IESO/OPG Indemnities

Ministry of Finance Questions

1. Could you please provide specific concerns/scenarios for which OPG/IESO or its directors, officers and employees may become liable and which the indemnity is intended to cover?
    - You have provided the examples which are related to financing mostly. Are there any other activities? Who would be most likely to sue: investors, what about other groups?

OPG's Response: The Protected Persons could potentially be liable in several circumstances relating to the Fair Hydro Plan, including potential liability to:

(i) the underwriters/agents selling debt securities of the financing entities;

(ii)the purchasers of debt securities of the financing entities (both the initial purchasers and subsequent purchasers of the debt securities in the secondary markets);

(iii) counterparties to agreements (e.g., the trustee of a financing entity that is a trust, the IESO);

(iv) other stakeholders of OPG if OPG (or any subsidiary thereof) is liable for any claim or obligation; these stakeholders could include, for example, the Province, as shareholder of OPG, pensioners, and employees; and

(v)regulators (e.g., OSC).

This is not an exhaustive list of all potential liability. It has been included for illustrative purposes only.

IESO's Response: Some examples of activities giving rise to liability include the following:

- Investors in any Fair Hydro investments or underwriters and banks regarding the offering of the investment asset to investors: any securities prospectus or underwriting arrangements, with the IESO named and / or IESO being involved
- OPG (or Financing Entity) in relation to the commercial arrangements regarding transfer of regulatory asset and servicing of investment asset, and related activities
- Market participants, program participants for issues in liquidity – e.g. short pay
- taxation authorities where prior approval of IESO's treatment is not approved by taxation authorities
- securities commissions regulators (US/Canada)
- parties who may challenge Fair Hydro Plan Act or any component of it and include the IESO as a party to such challenge

- in the case of an insolvency, Directors have statutory liability for payroll and taxes.

Are there situations where someone might not be acting in good faith and still warrant being covered under the indemnity? In that case, it would seem that the indemnity covers acting in bad faith. Should the indemnity cover actions "in good faith" to carry out the plan?

ENERGY's Response: The purpose of the indemnity is to provide coverage to the Protected Persons for Losses other than those arising out of gross negligence, dishonesty, or willful misconduct. Also, while a Protected Person may have been acting in good faith, this does not stop an individual/entity from bringing a claim against that Protected Person on the grounds that they did not "act in good faith" The Indemnity is to cover an expenses/losses etc. associated with defending against any such claims (coverage to be provided before a judgment is made).

i. Request for Approval points out that *Electricity Act, 1998* already protects IESO's directors, officers, employees or agents against civil proceedings if they act in good faith in the exercise or performance of powers or duties under the Act, etc. or for any neglect or default in the exercise or performance in good faith of such a power or duty. The Fair Hydro Plan has similar language for OPG s. 39(1), but only for employees of OPG (and the Province). Why doesn't the statutory provision also cover OPG's directors and officers of OPG and those of its subs?

ENERGY's Response: Section 39(1) was the result of ongoing discussions with OPG and the wording is what was agreed to by the Ministry and OPG. Further, the Ministry has made a commitment to OPG to provide an indemnity to its directors and officers.

ii. Has consideration been given to providing an indemnity to directors, officers and employees but not to the corporate entities themselves (IESO, OPG and its subs)

ENERGY's Response: This is the scope of the indemnity that has been requested by OPG/IESO (respectively). We are waiting to hear back from OPCD to determine whether there are accounting grounds to push back on having the Indemnities cover the Corporations, and in the case of OPG, also the Corporation's subsidiaries.

- Currently, IESO collects payments from ratepayers via LDCs, so are there any new processes required as a result of implementing FHP? If so, what are new processes need to be in place that will increase IESO's business risk?

IESO's Response:

- Additional processes are required to segregate the Fair Hydro flows (new charge types, new bank segregations, new input forms, new payment processing schedules).
- IESO may need to implement a separate process to receive and remit clean energy adjustments
- IESO will enter into commercial arrangements with the financing entity relating to the transfer of the regulatory asset, and to servicing arrangements relating to recovery of the clean energy adjustment.
- It is unclear at the moment what additional requirements OPG or the banks / underwriters may request.

