations of "fire sale", repeat of 2002 privatization attempt and Highway 407	▪ Detailed distinction between this proposal and past privatization – the new Hydro One remains regulated by a strengthened OEB; government would be the largest shareholder and have the right to nominate up to 40 percent of Board members; new powers of oversight given to the independent OEB; ownership limits; HQ stays in Ontario
Residential ratepayers / mayors in H1 service territory	▪ Concern about impact on rates and service reliability ▪ Concern that a rural service is being sold to pay for transit in big cities	▪ This deal unlocks the potential to find savings at Hydro One while maintaining and improving service levels ▪ The licence conditions imposed by the OEB will ensure consistent and reliable service levels. All existing customers will continue to be served ▪ Government has committed to $29B in transit and transportation infrastructure across the Province
Industrial & Commercial ratepayers	▪ Will this help contain costs? ▪ Will this improve access to power where it's needed?	▪ Operational improvements and organizational efficiency can help contain/lower costs ▪ New transmission would be opened up to competition, which helps reduce costs
Local Distribution Companies	▪ What does this mean for consolidation? ▪ Why was there no opportunity to bid for Brampton?	▪ We are still in favour of LDCs exploring voluntary consolidation and the Hydro One Brampton merger reflects our commitment to this objective ▪ LDCs will be free to deal with the new entity on commercial terms going forward

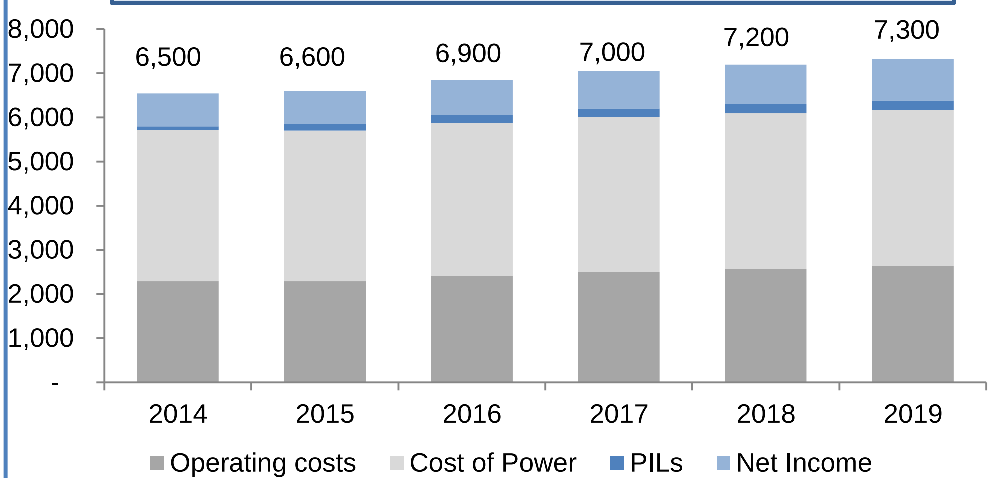
Appendices
Table of Contents

1. Key Hydro One Facts

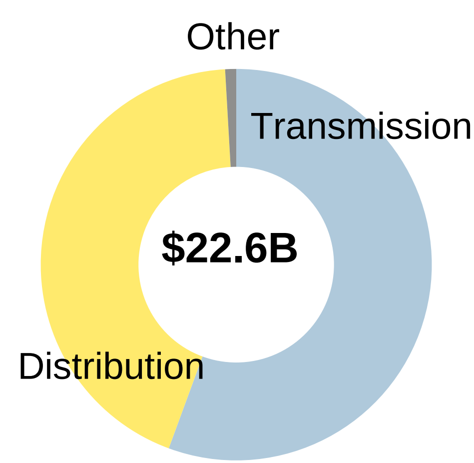
Hydro One Inc: Key Facts

- Hydro One is incorporated under the *Business Corporations Act (Ontario)* (OBCA). As one of the two provincially-owned OBCA electricity companies in Ontario, Hydro One is subject to a variety of unique and rigorous governance requirements
- Hydro One owns about 95 percent of transmission in Ontario with ~30,000 km of high-voltage transmission lines and 26 interconnections
- The company's distribution business serves approximately 1.4M customers through Hydro One Networks and Hydro One Brampton
- Hydro One net income and payments in lieu (PILs) of taxes are consolidated on the Province's income statement. The Province dedicates these revenues to pay down stranded debt of the former Ontario Hydro
- In 2014, Hydro One net income and PILs totalled $838M

Hydro One Projected Revenues ($M) *

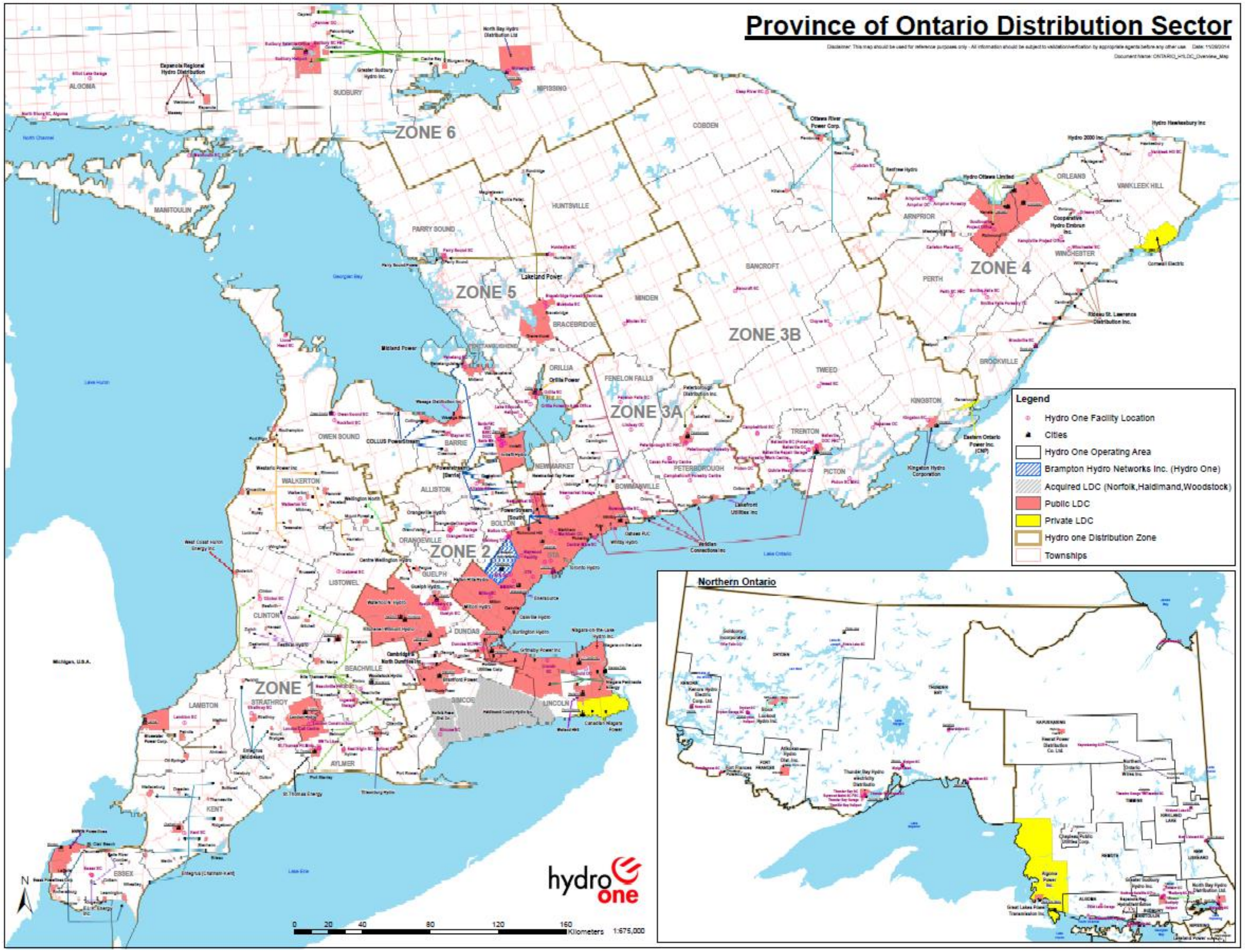


Hydro One Assets*



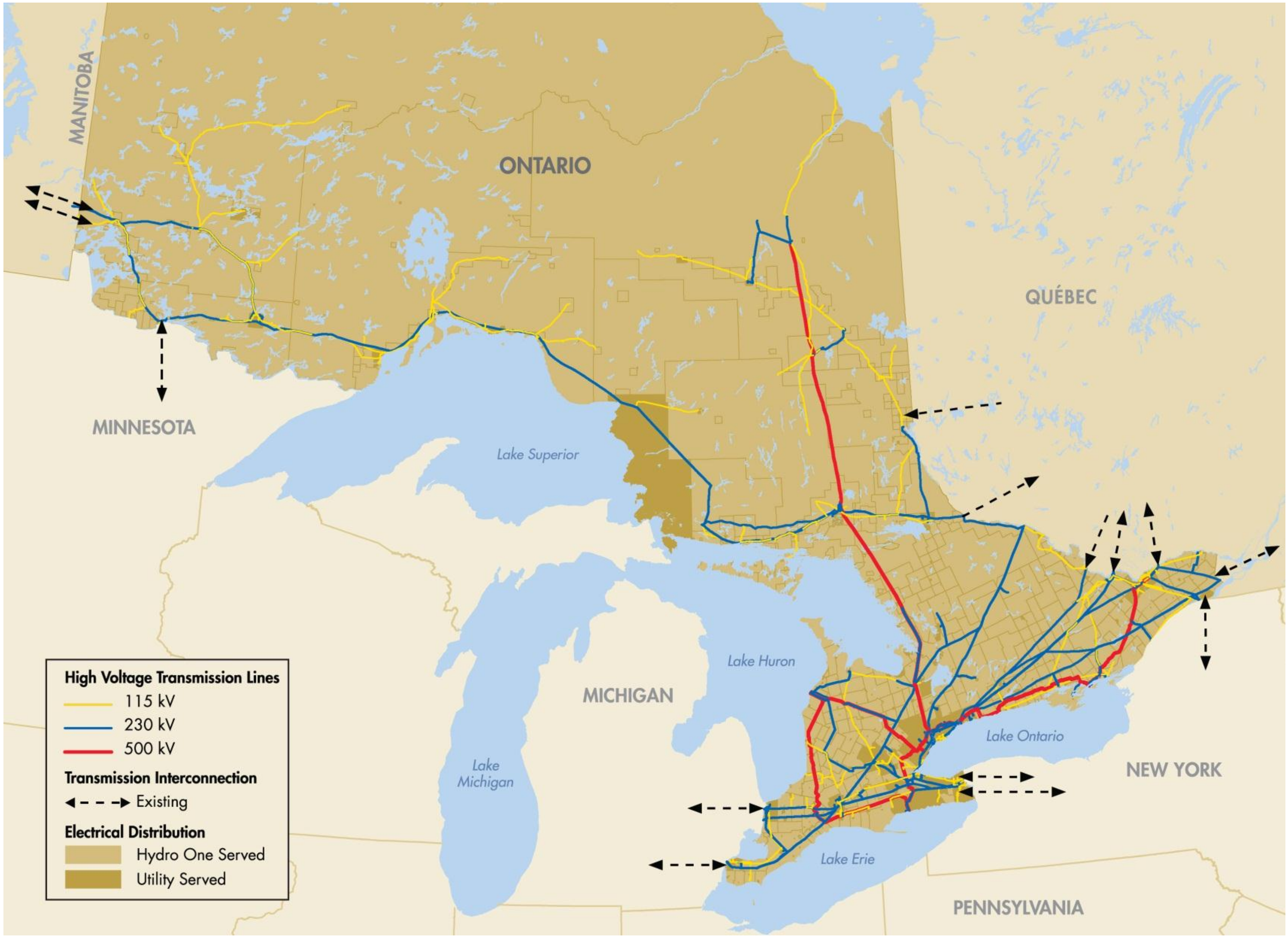
* Source: Hydro One 2015 Budget and the 2016-2019 Business Plan with 2014 actual results.

