Ontario

Expert Investment Advisory Committee and Investment and Governance Secretariat: Managing Shareholder Relations with Hydro One Post IPO

October 20, 2015

CONFIDENTIAL ADVICE TO CABINET

Overview

- In accordance with the recent TB/Cabinet approval, the Minister of Energy will represent the Province as an investor / shareholder of Hydro One Limited shares following the Hydro One initial public offering (IPO)
  - TB/MBC will approve broad policy to purchase and sell shares on an annual basis, and the Minister of Energy will approve individual transactions, unless otherwise delegated
- The Governance Agreement and Registration Rights Agreements outline the shareholder relationship between the Minister Energy and Hydro One post-IPO
  - Key shareholder responsibilities include both governance matters and investment decisions. The requirements are outlined on slides 3 and 4
- As discussed in the August submission, the Ministry of Energy will require dedicated resources and expertise to support the Province as shareholder in these decisions
  - ENERGY has been granted procurement exemptions to acquire services required to support the IPO process and to support the ongoing administrative framework to enable future share sales and purchases
- To support the Minister, it is proposed that an Expert Investment Advisory Committee and Investment and Governance Secretariat be established
  - The Ministry is now seeking necessary approvals related to the proposed structure
- Energy, in discussion with, Cabinet Office, TBS and MOF, would review structure in the future and assess whether any adjustments to the structure are necessary

Context

Governance Requirements

- The Province will need dedicated resources to ensure it is effectively monitoring and responding to items within the Governance Agreement, including:
  - Nominating 40 percent of Board Members
  - Reviewing nominees from the Hydro One board's nominating committee to ensure they meet the requirements set out in the governance agreement
  - Voting in annual meetings, including board elections
  - Voting on material changes to the company, including issuance of shares, creation of new share classes and substantial acquisitions
  - Exercising the Province's pre-emptive right to purchase shares up to 45% of any new issuance for cash
- The Province will also need to monitor other items including:
  - Periodically validate that the company is meeting its legal requirements to maintain its grid control, head office and substantially all of its strategic decision making functions in Ontario, and will need to develop a process to do so
  - Track the quarterly and annual financial performance of the company to monitor the Province's investment and to be informed about Hydro One's consolidation on the Province's financials
  - In addition, the relationship of the Province with the company as shareholder may change over time as its ownership stake diminishes and the shareholder will need to maintain a current understanding of its rights and responsibilities
- Consideration will need to be given to the management of Conflict of Interest issues and compliance with Securities laws