2. Should indemnity agreements be tailored to specific circumstances of each company? Currently they appear to be drafted identically.

ENERGY's Response: Yes, the scope of the work and who is covered under the indemnity will further be tailored to the specific circumstances of IESO/OPG. However, the general provisions making up most of the Indemnity would be the same for both as we would want to be providing OPG/IESO with similar type of rights under the Indemnity.

3. Indemnity would cover "loss of profits" and "loss of opportunity" – Is this too broad?

ENERGY's Response: No, we do not think that this is too broad. The Province has previously provided OPG directors indemnities (s.28 approval granted) that indemnified directors "from and against any and all losses" – this wording would be broad enough to cover both loss of profits and loss of opportunity.

4. Please provide more detail on the type of insurance that OPG and IESO have to cover these risks? i.e. directors and officers insurance?

OPG's Response: OPG maintains Directors & Officers (D & O) Liability insurance with limits of USD $110M. The D&O liability insurance includes Personal Coverage (Side A) and Corporate Reimbursement Coverage (Side B) as follows:

Personal Coverage (Side A)

Under Personal Coverage (Side A), the policy pays losses where the organization is either not permitted by law or unable due to insolvency to indemnify the Insured Person under the policy (includes directors, officers and designated executives). This includes losses arising from a claim made during the policy period for a wrongful act (e.g. breach of duty, neglect, error, misstatement or omission) of such Insured Person. The full $110M limit is available for Side A coverage.

Corporate Reimbursement Coverage (Side B)

Under the Corporate Reimbursement Coverage (Side B), the policy reimburses the Company for losses incurred to indemnify an Insured Person under a D&O claim. The coverage is up to a maximum of USD $75 million, less the corporate deductible of $500K.

Directors and Officers have priority of payments over the Company for the entire $110M limit.

In addition, we note that pursuant to Section 2(a) of the draft Indemnity Agreement that a Protected Person shall not be entitled to indemnification to the extent that coverage is provided under an insurance policy and such Protected Person is actually paid under such insurance policy.

IESO Response: IESO carries:

- Directors & Officers insurance: max $15 million limit and $200,000 retention per claim. Employees are included in the definition of Individual Insureds.
- Professional liability: max $75 million limit.

5. Has OPG given a standard indemnity to its directors and officers that would be called upon first before the indemnity from the Province?

OPG's Response: OPG has provided its directors (but not its officers or employees) with an indemnity.

IESO's Response: Aside from indemnification arising by operation of common law for employees acting within the scope of their employment, the IESO has provided formal indemnity as follows:

- IESO has provided an indemnity to its board members.
- There is an indemnity provided to members of the Society of Energy Professionals pursuant to their collective agreement, whose members form a subset of all employees at the IESO.

6. What is the standard that is applied to conducting a reasonable investigation for "due diligence" defence? Is it possible to fail to meet that standard without gross negligence or wilful misconduct?

OPG's Response: The test under the Securities Act (Ontario) is a reasonableness test. It is therefore certainly possible for a Protected Person to fail to meet the standard for the due diligence defence while not also committing gross negligence or wilful misconduct.

7. What is the purpose of the provincial waiver of claims – as distinct from the protection provided by the indemnity?

ENERGY's Response: The purpose of the indemnity is to provide indemnification to the Protected Persons (cover Persons to the extent of their losses that are covered under the indemnity (indemnity excludes losses related to the Protected Persons' gross negligence, wrongful misconduct, or dishonesty). The purpose of the waiver is to restrict the province's ability to bring any claims (other than those arising out of gross negligence and wilful misconduct) against the Protected Persons. OPG has specifically requested the waiver. They believe that because they are carrying out the Fair Hydro Plan activities at the request of the Province, they should be given this waiver in the indemnity. We believe the risk associated with providing this waiver is likely low given that it is unlikely that the Province would bring a claim against a Protected Person for acts they would be providing an indemnity to the Protected Person for.

8. In what situations would a director, officer or employee be acting in a different capacity at the request of the company?

OPG's Response: One example arises if a financing entity is a trust. OPG directors/officers/employees will need to sign the prospectus/offering documents, but not in their capacities as those directors/officers/employees of OPG as the offering documents will not be offering documents of OPG. The directors/officers/employees will be performing these functions as a result of OPG acting as the Financial Services Manager of the financing entity.