Hydro One Distribution Territory (in white)



Ontario

Hydro One Transmission Territory

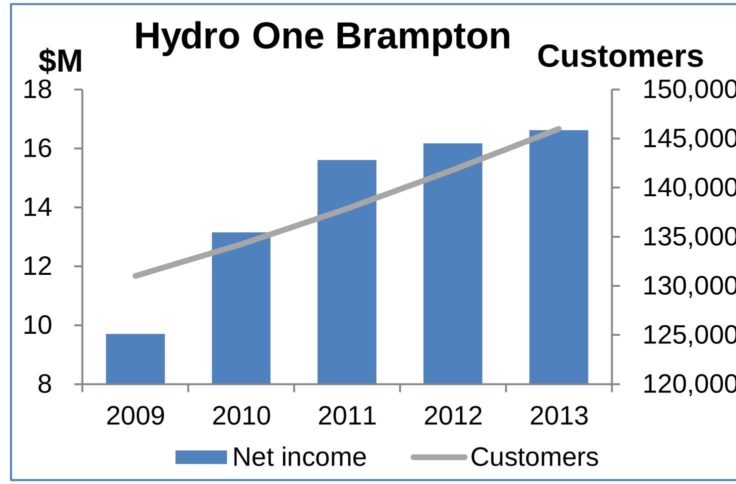


Hydro One and Transmission System Planning

- While Hydro One owns about 95 percent of Ontario's transmission system, Hydro One does not have a transmission monopoly, nor would it have one post-IPO
- Transmission system planning is the responsibility of the IESO, and involves assessing the need and timing for new transmission infrastructure. Key transmission projects can then be identified as priority projects in, for example, the Province's Long Term Energy Plan
- Priority transmission projects can move forward in a number of ways, and example of priority projects currently under development include:
  - *Northwest Bulk*: In January 2013, the Minister of Energy issued a directive to the OEB to amend Hydro One's transmission licence conditions to require Hydro One to undertake development work on Northwest Bulk line. Hydro One is currently working with Infrastructure Ontario on this early development work
  - *Line to Pickle Lake/Remote Community Connection*: two proponents, Wataynikaneyap Power (W-Power) and Sagatay are in the planning stages for this project. W-Power recently received approval for its Terms of Reference for an Environmental Assessment, and plans to file for Leave to Construct with the OEB in late 2015. W-Power is also currently negotiating with an experienced transmission partner
  - *East West Tie*: In March 2011, the Minister of Energy asked the OEB to designate a transmitter for the development work for the East West Tie. In 2011, the OEB invited licenced transmitters to submit development plans. Six transmitters filed applications in July 2012 and, in August 2013, the OEB awarded the designation to Upper Canada Transmission Inc. (operating as NextBridge)
- Energy will continue to explore ways to enhance the transmission planning process, including through proposed legislative changes to strengthen the OEB and with respect to remote community connections and northern transmission projects

Hydro One Brampton: Key Facts

- Hydro One Brampton was acquired from the City of Brampton in 2001
- Hydro One Brampton is an attractive asset for several reasons:
  - **Standalone entity:** It is a separate subsidiary of Hydro One with independent labour agreements
  - **High growth, urban asset:** Over the past several years, Brampton has had growing net income and customer base
  - **Efficient:** Highly efficient because of lower cost structure and newer age of assets relative to Hydro One
  - **Catalyst for consolidation:** Would help drive consolidation in and around the GTHA



Hydro One Brampton- Quick Facts*	
Customers	146,000
Service Territory	270 km sq
Total km of lines	3,100 (~75 percent underground)
Employees	210
Return on Equity	13.62 percent
Net assets**	$320M

*Data from 2013 OEB yearbook
**Net Property Plant & Equipment only

2. Council Activities

Ontario

Council Process

- **Hypothesis Development**
  - Develop strategic options around potential transactions for Hydro One Brampton and DxCo
  - Conduct preliminary analysis and magnitude assessments
- **Market Sounding**
  - Canvas players on strategic options and conduct market sounding
  - Develop pros and cons for transaction types
  - Be open to input from everyone
- **Financial Analysis**
  - Conduct rigorous analysis to understand financial impact of various potential transactions
  - Understand governance structures and public interest protections
  - Understand fiscal / cash implications
  - Understand impact to rate payer
- **Legal Analysis and Accounting Policy**
  - Understand legal and regulatory implications of potential transaction choices
  - Evaluate accounting policy implications to the Province
  - Evaluate changes required (if any) to facilitate transaction
- **Next Steps**
  - Recommend to Government the preferred transaction structure
  - Develop timeline for execution

Parties that Interacted with the Restructuring Secretariat

Industry Groups & Unions

- Electricity Distributors Association
- International Brotherhood of Electrical Workers
- Ontario Energy Association
- The Society of Energy Professionals

Strategic Investors

- Berkshire Hathaway Energy Canada/AltaLink
- Brookfield Renewable Power
- Enbridge Inc.
- Emera Incorporated
- Enersource Corporation
- Enwin Utilities
- EPCOR
- Fortis
- Horizon Utilities Corporation
- Hydro Ottawa Ltd.
- Lakeland Power Distribution Ltd.
- Liberty Energy Utilities Co./ Algonquin Power & Utilities Corp.
- Niagara-on-the-Lake Hydro
- NextEra Canada Transmission Investments, Inc.
- PowerStream Holdings Inc.
- Toronto Hydro
- Town of East Gwillimbury
- Trillium Energy Alliance
- Veridian Corporation

Advisors

- Barclays Capital Canada Inc.
- BMO Nesbitt Burns Inc.
- Borden Ladner Gervais LLP
- Canaccord Genuity
- Capgemini Canada Inc.
- CIBC World Markets
- Evercore Partners Canada Ltd.
- Goldman Sachs
- Morgan Stanley Canada Limited
- Nairn McQueen
- RBC Capital Markets
- Rod Taylor
- Rothchild Group
- Scotia Capital Inc.
- TD Securities Inc.
- Weirfoulds LLP

Financial Investors

- Alberta Investment Management Corp.
- Borealis Infrastructure
- Caledon Capital Management
- Capstone Infrastructure Corporation
- Fengate Capital Management
- MEAG MUNICH ERGO AssetManagement GmbH

Market Sounding Feedback to Council

Distribution Co. Spinoff	▪ Strategic parties were of the opinion that they had significant union management experience that could provide a better context for future labour relations at DxCo if they were the owner ▪ The issue with splitting up the HOI debt, which would be required in any DxCo alternative, was raised
Hydro One Inc.	▪ Two strategic parties expressed strong interest in the acquisition of all of HOI. A number of advisors noted (unsolicited) that the trading and transaction multiples available to HOI would exceed those of DxCo due to the inclusion of the transmission assets
Regulatory	▪ The Ontario Energy Board ("OEB") is generally viewed in the marketplace as a reliable and useful regulator. However, it was noted by many participants that the OEB actively encourages and supports small Municipal Electric Utilities ("MEUs") in the design of its fees and benchmarking — exacerbating the lack of consolidation activity ▪ A number of participants encouraged the OEB to consider longer rate processes to allow synergy costs to be assured in any acquisition scenario
Asset Attractiveness	▪ DxCo and Hydro One Brampton are very attractive assets in the marketplace today and will have substantial value in both public and strategic markets ▪ A number of advisors noted that the values that could be obtained in the public markets are at all-time highs given the interest rate market and demand for yield product. Public market values for DxCo could exceed strategic market values. However, a number of advisors also noted a strong, growth-oriented management team and recognized fully independent governance must be put in place first
Taxes	▪ While there was very significant interest in reducing or eliminating the Departure and Transfer Taxes, there was not a uniform opinion that in itself these changes would be sufficient to accelerate the process of LDC consolidation

Reasons for Changes From Initial Recommendation

- Included below are the reasons Council provided for why its final recommendation is different from the initial recommendation

Phase 1 Recommendation	Phase 2 Recommendation	Reason for change
Split Hydro One distribution and transmission businesses and divest the distribution portion	Keep Hydro One intact	• Through due diligence and market consultations, found that Hydro One as an integrated entity is worth more than simply the sum of its constituent parts • A partial divestiture of the Province's share in the integrated business of Hydro One would be a much simpler and less challenging process since it would not require splitting the company into two separate businesses ahead of the transaction. It would also avoid potentially inefficiencies and separation costs that would arise from splitting the company. Labour and pension arrangements at Hydro One could continue to be negotiated with a single employer, as opposed to splitting the company into two separate business units that would each require a split pension plan
Retain transmission as it is a strategic policy asset	IPO of HOI (includes both distribution and transmission)	• 100 percent ownership of Hydro One's transmission assets is not a pre-requisite in order to achieve equally good energy policy outcomes • The Province would still have policy levers to ensure that transmission infrastructure is built and maintained

Reasons for Proposed IPO Structure

- Included below are elements from the proposed structure with reasoning from the Council:

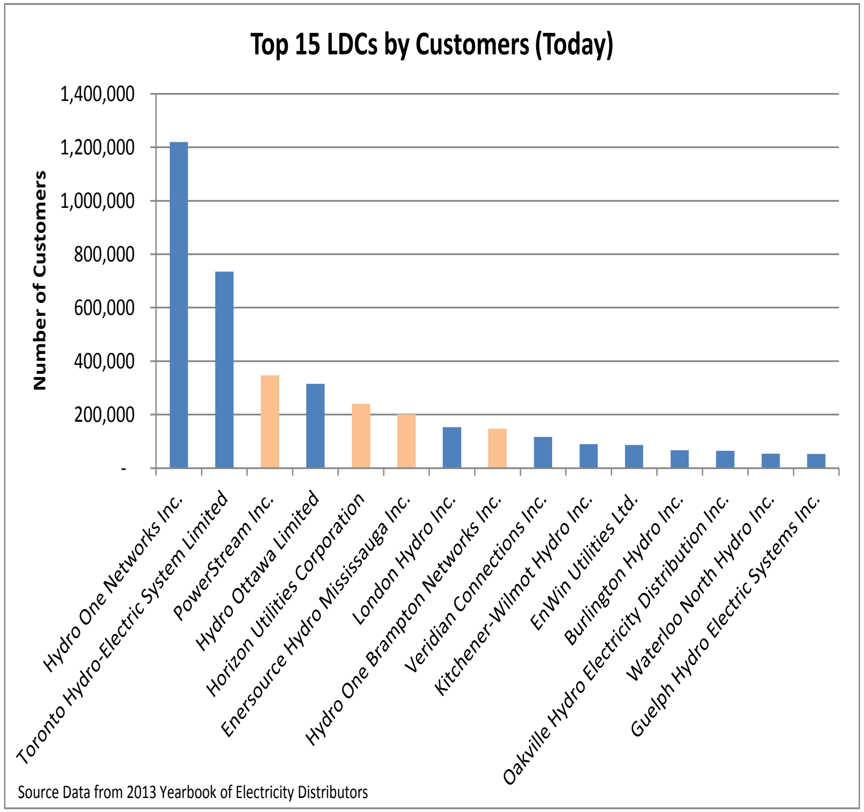
Proposal	Reasoning
Staged process	• Allow the Province to receive on-going income from the company and continued revenue gains. Would allow to offer sales at opportune times in the market • Analysis suggests that the IPO market could accommodate at least $3B of Hydro One shares at any one time
Retain 40 percent	• Investors need a clear signal from the Province • Province will continue to benefit from revenue stream of a growing company
No ownership over 10 percent (other than the Province)	• This restriction mitigates the risks of any one investor becoming too influential and helps protect the long-term interests of all Ontarians
Retail investors allocated 25-30 percent	• This will allow Canadian investors to participate in the creation and growth of a large, growth-oriented, Canadian company. The creation of such a new company free to grow and expand will generate returns, not only for the shareholders but for all Ontarians