Context

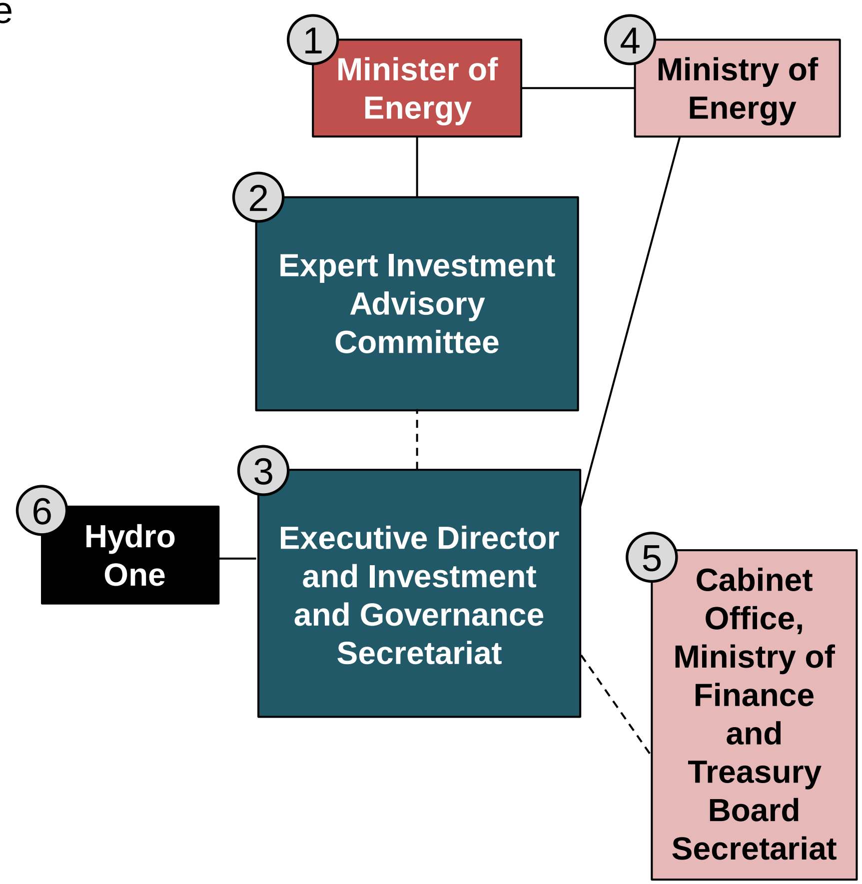
Management of Share Holdings

- To facilitate the effective management of holdings, investment, financial and legal expertise will be required to:
  - Provide advice regarding whether the Province should initiate a share offering
  - Analyse the share offering and conduct the necessary due diligence to determine if and how much to participate in the share offering as well as analyze the impact it would have on the fiscal statement
  - Actively monitor government's holdings in Hydro One shares so that ENERGY will be ready to act in share offerings when it occurs
  - Assess the fairness of share offerings in terms of price received/paid and fees paid
  - Work with Hydro One in compiling necessary documentation for securities filing purposes
- The Registration Rights Agreement which outlines the terms on which the Province can buy and sell shares and terms to facilitate coordination with Hydro One on its own issuances also sets out strict timelines within which the Province will need to act
  - Hydro One will give 30 days notice if it is moving forward with an offering, and the Province will have 10 business days to exercise its right to "piggy back" on this issuance
  - This is the same timeline that the Province will need to follow in order to exercise its pre-emptive right to purchase any of a Hydro One offering
- Given the strict timelines and confidential nature of market actions, the Province will need to consider how best to manage decisions to buy and sell shares. (See Appendix for initial work on monetization options)
- As a shareholder that will own more than 20% of a TSX listed company, the government may be required to submit documents on a periodic basis to disclose the amount of shares it holds to the Ontario Securities Commission

Proposed Structure

- The following provides an overview of the relationship and linkages between the Province as shareholder, Expert Investment Advisory Committee and Secretariat and Hydro One. Please note the Province would have separate interactions with Hydro One for policy purposes:

1. The Minister of Energy would represent the Province as an investor / shareholder of Hydro One Limited
2. The Expert Investment Advisory Committee would provide advice to the Minister regarding investment opportunities, Governance matters, compliance with securities laws and would develop the share sale plan
3. An Investment and Governance Secretariat, led by an Executive Director, would support the Expert Investment Advisory Committee
4. The Investment and Governance Secretariat would be structured as a division of the Ministry of Energy, formally reporting to the Deputy Minister
5. Cabinet Office, Treasury Board and Ministry of Finance staff would interact with the Secretariat
6. Hydro One would have direct communication with the Secretariat



Expert Investment Advisory Committee and Secretariat

Responsibilities

- As outlined in the Terms of Reference (ToR), the Expert Investment Advisory Committee and Secretariat would provide advice to the Minister on both financial and governance related matters

Investment and Financial Responsibilities:

- Establishing and maintaining an investment policy including purchase, sale and retention of shares
- Developing an annual share sale plan / targets based on direction from the Minister and Treasury Board an executing future offerings based on the approved plan
- Leveraging connections to potential investors in order to facilitate and enable efficient and value-maximizing transactions
- Providing advice to the Minister on current market conditions in support of share sale plan
- Monitoring progress to share sale targets
- During transactions will act as pricing committee in order to provide oversight and advice to the Minister regarding appropriate share sale price ranges, fee structures and other transaction related activities
- Making recommendations to the Minister on any other matters affecting the investment of assets which the Secretariat determines should be brought to the attention of the Minister
- Selecting investment advisors, managers and providers of other investment-related services, as required

Governance Responsibilities:

- Monitoring compliance with legislative and governance agreements
- Exercising shareholder rights including voting/proxy, participating in shareholders' meetings, election of directors, approval of by-laws, and appoint of the auditor of the corporation
- Performing such other functions as may be assigned from time to time by the Minister

