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Asset Optimization: Stranded Debt, Electricity Act & Trillium Trust Act

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Corporate and Electricity Finance Division
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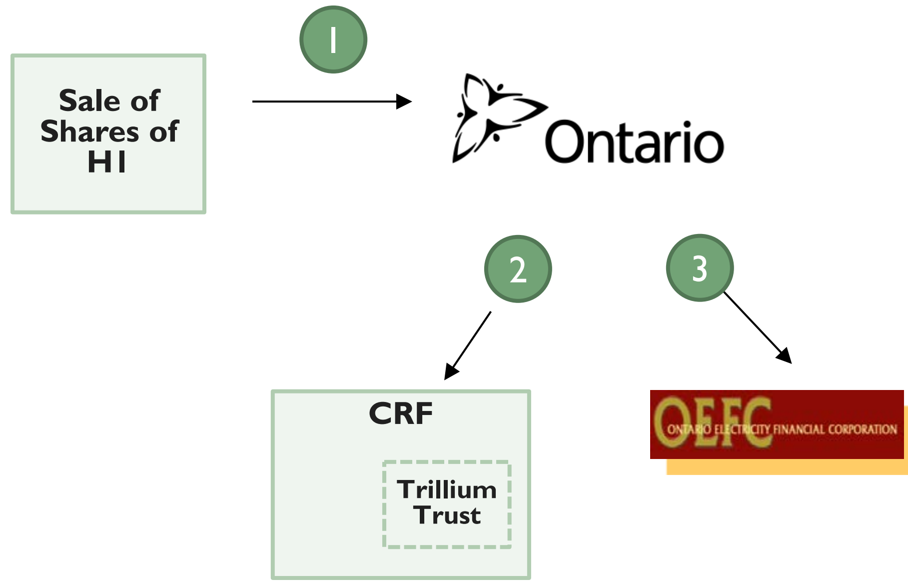
Issue / Context

- The government and the Council have both indicated that net proceeds from asset optimization initiatives should go to build new public infrastructure, through the Trillium Trust.
- Legislative change is being proposed to allow the net proceeds of disposition from divesting any part of Hydro One to be allocated to the Trillium Trust.
  - Section 3 of the Trillium Trust Act, 2014 currently only allows for the Trust to be credited with net proceeds of disposition of a designated asset, by Treasury Board regulation, that have been paid into the Consolidated Revenue Fund (CRF).
- Under the *Electricity Act, 1998*, proceeds from Hydro One divestment, less amounts determined by the Minister of Finance in connection with the Province's acquisition costs and obligations in H1 and transaction costs are to be paid to the Ontario Electricity Financial Corporation (OEFC).
  - Net proceeds of disposition (i.e., gain on sale) would not be available to be allocated to the Trillium Trust, without amending the Electricity Act.
- Legislative change to s.50.3 in the Electricity Act could allow for both a reduction in stranded debt from a transaction and allow for the net proceeds from a Hydro One IPO and subsequent share sales to fund the Trillium Trust.
- Using amounts from a Hydro One sale to fund the Trillium Trust, or directing amounts to OEFC, would require a specific communication plan.

Amendment to the Electricity Act

- **Solution: Amend the EA by changing section 50.3 to allow for a transaction between OEFC and the Province to ensure that OEFC (towards stranded debt) gets a financial benefit equivalent to what is provided for under s.50.3.**
  - Note that OEFC is consolidated onto the books of the Province on a line by line basis.

1. Proceeds from sale are paid to CRF/Province
2. Net proceeds of disposition are credited to the Trillium Trust (within CRF)*
3. Province provides financial benefit to OEFC (e.g., debt relief) for an amount equivalent to what would be payable to OEFC under s. 50.3 of the Electricity Act**



* Net proceeds for the Trillium Trust are calculated as proceeds from sale, less book value.

** This amount differs from the amount of net proceeds calculated for the purposes of the Trillium Trust.

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Sample Transaction

- The following diagram illustrates how estimated proceeds (subject to actual market conditions and transactions costs) from the sale of a 15% stake in Hydro One would flow, subject to legislative amendments.

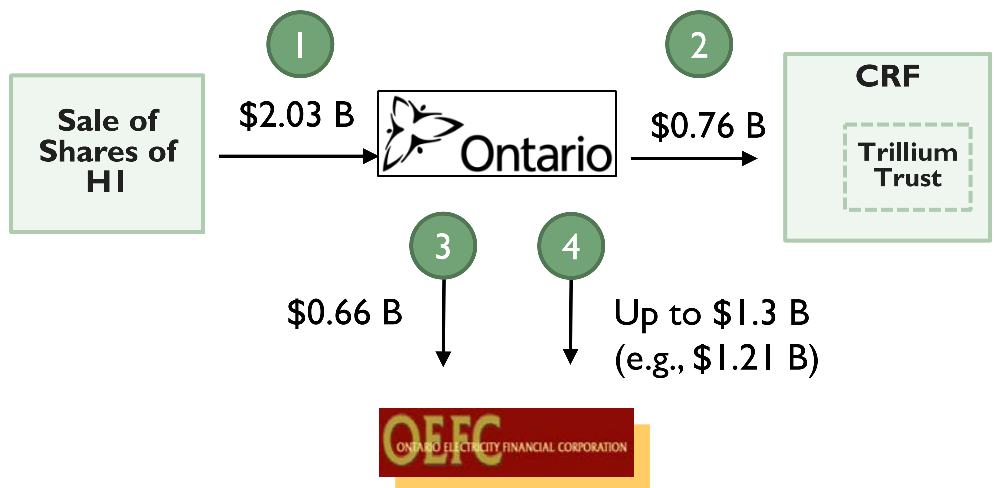
1. Proceeds from sale are paid to the Province.
2. Net proceeds of $0.76 billion dedicated to Trillium Trust
3. Province deducts transaction costs from proceeds, as well as proportional amounts owing on the notes receivable and the Electricity Sector Dedicated Income (ESDI) allocated to OEFC related to Hydro One, and makes some form of payment of the net amount ($0.66 B) to OEFC as per sec. 50.3 of the Electricity Act
4. The Province could also use cash from transaction up to H1 book value ($1.21 B) to pay to OEFC the amounts deducted in Step 2 above to reduce its obligations owing on the notes receivable and ESDI receivable held by OEFC