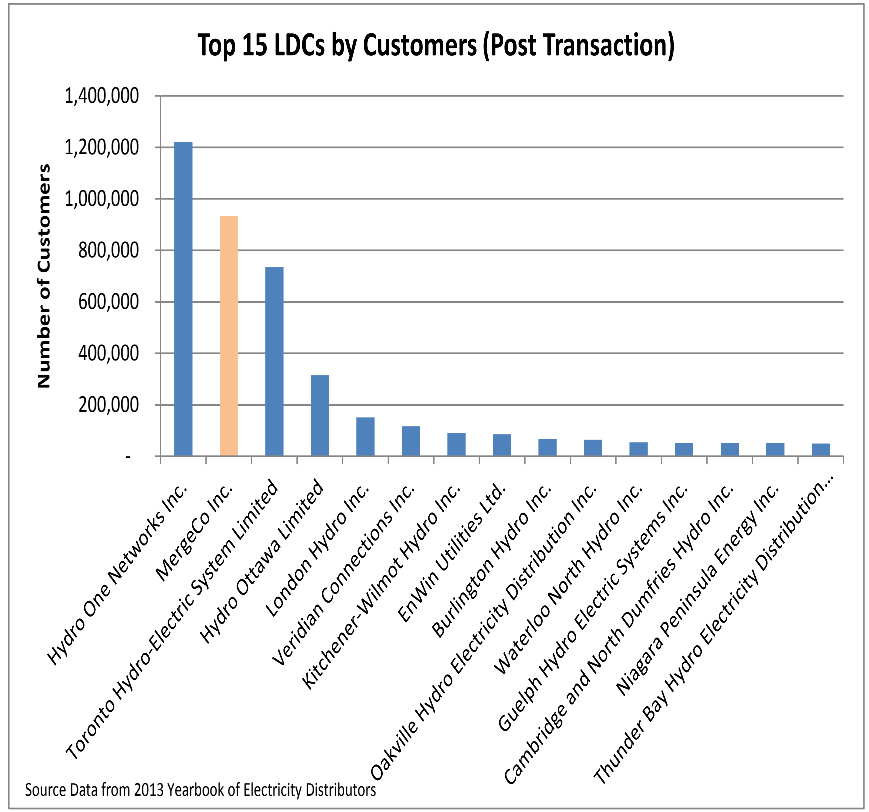
3. Brampton Merger

Ontario

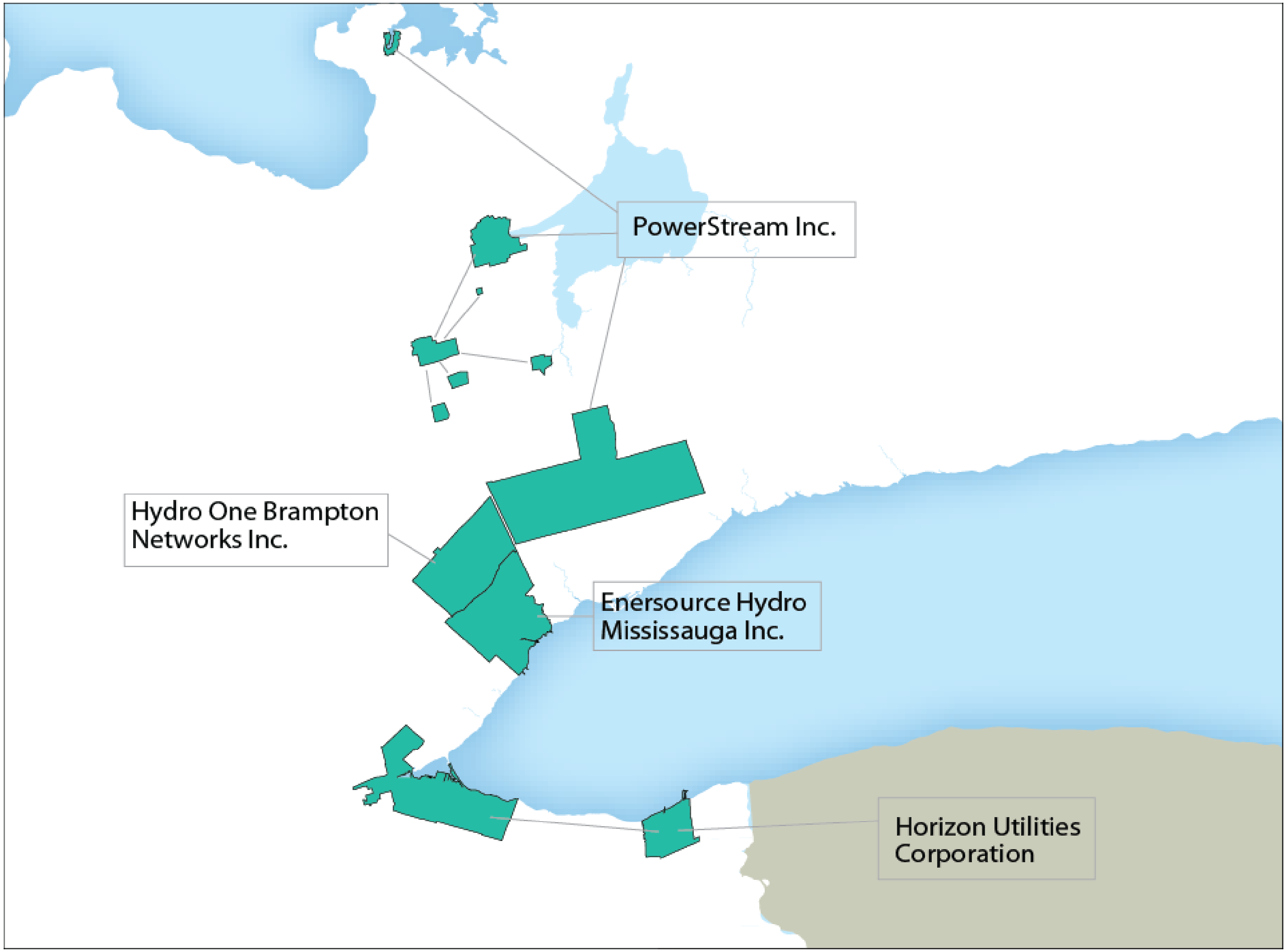
Finding Efficiencies

- The tables below illustrate the impact the merger will have on LDCs in the Province:



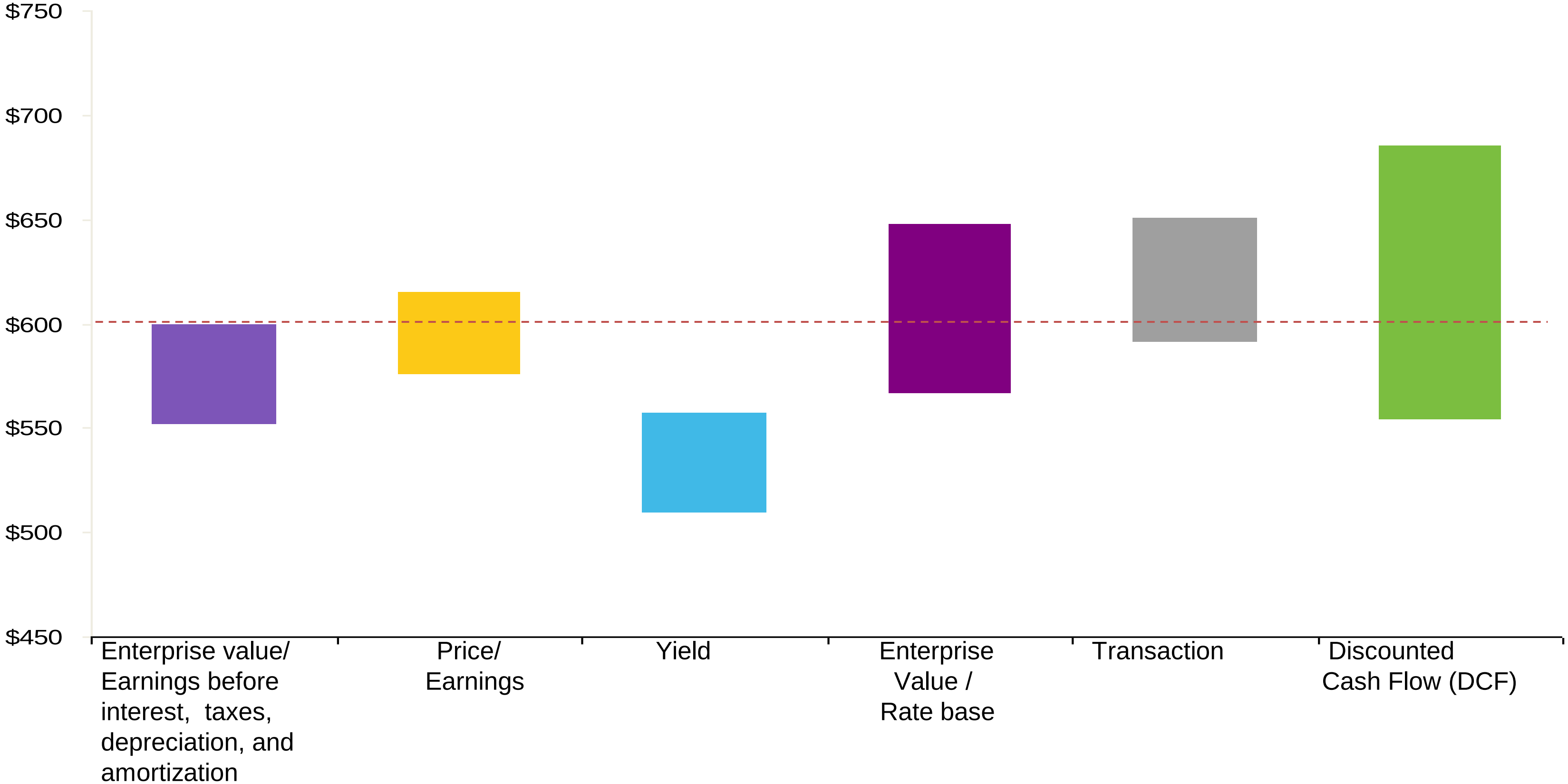


Current Service Territories



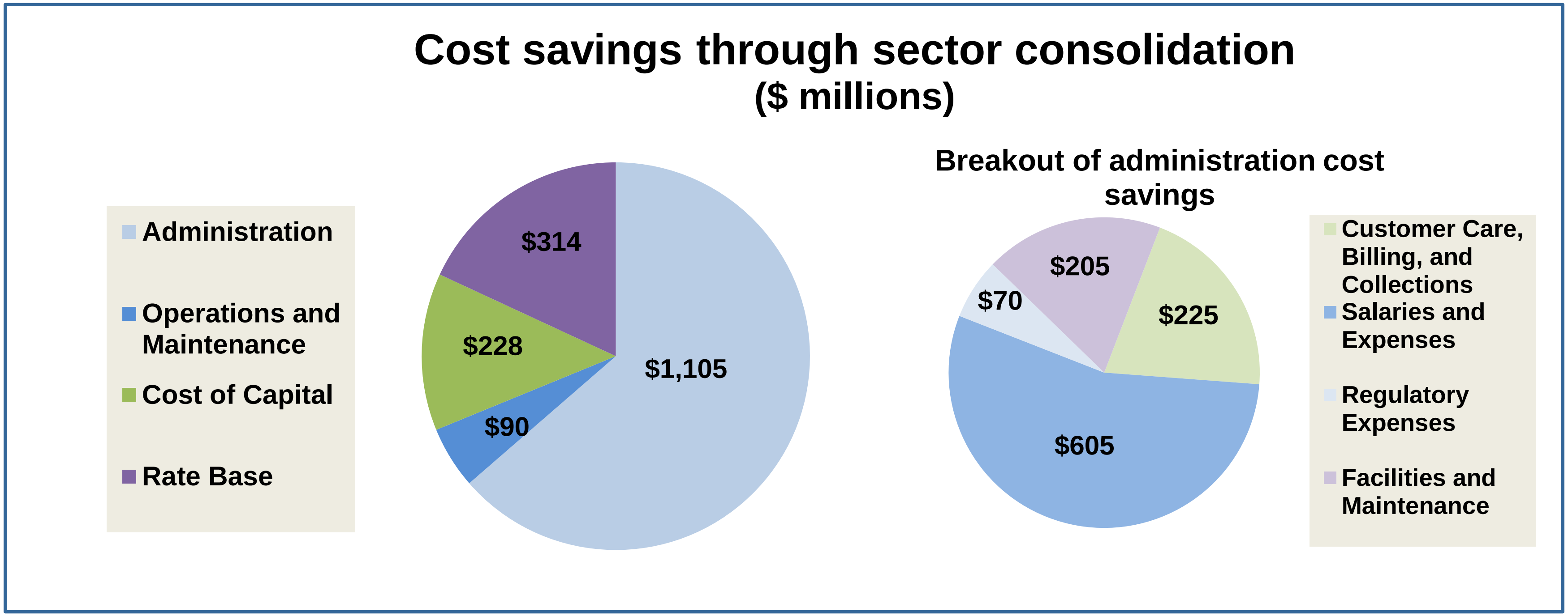
Hydro One Brampton Valuation

- The preliminary agreement between Hydro One, and the shareholders of PowerStream, Enersource and Horizon has established a value of $607M for Hydro One Brampton under the terms of the draft Letter of Intent
- This compares favourably with Council analysis, which values Hydro One Brampton at $500M to $600M



2012 Ontario Distribution Sector Review Panel Report

- The Ontario Distribution Review Panel estimated that cost savings from restructuring would be $1.2B over ten years valued in present terms
  - The majority of the savings identified by the Panel relate to reduced administration costs

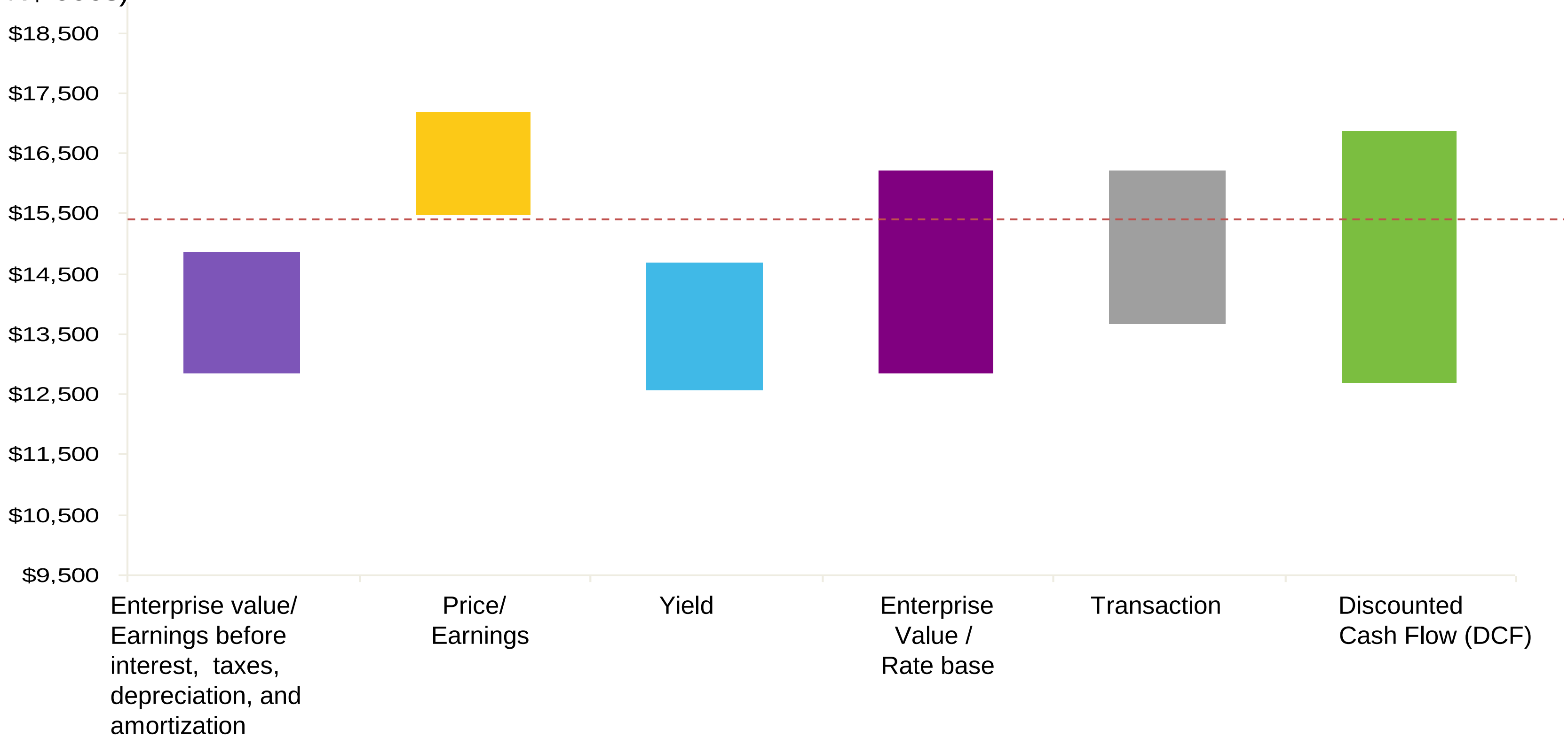


4. Valuation and Flow of Proceeds

Valuation of Hydro One

- Hydro One's current equity value is estimated at ~$13.5B to about ~$15B (a mid-point of about 20.5 times the company's projected 2015 net income of $695M). Including $9B in debt, the enterprise value is ~$24B
- Indicative valuations and figures based on analysis performed by the Council

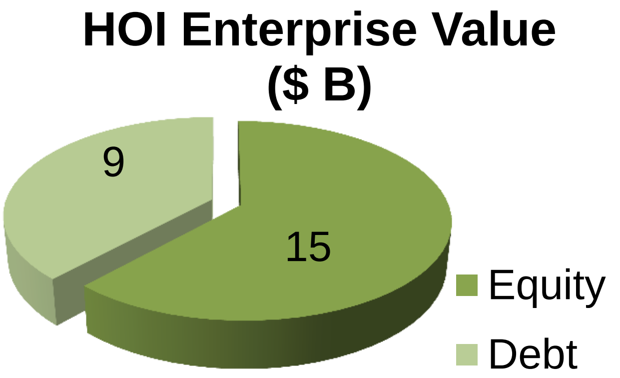
Hydro One Inc. Indicative 2015 Equity Valuation*
(CDN$ 000s)



*Includes Hydro One Brampton

Valuation of Hydro One

- Hydro One Inc (HOI) has been valued in the range of $13.5B to $15.0B by the Council's advisors
  - This yields an enterprise value of $24B, which consists of $15B equity, $9B debt and $323M preferred shares, which the province would retain post-IPO
  - This includes Brampton as part of the IPO valuation
  - Hydro One's expected Valuation of $15B is approximately 20.4x the company's expected 2015 net income of $750M



- Other Canadian publicly listed trading companies in the utilities sector are trading at marginally lower multiples however a premium on Hydro One' valuations is justified given:
  - Large liquid issue that will be part of a number of indexes
  - Significant balance of transmission assets in the utility mix
  - Relatively attractive regulatory environment

- Integrated valuation rationale:
  - The valuation multiples for an integrated HOI will tend to be higher than those for Distribution
  - Keeping HOI intact will not risk friction with bondholders
  - The HOI IPO will be of larger scale over time and will allow for fiscal benefits to be taken over a number of years

Tax Goodwill: Council H1 Sale Scenario

- The Council's analysis suggest an equity valuation of about $14.6 billion, before removing Brampton and applying a 5% IPO discount, and about $13.55 B after those adjustments
  - As HOI's debt net of the Brampton portion is about $11.65 billion, total enterprise value would be about $25.2 B
- The market premium (of $6.7 B in this example) is effectively the difference between the market valuation of the company (its Enterprise Value) and the Fair-Market-Value (FMV) of all its assets.
- Tax goodwill is treated as a capital gain and has been included by the Council in its analysis at 50% (for prudence) of the combined corporate tax rate (26.5%), for the portion retained by the Province post sale (85%) in fiscal 2015-2016

All figures are illustrative and rounded (Millions of $)	
HOI net equity value (amount is net of Brampton and IPO discount)	13,550
HOI net-debt (excluding Brampton)	11,650
Enterprise Value (net of Brampton)	25,200
Less: Fair Market Value of Fixed Assets and Tax carrying value of goodwill	18,500
Market Premium	6,700
Goodwill inclusion rate	50%
Tax rate	26.50%
Provincial Interest in H1 post sale	85%
Tax goodwill	**~ 770**

** Based on PAC figures as of February 4, 2015.*

- Tax goodwill is a non cash item and, therefore, doesn't create any interest-on-debt savings nor can it be used to "off-set" one time cash expenditures.
- Tax goodwill creates an accounting gain in H1, using U.S. GAAP, in the year of the transaction, and would contribute to reducing the deficit in the year of the transaction, if consolidated without adjustment into Public Accounts. Note that there would be, going-forward an amortisation expense from the tax goodwill.
- If tax goodwill is activated by HOI (which uses US GAAP) and recognized as part of Investment in GBEs under PSAB, it contributes to reducing net debt. Consolidation in Public Accounts is subject to AG review.