Expert Investment Advisory Committee
Structure and Resources

- **Establishment**: The Committee would be established by an Order in Council, pursuant to legislative authority under the Ministry of Energy Act, 2011 section 12(1)(a), in accordance with under the Agencies and Appointments Directive
  - The short term body would have a mandate of up to three years
  - Mandate as outlined in the ToR and summarized on the previous slide, would be signed by the Minister of Energy
- **Potential Membership**: Members would be appointed through an OIC, pursuant to legislative authority under the Ministry of Energy Act, 2011, section 12(1)(a), in accordance with under the Agencies and Appointments Directive
  - The Expert Investment Advisory Committee would be made up of 3 to 5 senior representatives, including a Chair. The Ministry is recommending the following members:
    - Ed Clark (Chair), David Leith, Sharon Ranson, Tom Rahilly, and Alan Hibben
  - The Ministry will engage the Public Appointments Secretariat to initiate the appointment process, and will work with PAS and the preferred candidates to facilitate all facets of the process, including the applicants conflict of interest declaration and personnel screening check
- **Remuneration:**
  - Members will be remunerated by way of an OIC. Remuneration will consist of $2000 per diem and reimbursements for expenses incurred in the performance of members' duties in accordance with all applicable Management Board of Cabinet Directives
  - Ed Clark will not receive remuneration but will be reimbursed for all reasonable expenses incurred in the performance of duty in accordance with all applicable Management Board of Cabinet directives
    - The Ministry estimates total remuneration up to a maximum of $25,000 for each member
  - These rates are within the ranges set out in the Agencies and Appointments Directive for Unique and Specialized Expertise. Appointees have specialized knowledge and possess unique experience and rare skills. The committee is addressing urgent priority issues of the government (see Slide 9 for further detail)

Investment and Governance Secretariat

Structure and Resources

- **Structure and Personnel**:
  - The Secretariat would be a separate Division of the Ministry of Energy, formally reporting to the Deputy Minister of Energy, with close linkages to the Expert Investment Advisory Committee
  - Ministry of Energy is requesting up to 5 additional FTEs with an annual cost of ~$830,000 that will not be offset internally some of which may be seconded from the Ministry of Energy, Ministry of Finance / Ontario Financing Authority, Infrastructure Ontario, Restructuring Secretariat
    - This would include an Executive Director (XSMC3), Manager (XSMC1), two Senior Advisors (7A007) and an Administrative Assistant (5A007)
  - Anticipated costs include salary and wages, benefits and office operation, broken down as follows:

Vote	Standard Account	FTEs	2015-16 ($M)	2016-17* ($M)	2017-18* ($M)
2902-01	Salary and Wages	5	0.290	0.580	0.580
	Benefits		0.038	0.075	0.075
	Services - office operation		0.088	0.175	0.175
	Subtotal		**0.416**	**0.830**	**0.830**

- **Office Space:**
  - A self-contained space is available on the 5th Floor, Mowat Block to house the Executive Director / Secretariat
- **External Expertise:**
  - The Ministry will also engage external support for the Expert Investment Committee and Investment and Governance Committee which it received in-year approval from TB for in August
  - The Ministry will require out-year funding for 2016-17 and 2017-18 for the ongoing external legal and financial expenditures, which it expects to be ~$500,000 per year, which will be requested through the 2016-17 PRRT process

Expert Investment Advisory Committee

Structure and Resources: Rationale

- Appointed by OIC, this short term advisory committee will be made up of senior executives with broad investment and financial expertise
- This type of expertise is highly specialized and currently not widely available within OPS, and will be required to draw upon in order to implement the Province's asset transformation strategy effectively
- It is estimated the Province will need to enter the market approximately 3-4 times per year, which is when the majority of the Advisory Committee's efforts would be required
- This group will be able to leverage connections to potential investors to facilitate and enable efficient and value-maximizing transactions
- The committee will require specific expertise in order to effectively manage the governance relationship with Hydro One Inc. including exercising shareholder rights including voting/proxy, participating in shareholders' meetings, election of directors, etc.
- Information on comparable remuneration is found in Appendix II

Investment and Governance Secretariat

Structure and Resources: Rationale

- Senior level expertise is required for the Investment and Governance Secretariat in order to effectively support the Expert Investment Advisory Committee
- Hired as OPS employees, this will be a senior level group mandated with the responsibilities of supporting the Expert Investment Advisory Committee, and will need the requisite skill sets to be able to effectively carry out this role and ensure the Minister is supported on a daily basis
- The Executive Director would be an ADM level, and would be responsible for briefing the Minister and liaising with the Expert Advisory Committee, leading and managing the Secretariat, interfacing with Hydro One, and leading the execution of future share offerings based on the approved share sale plan
- The Secretariat will require a range of senior level experience to support this high profile undertaking and manage these key relationships effectively
- The Secretariat will need to maintain contact with top research analysts covering stock to inform monetization decisions and maintain good relations with top 5 - 10 shareholders for quick monetization options