Trillium Trust*

Proceeds:	$2.03 B
Transaction costs:	$(0.06)
H1 Book Value:	$(1.21)
Net Proceeds:	**$0.76**

OEFC*

Proceeds:	$2.03 B
Transaction costs:	$(0.06)
Note receivable:	$(0.56)
ESDI**:	$(0.74)
Gain to OEFC:	**$0.66**



Numbers may not add due to rounding. Numbers provided are for illustrative purposes only and are subject to change.
***ESDI amount is based on the amount Due from Province of Ontario as per OEFC's financial statements.*

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Key Messages

- The following provides an overview of potential communications positioning on the issue. As additional details on the transaction are made public, a more thorough communications package can be rolled out to explain how the transaction will affect the Trillium Trust and OEFC.
  - The government is committed to reinvesting net proceeds from sales of designated assets through the Trillium Trust to invest into important infrastructure and transit projects that will create jobs, expand opportunity and secure prosperity for all Ontarians.
  - Investing in new infrastructure such as transit, roads and bridges is an important way to promote economic growth, improve competitiveness and productivity and the well-being for all Ontarians.
  - The government is also committed to ensuring that electricity ratepayers are treated fairly. The government will ensure it is in compliance with any legal obligations under the Electricity Act, 1998 or any other Act.
  - The government's proposed amendments to the Electricity Act would allow the Province to ensure OEFC receives the equivalent financial benefit as provided for under the Electricity Act, either in cash or, e.g., debt relief, that will reduce stranded debt to the benefit of ratepayers.
  - This proposed amendment to the Electricity Act will also allow the net proceeds of a transaction to go to the Trillium Trust to build new public and transit infrastructure.
  - The proposed amendment expedites the end result for OEFC, while keeping it financially whole. If OEFC received the cash directly, it would be able to pay down debt in the same amount as the Province will be able to relieve OEFC from, under the proposed amendment to the Electricity Act.

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Appendix: Hydro One Divestiture and the Electricity Act

Key Considerations: Stranded Debt

- Section 50.3 of the *Electricity Act, 1998*, requires that the proceeds from a sale of Hydro One equity, less amounts determined by the Minister of Finance in connection with the Province's ownership stake in H1 / transaction costs, are paid to OEFC, helping to pay down stranded debt.
  - OEFC is consolidated on the Province's financial statements on a line by line basis, so amounts from a Hydro One divestment paid to OEFC still results in a fiscal benefit to the Province.
  - It is the Minister of Finance's determination on what to deduct from gross proceeds. Amounts could include amounts owed by the Province to OEFC in connection with H1 (e.g., cost of acquisition).

- Section 50.3 is consistent with the government's commitment to paying down stranded debt whereby the Province dedicates revenues (e.g., payments-in-lieu of taxes – PILs – while non-taxable, and an amount for Hydro One and Ontario Power Generation's (OPG) net incomes) it receives from the electricity sector to OEFC to help service and pay down stranded debt.

- Not paying proceeds (less amounts determined by the Minister) of a Hydro One divestiture to OEFC would have significant implications for the timing of residual stranded debt retirement and the end date of the Debt Retirement Charge (DRC).
  - The government has committed to removing the DRC from residential users' electricity bills after December 31, 2015.
  - As communicated in the *2014 Ontario Economic Outlook and Fiscal* Review, it is estimated the DRC will end for non-residential electricity users by the end of 2018.
  - If amounts are not paid to OEFC, the retirement of residual stranded debt and end date for the DRC could be pushed beyond 2018.

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Electricity Act

- The *Electricity Act, 1998* specifies that proceeds payable to Ontario in respect of the whole or partial sale of Hydro One Inc. or its subsidiaries must be paid to OEFC, less amounts determined by the Minister of Finance in connection with the Province's ownership stake in H1 / transaction costs.
  - This would result in a reduction to OEFC's unfunded liability (or "stranded debt of the electricity sector" – the current measure of stranded debt, as determined by the Minister of Finance, is OEFC's unfunded liability).

"50.3: All proceeds payable to Her Majesty in right of Ontario in respect of the disposition of any securities or debt obligations of, or any other interest in, Hydro One Inc., a corporation established under section 50, a corporation or other entity established under section 50.1 or an arrangement made under section 50.1 shall be paid to the Financial Corporation,

a) *less any amount that the Minister of Finance considers advisable in connection with the acquisition of such securities, debt obligations or interest, including the amount of the purchase price, any obligations assumed and any other costs incurred by Her Majesty in right of Ontario; and*

b) *less the amount of any costs incurred by Her Majesty in right of Ontario in disposing of the securities, debt obligations or other interest."*