Cash Proceeds and Fiscal Calculations (Hydro One IPO only)

- The table shows the Council's estimated cash proceeds, compared to projected book value, for a gain on sale
  - Under the Trillium Trust Act, Treasury Board could designate Hydro One shares as a qualifying asset and direct that net proceeds (amount "c" below: gain on sale, and net of transactions costs) be credited to the Trillium Trust
  - Currently, only the gain is available for the Trillium Trust, as the proceeds in respect of the book value are already used to offset existing Provincial debt in the Province's net debt calculation
    - Note that the original book value of the equity was acquired by the Province in a debt-for-equity swap when the old Ontario Hydro was restructured. The Province owes that amount to OEFC, as well as an allocation to OEFC, in respect of Hydro One net income over time, that is greater than the retained earnings
- Note: These asset optimisation amounts are not all incremental to the 2014 fiscal plan – they contribute to meeting asset optimisation targets in the 2014 fiscal plan
- Estimated tax goodwill (see preceding slides) associated with the IPO would contribute to the overall fiscal benefits from the transaction, and subject to necessary amendments to the *Trillium Trust Act, 2014*, it could be credited to the Trillium Trust.

Fiscal Impact ($M)*		2015-16	2016-17	2017-18	2018-19	2019-20/ Ongoing
Proceeds from H1 IPO (cash)	a	$1,970	$2,230	$2,340	$2,480	
Less: Book Value of Equity	b	$1,210	$1,240	$1,300	$1,350	
Gain on Sale: Upfront Impact from Transaction (Before Tax Goodwill)	**c = a-b**	**$760**	**$990**	**$1,040**	**$1,130**	**-**
Tax Goodwill**	d	$770	-	-	-	-
Loss of Net Income/PILs/Indemnity Payments	e	($140)	($350)	($480)	($640)	($740)
Estimated Fiscal Contribution	**f = c+d+e**	**$1,390**	**$640**	**$570**	**$500**	**($740)**
Potential Interest Savings***	g	$40	$130	$220	$330	$390
Total	**f+g**	**$1,430**	**$770**	**$790**	**$820**	**($350)**

* Based on PAC information as of February 20, 2015 and includes only Hydro One IPO figures. Numbers are based on Council analysis, and subject to change arising from new options. Numbers rounded to the nearest $10M. Numbers may not add due to rounding. On-going amounts forgone would change over time, depending on amount of forgone H1 growth and other changes in market conditions. Assumes mid-fiscal year transactions.

** Tax Goodwill based on fair value on entire H1 less Brampton, arising from H1 partial IPO transaction per Council analysis and assuming modified equity consolidation. This is subject to AG review. Tax Goodwill could go to fund the Trillium Trust subject to necessary amendments to the *Trillium Trust Act, 2014*

*** Potential IOD savings would decrease and effectively be eliminated over the long-term as infrastructure projects materialize. Up-front proceeds provide immediate IOD savings, and above assumes that IOD expenditure related to investment projects is capitalized until projects are finalized and in-service.

Hydro One IPO and Exit from the PILs Regime

Departure "Tax"

- As a result of the proposed IPO, Hydro One would have a "Departure Tax" payable to OEFC
- The Departure Tax (a.k.a. exit tax or depreciation recapture) is not a unique tax for the electricity sector but a function of the income tax system, and mirrored in the payments-in-lieu of tax (PILs) system
- With an IPO sale of Hydro One greater than 10 per cent, Hydro One would become taxable under the federal *Income Tax Act* and the Province's *Taxation Act, 2007,* and exit the PILs system
- On exit, there would be a deemed disposition of assets, which can result in a gain or a loss based on the difference between the sale price (e.g. fair market value) and the tax depreciated value of the asset
  - For depreciable property, when the deemed fair market value proceeds of disposition are:
    - more than the undepreciated capital cost (original cost minus tax depreciation claimed in previous years in the PILs system) of the property, there is a **recapture** of tax depreciation. 100% of the recapture amount is included in PILs taxable income
    - less than the undepreciated capital cost, the result is a **terminal loss**. 100% of the terminal loss is deductible from PILs income
    - Recapture and terminal loss reflect the fact that tax depreciation rates may not reflect the actual depreciation of a property. For example, excess tax depreciation claims are clawed back in the form of the recapture portion of the departure tax
  - When the deemed proceeds of disposition of a property at fair market value are more than the original cost of the property, the result is a capital gain. One half of the capital gain is the **taxable capital gain**
- The departure tax / loss plays an important role in ensuring proper payment of PILs to the Province as it is designed to bring past claims for depreciation and associated PILs amounts in line with actual depreciation and PILs that should have been paid

Departure Tax and Capital Contribution

- In the case of Hydro One, the Council has estimated that the departure tax would be about $2.6 billion, under the Council's estimated Hydro One valuation and gains
- The Departure Tax would be fiscally neutral as Hydro One would be paying it to the Province (OEFC). The revenues recorded by OEFC (and the Province upon consolidation) would be offset by the impact to H1's bottom line, which is also consolidated, resulting in no net fiscal impact
- In order to maintain Hydro One's financial ratios, the Council recommend that the departure tax payment by Hydro One be financed by a capital contribution from the Province
- A Departure tax payment in the absence of a capital contribution would result in a significant reduction in financial ratios and capital structure flexibility for Hydro One (say, the departure tax were financed with debt instead) and could affect potential investor perception and reduce the value of Hydro One
- Due to the large size of the appropriation requirement, the Province's provision of the capital contribution will result in the government needing to table Supplementary Estimates in the days immediately preceding the IPO and once a final valuation has been determined, or agreed to for departure tax purposes
    - The final value of the departure tax and capital contribution will not be known until there is a better understanding of the final valuation for Hydro One

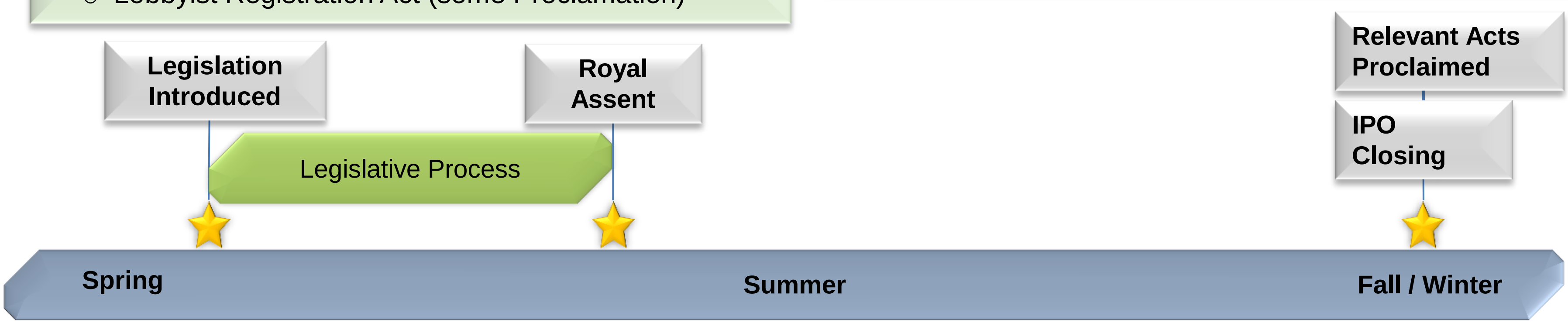
5. Legislative Amendments and Changes in Governance

Legislative Amendments: Changes at Royal Assent and Proclamation

- In order to exempt Hydro One Inc. from the various accountability measures, including compensation restrictions and oversight from officers of the Legislature, amendments to the certain Acts would be required as detailed below

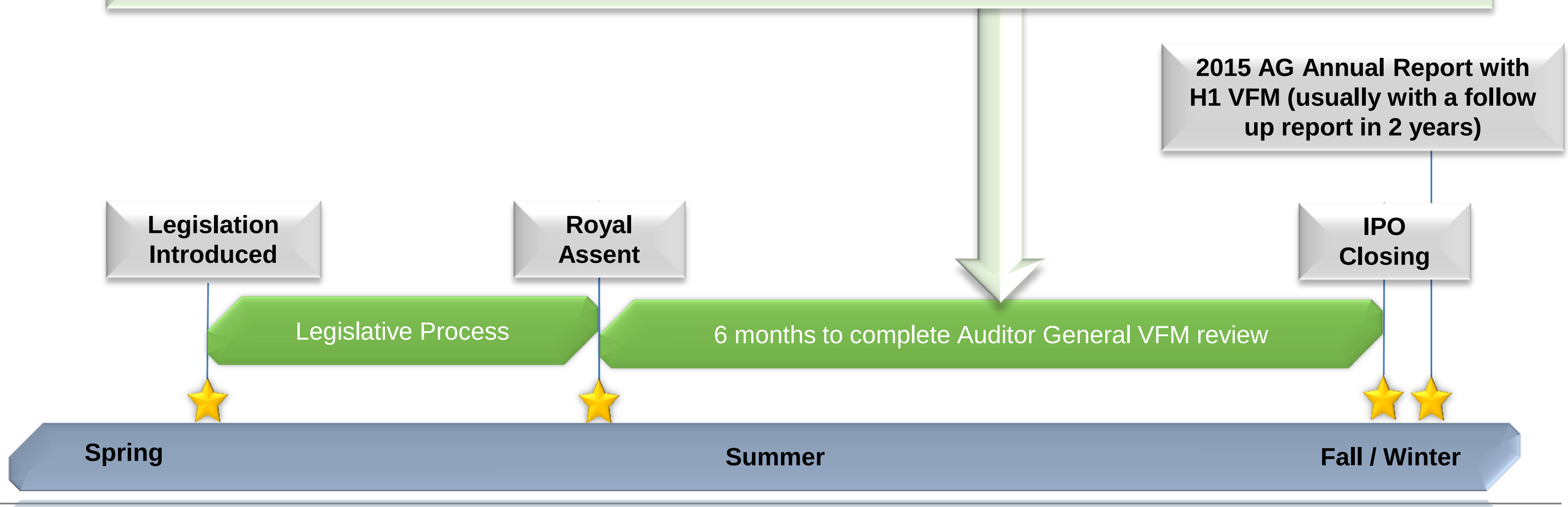
Royal Assent:
- Electricity Act
  - Create Ombudsperson Office
- Hydro One, like other publicly traded companies, would no longer be subject to:
  - Financial Accountability Officer Act (6 mo. transition)
  - Management Board of Cabinet Act
  - Public Sector Expenses Review Act
  - Broader Public Sector Accountability Act
  - Broader Public Sector Executive Compensation Act
  - Auditor General Act (6 mo. transition for VFM audits, but continuing information re Public Accounts)
  - Ombudsman Act (6 mo. transition)
  - FIPPA/MFIPPA (6 mo. transition)
  - Public Sector Salary Disclosure Act
  - Lobbyist Registration Act (some Proclamation)

Proclamation:
- Electricity Act
  - Allow transmission/distribution activities outside Ontario
  - Maintain head office in Ontario
  - Can't sell substantially all of Tx or Dx business
  - 10 percent limit on any one shareholder
  - Require government seek approval for legislative amendment to sell below 40 percent of shares at the time of IPO
- Hydro One, like other publicly traded companies, would no longer be subject to:
  - Financial Administration Act (but continuing information re Public Accounts)
- Lobbyist Registration Act (some Royal Assent)