Controls and Conflict of Interest

- Policies to manage confidential and market sensitive information will need to be in place in order to ensure the Province follows Ontario Securities Commission rules
- Consideration will need to be given to the management of Conflict of Interest issues
  - The Province is currently looking at what restrictions may be placed on public servants and ministers with respect to participation in any share offerings in light of the application of COI rules
  - Energy Legal is working with Cabinet Office to provide draft rules for consideration

Proposed Minutes

- APPROVE an OIC for the establishment of the Expert Investment Advisory Committee as a short term body with a mandate of up to three years consisting of up to five members including a Chair, and associated appointment OICs
- APPROVE the establishment of the Investment and Governance Secretariat on the supervision of the sale of Hydro One
- APPROVE 5 new FTEs starting in 2015/16 to the Ministry of Energy for the establishment of the Investment and Governance Secretariat
- APPROVE an appropriation increase of $0.516M including $0.29M in salaries and wages in 2015-16 in Vote-Item 2902-01 Energy Development and Management to support the establishment of the Expert Investment Advisory Committee and Investment and Governance Secretariat
- NOTE that the ministry will require out-year funding of $.930M including $0. 580M in salary and wages in 2016-17 and 2017-18, which will be requested through the 2016-17 Program Review, Renewal & Transformation process
- NOTE the Ministry received approval in August for external support required to assist with broadening the ownership of Hydro One, and will seek approval for out-year funding for these continued costs in 2016-17 and 2017-18, which it expects to be approximately $500,000 per year, through the 2016-17 PRRT process
- APPROVE the Terms of Reference for the Expert Investment Advisory Committee
- APPROVE a remuneration Order-in-Council of $2,000 per diem up to a maximum of $25,000 per year for each member of the Expert Investment Advisory Committee, with the exception of the Chair who will not be remunerated, and for the reimbursement of all reasonable expenses incurred in the performance of members' duties in accordance with all applicable Management Board of Cabinet Directives
- NOTE that the Ministry of Energy, working with Treasury Board and Cabinet Office, will establish control and conflict of interest rules that will apply to members of the Expert Investment Advisory Committee, the Investment and Governance Secretariat and public servants associated with any and all Hydro One related transactions

Appendix – Monetization Options

Context

- The Province is moving forward with broadening the ownership of Hydro One through an Initial Public Offering (IPO) of ~15%
  - It is expected to sell down its ownership until it owns ~40% of shares
- Although the Province has committed that it will sell ~15% through an IPO, there are several options for selling shares in the future, including:
  - Prospectus offering
  - Market sale
  - Private placement
- The Province will also require robust and ongoing management of shares to decide when it the best time to sell, which is the best approach for divestment and in some cases, to whom to sell
- To support the Minister in his role as Shareholder, on behalf of the Province, the creation of an Investment and Governance Secretariat and an Expert Advisory Committee has been proposed
  - This following slides provide an overview of some of the possible options and considerations which the Secretariat would advise on

Considerations

- The Province will set out annual targets for share sales in the context of the commitment to sell down to 40 percent ownership
- The Province will need a robust system and a strong team with market experience in order to manage the shares of Hydro One to meet these targets while maximizing value
  - The Restructuring Secretariat believes the Province will need to access the market between 1-3 times per year in order to meet its objectives
- To accommodate the need for these share offerings, the Province will need to maintain the following relationships and capabilities:

Relationship with the "Street"

- Maintain good relations with top 5 - 10 shareholders for quick monetization options
- Maintain contact with top research analysts covering stock to inform monetization decisions

Relationship with Hydro One

- Maintain active dialogue and clear visibility on monetization objectives, price targets, etc.
- Hold quarterly check-ins with Management on earnings reports as well as potential for competing primary securities offering

In House Research

- Develop and maintain in house financial model for Hydro One
- Keep up with emerging industry developments and trends that may impact Hydro One
- Ensure close coordination with the Ministry of Finance to manage changes to the fiscal plan

Monetization Options

- Several monetization options exist and can be considered by the Province when selling its shares after the IPO

1. Prospectus Offering	A public market sale akin to an IPO, but for offerings after the IPO. Prospectus offering allows for the sale of shares to the public with no hold period or resale restrictions for buyers
2. Market Sale	A public market sale. Province can sell shares on a “prospectus exempt” basis to buyers when certain conditions are met. The sale is allowed under the Ontario Securities Commission’s (OSC) National Instrument (NI) 45-102
3. Private Placement	A private market sale. Prospectus-exempt sale of shares to “accredited investors” in Canada or equivalent institutional/sophisticated buyers outside Canada

1. Prospectus Offering

- Prospectus offerings are similar to IPOs from a process perspective
  - However, instead of using a long form prospectus (required for an IPO), Hydro One can file a Notice of Intent to qualify as a short-form eligible issuer, which would allow the Province to engage with potential purchasers at any time and streamline the offering process
- Prospectus offerings allow for the sale of shares to the public with no hold period or resale restrictions to buyers at any time in a streamlined process. Can either be initiated by Hydro One or by the Province (see next slide for details)
- Can be completed either through
  1. *Bought Deal:* Dealers purchase shares at fixed price / offering size and assume market risk; or
  2. *Overnight/Expedited Marketing*: Dealer(s) market shares to public (with assistance of Hydro One) and determine price based on investor demand (similar to the current process for the IPO)

Benefits
- May potentially lead to full value being realized as it allows for broadest investor audience
- A short-form or shelf prospectus reduces execution time
- Any potential liability regarding disclosure would be the responsibility of Hydro One as the main preparer of the prospectus
- Allows for large volume of shares to be sold in an efficient and value maximized process

Considerations
- Will require the involvement of the issuer i.e. Hydro One
- May lead to higher transaction costs (4% fee typical*)
- Best suited for larger offerings
- May require marketing activities which could take additional time

Estimated time is 16-28 days if initiated by Province

*Based on follow-on equity offerings greater than $500M since 2013

1. Prospectus Offering (continued)

- The Province may choose to initiate the Prospectus Offering itself through **Demand Registration**, or may participate in Hydro One's offering through **Piggy Back Registration**.
- Some differences between the two possible Prospective Offerings are included below:

Demand Registration (Province Initiates)

Day 0 — Province delivers notice to Hydro One

Day 9 — Hydro One deadline to file a prospectus supplement (shelf prospectus)

Day 14 — Hydro One deadline to file a short form prospectus

Day 16 — Closing of shelf prospectus offering

Day 28 — Closing of short form prospectus offering

Piggy-Back Registration (Hydro One Initiates)

Day 0 — Hydro One delivers notice to Province intention of prospectus, with anticipated terms

Day 14 — Province deadline to advise of intention to participate in offering

After the Province responds & elects to participate, there are no fixed timelines. After prospectus is filed (with agreement from Hydro One & Province), offering can close as early as:

- 10 business days after response (shelf prospectus)**; or
- 15 business days after response (short form prospectus)*

* **Shelf Prospectus:** Required disclosure similar to short-form prospectus. Certain information can be omitted from the base shelf prospectus & provided in a supplementary document (called shelf supplement) that is filed when the distribution of securities occurs. Once base shelf prospectus is filed, only shelf supplement is required to offer securities.

****Short Form Prospectus Definition:** Allows issuer to incorporate information by reference (i.e. financial statements, annual information forms) making it shorter than the long-form prospectus. The review period is generally 3 working days.

2. Market Sale

- The OSC allows "prospectus exempt" sales when certain conditions are met, some of which are listed below:
  - The seller has a controlling share in company, they have held the shares for the last 4 months or more, the shares are being sold in good faith, no "unusual" marketing efforts have been made and no extraordinary commission is being paid with regards to the sale [*confirming that this means limited to existing S/H*]
- This requires the issuer to file a "Notice of Intention" (NOI) followed by a 7 day dissemination period prior to first sale. As part of the NOI, the Province must certify it has no material undisclosed information. No marketing efforts can be made after the NOI is filed
- Sales can begin as early as the 7th day and can continue at any time for the next 23 days. After that point, Province could file a new NOI, wait another 7 day period, and sales under NI 45-102 can continue for another 23 days
- Can be further broken down into:
  1. *Block Trade:* Dealer(s) purchase shares from Province at fixed price and assume risk on selling stock to investors at fixed price (equivalent to "Bought Deal" in a prospectus offering); or
  2. *Overnight Bookbuild*: Dealer(s) market shares to public after market close and presents firm transaction to Province prior to market open (equivalent to "Overnight Marketing" in a prospectus offering)