Legislative Timeline: Auditor General

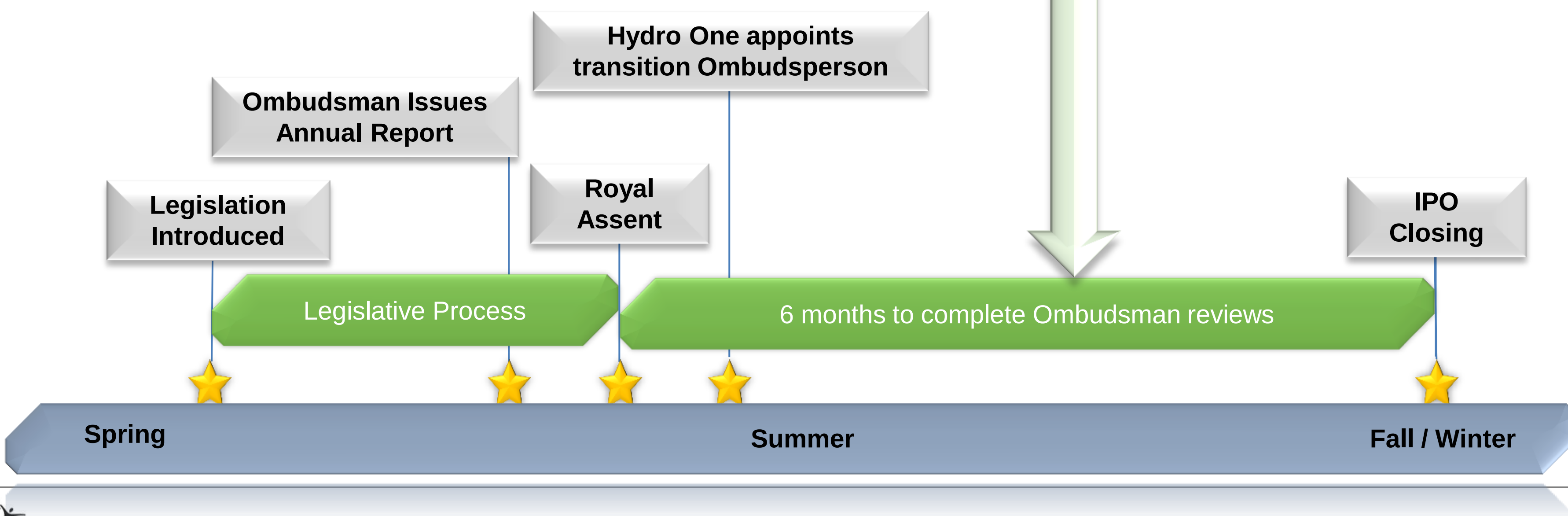
On Royal Assent:
- Auditor General Act
  - Hydro One would no longer be subject to most of the Act
  - Auditor General would have 6 months to complete any outstanding VFM reviews, but could issue report after that date
  - Auditor General provided with the ability to review company financial information related to its consolidation in the Province's Public Accounts via limited statutory powers (to be repealed upon proclamation expected to be when Hydro One is no longer consolidated)



Legislative Timeline: Ombudsman

On Royal Assent:

- Ombudsman Act
  - Hydro One would no longer be subject to Act
  - Ombudsman would have 6 months to complete any outstanding reviews, but could still issue a report after that date
- Independent Hydro One Ombudsperson Office would be established through Electricity Act and Governance Agreement between Province and Hydro One

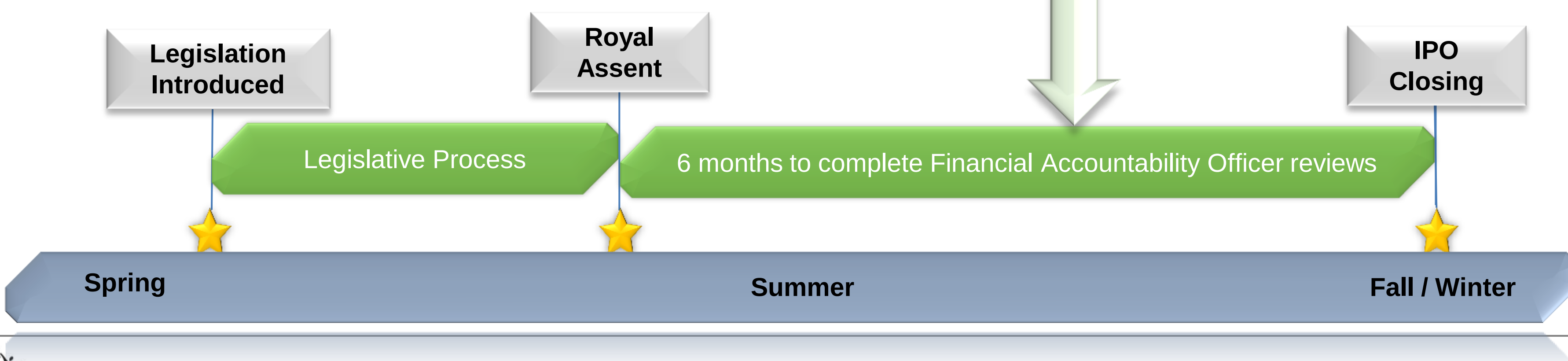


Ontario

Legislative Timeline: Financial Accountability Officer

On Royal Assent:

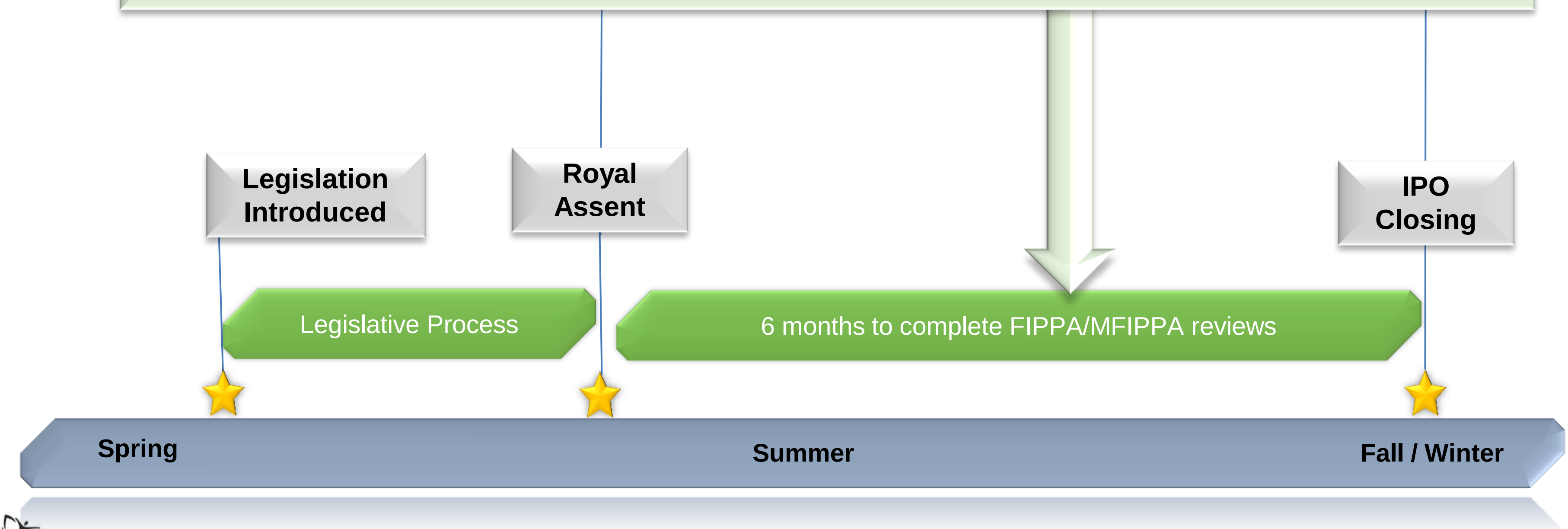
- Financial Accountability Officer Act
    - Hydro One would no longer be subject to Act
    - Financial Accountability Officer would be able to obtain information from Hydro One and its subsidiaries with respect to research undertaken before that date
    - After six months, Hydro One would no longer have an obligation to provide information to the FAO, but the FAO could still release a report or comment on H1 after the six month period expired



Legislative Timeline: FIPPA / MFIPPA

On Royal Assent:

- Legislation would remove Hydro One from FIPPA / MFIPPA
  - Would have 6 months to complete all outstanding requests at the time of Royal Assent but could still issue a report after that date
  - Would end continuing access requests retroactively at the date of introduction



6. OEB Proposed Legislative Enhancements

Context

- In concert with a potential Hydro One divestiture, there is an opportunity to further enhance the Ontario Energy Board's (OEB) mandate and organization to ensure it continues to have a robust set of tools to regulate and protect consumers

- The following slides outline some potential options for legislative amendments that could be introduced this spring
  - e.g. enhanced consumer protection, strengthening penalty/non-compliance, emergency provisions, promoting OEB oversight of utility sector

- The Ministry and the OEB are working to finalize these proposed enhancements and initiate drafting of the legislation

Overview of the Ontario Energy Board

- The Ontario Energy Board (OEB) is a quasi-judicial economic regulator of the Province's energy sector, including both Local Distribution Companies (LDCs) and transmission companies with respect to electricity, as well as natural gas distribution

- The OEB's mandate is to act as a fair, impartial, and independent regulator, and its objects and powers are set by the *Ontario Energy Board Act, 1998* (OEBA), which include:

  - The objective to "protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service"

  - Responsibility to set just and reasonable rates and to licence electricity transmitters and distributors

  - The ability to impose licence conditions on LDCs and transmitters, including the authority to make rules for electricity participants through codes and other guidelines

  - The OEBA also requires OEB approval involving change in ownership or control of a distribution or transmission system

  - The authority to impose administrative penalties and fines on LDCs and transmission companies

OEB Regulation of the Electricity Sector

- With respect to the electricity sector, some of the key OEB roles are:
  - Approving transmission and distribution rates
    - The OEB sets the rates for over 70 LDCs and 5 transmitters
    - Distribution and Transmission companies must submit rate filings regularly with the OEB to ensure costs are allocated appropriately and rates for consumers are adjusted as needed
  - Reviewing applications for mergers, acquisitions and divestitures for transmission or distribution assets to ensure that ratepayers are not harmed as a result of the transaction
  - Setting codes, which are rules governing the conduct of distributors and transmitters
    - Codes are considered a condition of licence, as set out in the OEBA
    - The important codes for distributors and transmitters are the Affiliate Relationships Code for Distributors and Transmitters (ARC), the Distribution System Code (DSC), and the Transmission System Code (TSC)
      - The ARC outlines how core regulated business activities and non-utility business activities should be undertaken and accounted for by LDCs and transmitters
      - The DSC and TSC set out the minimum standards and obligations for LDCs and transmitters respectively in serving customers
  - Administering the *Energy Consumer Protection Act* (ECPA) and undertaking other activities to protect and educate electricity rate payers

Proposed Legislative Enhancements

Further enhancing consumer protection

- Implementing OEB recommendations on enhancing the *Energy Consumer Protection Act* with respect to energy retailers
    - Exploring options to eliminate or limit door to door sales by energy retailers
    - Introducing stricter retailer oversight and greater consumer education

Increasing reliability / continuity of service to customers

- Ensure OEB could extend emergency provisions to transmitters and ensure a third party could take over operations if a distributor is unable to continue to provide service to its customers for financial or other reasons
- Allow for safety-related information sharing between OEB/TSSA/ESA

Providing further compliance tools to the OEB

- Increasing penalties and OEB flexibility for non-compliant activities by distributors and transmitters
    - Increase (or remove) existing legislative cap on penalties
    - Remove / amend existing ‘penalty–impact matrix’
    - Consider provisions that would allow the OEB to impose penalties without a hearing for non-compliance with certain enforceable provisions

Proposed Legislative Enhancements (*cont'd*)