Benefits

- Has lower transaction costs compared to a prospectus offering
- Does not require involvement from Hydro One
- Does not require disclosure to underwriters or purchasers from the Province (i.e. preparing a prospectus)
- Timing flexibility with 23 days to execute after the 7 day dissemination period

Considerations

- Potential civil & regulatory liabilities as seller must disclose it has no knowledge of undisclosed material facts or changes
- No efforts to prepare market or create demand, making it difficult to reach retail investors
- Ministry could explore options for averaging sell orders through time, though this may be restrained by securities laws and could impact future share pricing of the stock

Fastest time for first sale is 7 days, with flexibility to sell any time within the next 23 days

3. Private Placement

- Allows the sale of shares on a “prospectus exempt” basis to “Accredited Investors” (large, sophisticated or institutional investors)

Benefits

- Requires no involvement from Hydro One
- Limits the amount of documents required (i.e. offering memorandum and other disclosure)
- Expedited timelines
- Purchase agreement can be utilized between vendor and purchaser with no issuer involvement

Considerations

- Narrower audience of potential investors
- May require the Province to provide disclosure representations to the Purchaser, unless Hydro One agrees to provide
- Risk of disenfranchising existing shareholders if not given a chance to participate
- May given impression of “preferential treatment”
- Buyer is subject to resale restrictions (4 months)
- Need to stay within 10% limit as set out in legislation

Estimated time varies, but a common timeframe would be about 28 days

Comparison of Monetization Options

- The following chart provides a comparison across the different options on a variety of factors

	Prospective Offering	Market Sale	Private Placement
Cost	• Relatively high transaction costs	• Lower transaction costs compared to prospectus offering	• Least Costly
Timing	• Could take a month to complete (if initiated by the Province)	• Could undertake several sales between 7-30 days, with option to continue after 7 more days	• Typically 1 month but time will vary depending on several factors
Disclosure	• Hydro One provides disclosure	• Requires no disclosure, but Province must certify it has no knowledge of material, undisclosed facts	• Province will have to provide disclosures to purchasers
Value	• <u>High</u>: Allows broadest audience and large marketing activities which will help maximize investor interest and realized value	• <u>Medium</u>: With limited marketing activities, may have a limited audience and therefore not lead to the best value	• <u>Low</u>: Only limited to large institutional investors that may have resources to gain better terms on transaction thus limiting value
Fairness	• Allows broad participation	• Limited marketing efforts, making it difficult to solicit retail participation	• Allows limited participation- may be seen as giving preferential treatment

Potential Investors

- The IPO will likely be oversubscribed, with some investors unable to participate or receiving fewer shares than bid
- This pent up demand should create an environment that allows for successful future offerings
- In this context the Province and Hydro One may have an opportunity to focus on the sorts of potential future investors that they prefer to attract
  - Hydro One may seek a mix weighted toward long term investors focused on consistent, performance and dividend yield, combined with some shorter term investors that will help to provide liquidity and pricing for the stock
  - Hydro One will also likely seek a mix mostly Canadian retail and institutional investors with some international presence. This may evolve over time as company strategy and investment focus changes
- The Province could also consider other policy priorities as it sells down its interest in the company
  - For example, Ontario pension funds and First Nations may make good, long-term investors
- Monetization options should, in part, be considered in relation to the mix of potential investors they are likely to favour
- The proposed Investment and Governance Secretariat would provide advice to the Minister regarding these considerations and decisions, with support from the Expert Advisory Committee

Appendix II – Comparable Remuneration

Comparable Remuneration

Ministry	Position (Year) and Description	Per Diem Amount	Maximum Compensation
Community and Social Services **(Accessibility Directorate of Ontario)**	Reviewer for the First Legislative Review of the Accessibility for Ontarians with Disabilities Act (2009)	$1000 per diem	Maximum of $80,000 to a maximum of 80 days in total for the duration of the appointment.
Education	Advisor (2012) Provide advice to Premier, Minister and Ministry with respect to student achievement and other advice in respect of issues in the education sector.	$1500 per diem	Maximum of $80,000 per annum (in addition to reasonable expenses)
Health and Long-Term Care	New Pharmacy Funding Model Lead Negotiator (2012)	$2,000 per diem	Maximum of $75,000 per annum