OEB oversight of utility transactions

- Would reflect "best practices" of the Hydro One IPO
  - Reduce threshold for OEB review of share purchases where an individual / entity would own more than 10 percent (down from the current threshold of 20 percent)
  - LDCs should have head office, key personal and records in Ontario to ensure quality of customer service
  - Ensure OEB can review all corporate / financial structures in LDC transactions

New / enhanced tools to ensure that critical transmission infrastructure is built

- Government through an LGIC OIC could deem certain transmission infrastructure as a "public good"
  - Would not need to undergo a "needs" test by the OEB

Clarifying the relationship between the LDC and its affiliate

- Would create a level playing field between utilities regardless of ownership structure and give the OEB greater flexibility to determine when an affiliate is or is not needed
  - Currently activities undertaken by a municipally-owned affiliate are more restricted than those owned by a non-municipal shareholder
  - Legislation currently codifies permissible activities, which may leave limited scope for new business models / partnerships

Proposed Legislative Enhancements (*cont'd*)

Consumer advocacy

- Amend legislation to allow the OEB to appoint a consumer advocate(s), or where the OEB has not already done so, allow the appointment of a consumer advocate(s) through an LGIC OIC
  - This is the model used in the province of Nova Scotia where the consumer advocate acts as an intervenor in rate cases and their costs are paid by the applicant

Rural or Remote Rate Protection (RRRP)

- Currently Hydro One is the settlement agent for the RRRP
- Revise the RRRP regulation and legislation to make IESO the settlement agent rather than Hydro One post-IPO

7. Governance and Oversight Post-IPO

Ontario

OEB and IESO Requirements

Ontario Energy Board

- Required under the *Ontario Energy Board Act, 1998* to file transmission and distribution rate applications with the Ontario Energy Board from time to time or as may be required by the Board;
  - Required to comply with any reporting or filing obligations as may be specified by the Ontario Energy Board in connection with the approval of transmission or distribution rates
- Required under each of its Electricity Transmission License and its Electricity Distribution License to:
  - maintain records and provide, in the manner and form determined by the Ontario Energy Board, such information as the Board may require from time to time;
  - notify the Board of any material change in circumstances that adversely affects or is likely to adversely affect the business, operations or assets of the Licensee as soon as practicable, but in any event no more than 20 days past the date of such change
- Required to comply with the Ontario Energy Board's Electricity Reporting and Record Keeping Requirements ("RRS"), which are the Board's minimum requirements for maintaining and filing information under the license conditions

Independent Electricity System Operator

- Required to comply with all reporting, record keeping and filing obligations under the Market Rules for the Ontario Electricity Market, as applicable to each of Hydro One's transmission and distribution businesses

Canadian Securities Law and Ontario *Business Corporations Act* Requirements

- Disclosure Obligations Imposed Under Canadian Securities Laws and the *Business Corporations Act (Ontario)*

  - **Annual Disclosure:** including board approved annual financial statements; Annual Information Form; and Management Discussion and Analysis (MD&A) which much discuss liquidity and capital resources, as well as commitments, events, and uncertainties that are reasonably likely to have a material impact on the business

  - **Quarterly Disclosure:** providing updates to the annual requirements

  - **CEO and CFO Certifications and Associated Controls:** certifying that there are no misrepresentations in the annual or quarterly materials, the company has designed disclosure controls and procedures; and any material weaknesses disclosed in the MD&A

  - **Shareholders' Meeting Requirements:** rules governing solicitation of proxies and requirements for disclosure in 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; as well as compensation objectives, benchmarks and targets)

  - **Event-Driven Disclosure**: requirements to issue material change reports, and press releases describing the event as soon as possible and no later than 10 days

Canadian Securities Law and Ontario *Business Corporations Act* Requirements (*cont'd*)

- Disclosure Obligations Imposed Under Canadian Securities Laws and the *Business Corporations Act (Ontario)*
  - **Business Acquisition Reports**: must be filed within 75 days of the company completing a significant acquisition (exceeding 20 percent of the company's assets or income)
  - **Additional Filing Requirements:**
    - Disclosure of shareholder meeting voting results
    - Earnings releases
    - Notice of change in auditor
    - Changes to documents affecting the rights of securities holders (constating documents, indentures, etc.)
    - Material contracts
  - **Insider Reporting:**
    - insiders include senior officers, directors, major security holders and anyone with access to material information and influence over the company
    - Any insiders holding securities in the company must file reports disclosing material amendments (e.g. sale or purchase of shares in the company)

Toronto Stock Exchange (TSX) Requirements

- The company must meet rules established by the Toronto Stock Exchange (assuming shares are issued on this exchange) including:
  - **Timely disclosure:**
    - Material information must be released immediately
    - Releases must be provided in advance to TSX's market surveillance department (IIROC)
    - TSX may require a clarifying announcement if the market appears to be affected by rumours or insider trading
  - **Notice and Review of certain corporate events:**
    - TSX must be notified of transactions, issuance of capital, dividends, granting of options and other financial activities that could impact shareholders
    - TSX must approve all capital issuances and must be provided with-monthly notice of increases or decreases in the number of issued securities of the company
  - **Security Holder Approval:**
    - TSX generally requires security holder approval for transactions that materially affect control, provide insiders more than 10 percent of the company's projected capitalizations and, acquisitions funded through issuance of shares representing more than 25 percent of existing shares outstanding
  - **Security-based compensation arrangements:**
    - For stock options and other share-based employee compensation, shareholder approval is required (for adoption and material amendments); exercise price of options must be at the market price at date of grant; must have a fixed maximum number / percentage outstanding
  - **Board Elections**
    - TSX requires all issuers to adopt a majority voting policy applicable to uncontested director elections. Under the policy, if a director does not receive a majority of votes in favour, he or she must resign and the board must accept the resignation, absent exceptional circumstances
    - TSX does not permit slate voting in director elections (i.e., shareholders must be able to vote on each individual director)

US Securities Exchange Commission Requirements

- As a US debt issuer Hydro One must adhere to the following disclosure obligations imposed by the US Securities Exchange Commission (SEC):
  - **Form 40-F Annual Filing:**
    - Requires filing of Annual Information Forms, MD&A and annual financials
    - Disclosure of presence of a financial expert on the company's audit committee
    - Disclosure of off-balance sheet arrangements and contractual obligations
    - Changes to documents affecting the rights of securities holders (constating documents, indentures, etc.)
    - Material contracts
  - **Material Information:**
    - Similar to Canadian requirements, all material changes to the company must be made public immediately

8. Transfer Tax and Departure Tax

Transfer Tax, Departure Tax

Council Recommends Time-limited Tax Changes to Incent Private Sector Consolidation

1: Reduce the *transfer tax* rate

- The Council suggests reducing the transfer tax rate from the current 33 to 22 percent for all LDCs for a time-limited period in order to spur consolidation
- While the net transfer tax liability would be different for each LDC due to the deduction of past payments-in-lieu of taxes (PIL) from transfer tax owing, the reduction may help to incent private sector investment and consolidation for some LDCs

2: Exempt “small” MEUs from the *transfer tax*

- Small LDCs (eg: < 30,000 customers, or a smaller amount of total assets) for a time-limited period
- This could lead to a relatively small leakage in PILs (Ministry of Finance estimates suggest currently ~$4M/yr)
- Provides a limited response to stakeholder requests for elimination of the transfer tax as a barrier to LDC consolidation

3: Exempt capital gains portion of the *departure tax*

- Provide an exemption on the taxable capital gains portion of the departure tax for a time-limited period
- According to the Council, this represents a small portion of total departure tax that would likely be levied; therefore, the fiscal impacts are limited
- Specific impacts would vary depending on the tax circumstances on each LDC

- **Time-limited:** Council recommends these changes be made available for a three-year,~~s~~ period beginning January 1, 2016 and ending December 31, 2018 (LDCs before OEB at time of expiry, with a firm proposed transaction, should be allowed to continue their proceedings)

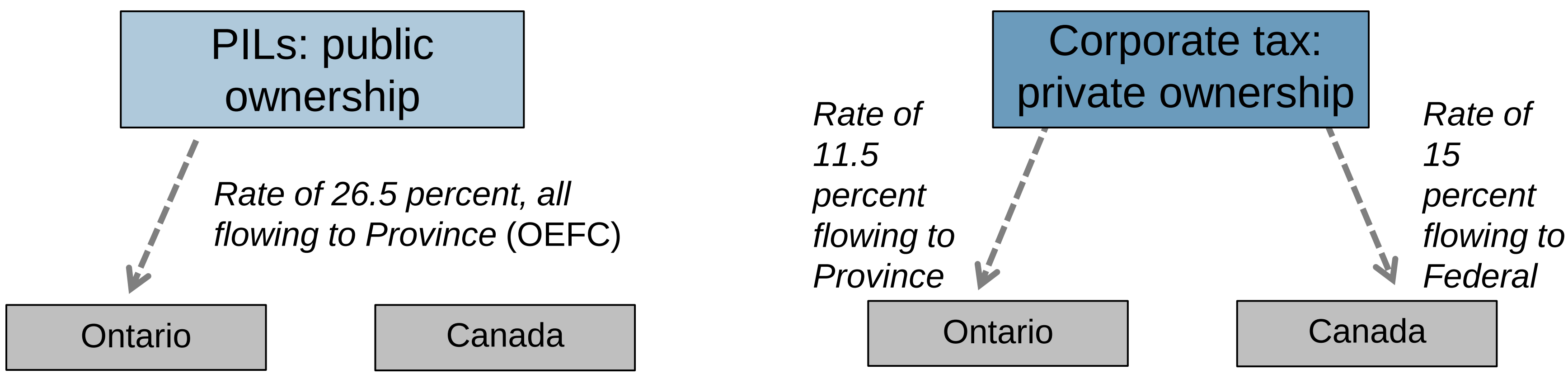
Overview
LDC Payments in lieu of taxes

Context

- The electricity sector was restructured in 1998 and as part of that restructuring municipalities were given ownership of their electrical utilities, on a debt-free basis. These utilities were restructured under the Ontario *Business Corporation Act* as business corporations, providing municipalities with a source of income and the potential to realize significant proceeds in the event of divestiture

Payments-in-Lieu of Taxes

- Under the federal *Income Tax Act* and the Ontario *Taxation Act, 2007*, municipally owned and provincially owned LDCs are exempt from paying corporate taxes; instead, they make payments-in-lieu (PIL) of taxes which replicate the federal and provincial corporate taxes as well as municipal property taxes that would otherwise by payable
    - PILs are paid to the Ontario Electricity Financial Corporation (OEFC) and help service and pay down the stranded debt of the former Ontario Hydro
    - As shown below, utilities with >10 percent ownership by the private sector move, in accordance with federal and provincial tax legislation, from the PILs regime to the income tax regime, resulting in lost revenue to the Province



Overview
Transfer Tax

- In order to have municipalities pay a fair share towards stranded debt for receiving ownership of the MEUs, and also mitigating against PILs leakage, described on the previous slide, the Province implemented a 33 percent Transfer Tax on the fair market value of any LDC assets sold to the private sector
  - The tax is reduced by PILs previously paid by the MEU up to the time of the transfer
- The 33 percent rate was set to ensure that municipalities contribute their fair share to paying down the stranded debt and compensates the Province for the loss of the federal portion of PILs
- According to MOF, a transfer tax rate of 20 to 25 percent may be sufficient to hold the OEFC whole on federal PILs leakage, on average, but will vary by LDC and a sale structure, and would be lower than the 33 percent amount earlier set as a contribution to stranded debt
- Hydro One and its subsidiaries are not subject to transfer taxes and, thus, a sale of the company's subsidiaries would not incur the 33 percent tax

Overview

Departure "Tax"

- Departure "tax" (a.k.a. exit tax or depreciation recapture) is not a separate tax but a function of the income tax system, and the PILs system, that results from a gain on the deemed disposition of assets that occurs when an MEU ceases to be exempt from income tax
- The sale of an asset can result in a gain or a loss based on the difference between the sale price (e.g. fair market value) and the tax value of the asset
- The PILs impact of the sale of an asset is the:
  - [gain or loss] x [the corporate income tax rate up to the original value of assets (called the recapture of depreciation)] + [50 percent of the corporate income tax rate for any capital gains]
- A sale of over 10 per cent of an MEU to the private sector results in a deemed sale of the MEU's assets and a transition from the PILs regime to the corporate tax system
  - A deemed sale of the MEU's assets results in either a gain requiring a PILs payment (aka departure tax) or a loss that when carried back to prior years would generate a PILs refund
  - At the time the MEU exits the PILs system, any PILs payment or refund related to the deemed sale of the MEU's assets is applied against the transfer tax (e.g. PILs payment reduces transfer tax and PILs refund increases the transfer tax)
  - At the time the MEU enters the corporate tax system, the new value of the assets (e.g. FMV) becomes the basis for tax depreciation (e.g. capital cost allowance)

Recommendations

Transfer Tax and Departure Tax

Transfer Tax Recommendations

- Two key recommendations are:
  - Reducing the transfer tax rate from the current 33 to 22 percent for all LDCs for a three year period in order to spur consolidation
  - Exempt “small” LDCs (with less than 30,000 customers) for a three year period
- Provides a balanced approach to incent consolidation, while mitigating potential fiscal impacts
- Time limits are designed to spur consolidation in the near term, building on the momentum created by the Hydro One Brampton merger and Hydro One IPO

PILs/Departure Tax Recommendations

- Key recommendation is:
  - Exemption on the taxable capital gains portion of the departure tax for a three year period
- Removes the “double taxation” effects on capital investments made by utilities that would be subject to both the transfer and departure tax
- Time limits are designed to spur consolidation in the near term, building on the momentum created by the Hydro One Brampton merger and Hydro One IPO

9. Precedent Transactions

Comparison of 2002 and Proposed 2015 Transactions

Key Terms	Proposed Hydro One 2002 Transaction	Hydro One IPO (2015)
Transaction	• Up to 100 percent of Hydro One shares up for sale in initial announcement (subsequently amended) • Common shares were to be offered in Canada, United States, and internationally • Shares were to be listed on TSX and NYSE	• Up to 60 percent in multiple tranches, initial IPO of approximately 15 percent • Common shares would be offered publicly in Canada and by private placement in the United States • Listing potentially on TSX and other Canadian exchanges • Divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Ownership	• No single entity could own or control more than 15 percent of voting shares	• Maximum of 10 percent ownership limitation for any individual or group with exception for the Province
Protections	• Province was to be issued one special share to allow to veto any proposal to: – amend the articles of Hydro One to relocate its head office outside of Ontario; – change the jurisdiction of Hydro One's incorporation; or – alter rights attached to the special share	• A combination of protections in legislation and, through a governance agreement between the Province and Hydro One, to: – Maintain head office, CEO, and substantially all strategic decision-making management and functions in Ontario – Restrict sale of substantially all assets regulated by the OEB (transmission or distribution assets) – Return to legislature prior to selling > 60 percent ownership – Province has the right to acquire up to 40 percent of each share issue – Province nominates up to 40 percent of directors pro rata to its interest – Company must be listed on TSX
Regulatory Oversight	• Rate regulated. Transmission and distribution rates are set by the Ontario Energy Board	• Regulated, and strengthen OEB to ensure regulatory rigour
Use of Proceeds	• Province was to receive all proceeds from the sale of the common shares • Proceeds to be used to pay down the legacy debt and liabilities of former Ontario Hydro	• Province will receive all the proceeds from the sale • Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Taxes	• Province agreed up front to the amount of the PILs payable by Hydro ($440M), and a capital contribution of $290M • Hydro One agreed not to request to have the PILs amount included in rate recovery	• Upfront payment of departure tax paid to OEFC in year one of offering • Amounts equivalent to departure taxes to be re-injected into Hydro One as additional equity

Comparison to Highway 407

Key Item	Highway 407	Hydro One IPO (2015)
Ownership	• Sold 99-year lease to a foreign syndicate	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Self-contained toll-road that would be easier to operate, more limited opportunities for efficiencies	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• Proceeds were not maximized as significant value was lost due to the structure of the transaction which allowed the foreign syndicate to raise rates and there was no mechanism in place to share any additional revenues with the Province • Used for general government purposes	• Proceeds would be maximized based on structure of the proposed IPO. A partial share offering allows the market to establish value through improved company performance, which would benefit the Province in subsequent share offerings. The Province would continue to benefit from the net income of the company and it would also be able to monitor the market and determine the optimal timing for the secondary share offerings • Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• Province receives no on-going revenues	• Province would continue to receive a portion of dividends and improved earnings as a 40 percent owner
Restrictions	• Responsibility for completing partial extension and highway usage minimums	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• No price setting ability in place; unregulated	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to Nova Scotia Power Company (NSPC)

Key Item	Nova Scotia Power Company	Hydro One IPO (2015)
Ownership	• Complete government divestment in 1992	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Vertically Integrated electrical utility • Privatization designed to reduce systems costs	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• Total proceeds of $851M, of which: – Majority of proceeds used to pay down outstanding debt – Portion of proceeds to the Nova Scotia government for general purposes	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• None	• Province would continue to receive a portion of dividends and improved earnings as a 40 percent owner
Restrictions	• No single entity may own more than 15 percent • Non-residents may not beneficially own or control more than 25 percent of the votes attached to all outstanding voting shares • Non-resident votes at shareholder meetings pro-rated to not exceed 25 percent of total vote	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• Rate regulated with a permitted ROE range	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to Petro-Canada

Key Item	**Petro Canada**	**Hydro One IPO (2015)**
Ownership	• Government of Canada sold ~20 percent in 1991 • Remaining ~80 percent sold in tranches between 1992 and 2004	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Integrated oil and gas company	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• To reduce the deficit • CAN ~$550M initial offering and ~$5.7B total between 1992 and 2004	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• Revenues continued during sell-down period; none beyond 2004	• Province would continue to receive a portion of dividends and improved earnings as a 40 percent owner
Restrictions	• Cap at 20 percent of shares per shareholder • Head office to remain in Calgary, Alberta • A provision prevented selling, transferring or otherwise disposing of substantial assets	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• No economic regulation	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to CN Rail

Key Item	CN Rail	Hydro One IPO (2015)
Ownership	• Government of Canada sold 95 percent of Equity in 1995 • Remaining 5 percent sold at a later date	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Rail and transportation conglomerate	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• (CAD ~$2B) used to pay down CN debt and remaining for general government purposes	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• No revenues once final 5 percent was divested	• Province would continue to receive on-going dividends and a portion of improved earnings as a 40 percent owner
Restrictions	• No individual or corporate shareholder may own more than 15 percent of CN • The company's headquarters must remain in Montreal	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• Largely unregulated. Price regulation effects setting railway revenue caps for moving western grain and interswitching rates	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to Air Canada

Key Item	Air Canada	Hydro One IPO (2015)
Ownership	• Government of Canada sold 100 percent of its interest in two stages (57 percent 1988 and 43 percent 1989)	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Commercial airline	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• The government used the proceeds from the IPO to re-capitalize the airline	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• None beyond 1989	• Province would continue to receive on-going dividends and a portion of improved earnings as a 40 percent owner
Restrictions	• Maintain select Canadian operational and overhaul centres • No shareholder may own more than 10 percent of the airline's stock • Foreign ownership capped at 25 percent • Air Canada's corporate headquarters to remain in Montreal • Service must be provided in both official languages • A majority of the board of directors must be residents of Canada	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• No economic regulator	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to Royal Mail

Key Item	Royal Mail	Hydro One IPO (2015)
Ownership	• Sale by British government closed on October 2013 • The British government retains a 30 percent stake	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• National mail and parcel delivery service	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• Proceeds equivalent to ~$3.4 B (in 2015 Canadian dollars) • In UK transactions proceeds usually go to general revenues	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• Continue to receive benefit equivalent to the government's 30 percent ownership stake	• Province would continue to receive on-going dividends and a portion of improved earnings as a 40 percent owner
Restrictions	• No ownership conditions • Shareholder governance provisions: limited voting rights if more than 30 percent government ownership maintained • One board seat if ownership above 10 percent	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• Ofcom (the regulator) removed price controls on the majority of Royal Mail's products and services. The proportion of Royal Mail revenues under direct price regulation is now approximately 5 percent	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to UK Regional Electricity Companies (RECs)

Key Item	UK Regional Electricity Companies (RECs)	Hydro One IPO (2015)
Ownership	• British government sold 100 percent of its equity interest in 1999	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Electrical distribution companies, geographical monopoly franchises	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• Proceeds equivalent to $18.7B (in 2015 Canadian dollars) • In UK transactions proceeds usually go to general revenues	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• None	• Province would continue to receive on-going dividends and a portion of improved earnings as a 40 percent owner
Restrictions	• No one was able to own more than 15 percent for the first 5 years	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• Regulated by Ofgem using a price cap methodology comprised of the retail price index, adjusted to reflect the potential for additional productivity	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to United Energy (Australian Distribution Privatization)

Key Item	United Energy	Hydro One IPO (2015)
Ownership	• Australian government sold its 100 percent equity interest in the company in 1995	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• Electrical Distribution Company	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• Proceeds equivalent to ~$2.2 B (in 2015 Canadian dollars) • Debt reduction and investments	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• None	• Province would continue to receive on-going dividends and a portion of improved earnings as a 40 percent owner
Restrictions	• Retail tariffs were frozen until 1996 (i.e. less than a year)	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• Economically regulated	• Regulated, and strengthen OEB to ensure regulatory rigour

Comparison to Railtrack

Key Item	Railtrack	Hydro One IPO (2015)
Ownership	• British government sold 100 percent of its equity interest in 1996	• Province to sell up to 60 percent in multiple tranches, with an initial round of approximately15 percent. Also, divesting the of Province's interest in Hydro One Brampton for cash or a 17 percent interest in the merged entity
Assets / Business Model	• England national rail track and signaling infrastructure	• Complex, integrated, and multi-faceted business with considerable opportunity to drive operating efficiencies from private ownership
Proceeds & Use (if known)	• Proceeds equivalent to ~$5.6 B (in 2015 Canadian dollars)	• Dedicated to Trillium Trust and investments in public transit, transportation and other infrastructure
Ongoing revenues	• None	• Province would continue to receive on-going dividends and a portion of improved earnings as a 40 percent owner
Restrictions	• No Restrictions on Ownership	• Must be listed on TSX; 10 percent ownership cap (excluding Province); Ontario Grid control, head office and substantially all of strategic decision-making management and functions to stay in Ontario; cannot sell substantially all OEB regulated transmission or distribution assets; 25-30 percent retail investor access for IPO; potential conditions regarding offshoring; Province has the right to acquire up to 40 percent of each share issue; Province nominates up to 40 percent of directors pro rata to its interest;
Regulatory	• Railtrack's main source of income was access charges levied on passenger and freight traffic. The regulator established access charges through negotiation with the industry	• Regulated, and strengthen OEB to ensure regulatory rigour