9. Does the indemnity for OPG and its subsidiaries also include SPV (financing entity) and its directors, officers and employees?
   - What impact does this have on the SPV being treated as a separate entity to the OPG from an accounting perspective?
   - Or does SPV require an indemnity as well and why?
   - How does an indemnity for the SPV interact or overlap with the request for a guarantee from the Province in connection with the proposed financing transaction?

OPG's Response: OPG has clarified that it is not OPG's intention that the financing entities themselves be covered by this Indemnity Agreement. The Protected Persons would include

OPG and its subsidiaries that are not financing entities. Separate arrangements with the Province are being negotiated for the financing entities.

- Has consideration been given to limiting the indemnity to directors, officers and employees and not indemnifying the corporations, OPG, IESO, its subs? What are the implications?

ENERGY's Response: We had initially considered limiting the indemnities to directors and officers. However, IESO and OPG both have indicated that they require their respective indemnity cover their respective corporation as well (and in the case of OPG, its subsidiaries) given the nature of the risks they face.

OPCD is being consulted on whether there are accounting implications on extending the Indemnities to the Corporations and in the case of OPG, its subsidiaries. If there are accounting implications, ENERGY can take this back to OPG/IESO for further negotiation (i.e. to limit the indemnity to directors, officers and employees).

OPG's Response: OPG has indicated that they require an indemnity for the corporation and its subsidiaries for the following reason: as noted above in Question #1, OPG (and its subsidiaries) have potential liability to many stakeholders, including, for example, its pensioners. In approving OPG's participation in the Fair Hydro Plan, the OPG directors will want to know that these stakeholders are protected in the event that OPG or any of its subsidiaries is liable for a claim in relation to the Fair Hydro Plan. For example, if there is a large claim against OPG which could affect OPG's ability to make its pension contributions, the OPG directors will want to know that the indemnity agreement will protect OPG in this regard and allow OPG to make its pension contributions.

*** A response from IESO on this is pending. We will send to you once we receive it.*

10. Have previous Cabinet or TB submissions made reference to the requirement for indemnity agreements for IESO and OPG?

ENERGY's Response: No, the Cabinet decks and TB submissions in March did not reference the need for indemnity.

In the draft June TB submission, the document states that legislation includes… "scope of provincial undertaking and enabling the Province to provide guarantees and indemnities to back stop that undertaking."

11. It is mentioned that IESO and OPG management view their participation under the OFHP Act as "…outside their typical business activities and corporate mandate". However, the

legislation is specifically adding these activities as objects and activities of the companies? Wouldn't their other corporate documents be updated to reflect their role in OFHP? Can't the Minister of Energy provide an updated mandate to OPG and IESO? However, would this potentially affect accounting?

OPG's Response: OPG acknowledges that the Electricity Act has been amended to contemplate that OPG's objects include those related to the Fair Hydro Plan. This was a technical amendment designed to ensure that OPG could, if it chose to, participate in the Fair Hydro Plan. However, the role that the Province has requested OPG carry out in connection with the Fair Hydro Plan is outside its typical business activities and corporate mandate relating to power generation and therefore OPG's directors will need the indemnity agreement in order to approve OPG's participation in the Fair Hydro Plan. The accounting criteria that enable OPG to consolidate the financing entity is based on the relevant activities of the financing entity, and who has the power to control those activities. It is not dependent on the legal form of the structure, as accounting looks beyond legal form to the 'substance' of the transaction.

IESO's Response: The Fair Hydro Plan is a new element of IESO's mandate that it is being asked to implement, and one that may create material risk to the IESO, and potentially its directors, officers and employees.

Generally, the IESO currently administers a net zero market where money in equals money out within the normal monthly cycle (in the case of the current RPP program, the cash flows are expected to net to zero every six months). The Fair Hydro program(s) provides where the IESO will be responsible to settle and potentially carry very large amounts over many years and the IESO may be embroiled with investors' responsibilities as OPG Trust sells to investors.

12. The latest draft of the OPG Indemnity Agreement, second recital, now states that the indemnity is for "…risk of liability due to or as a result of the Fair Hydro Plan.". Previously, the indemnity only covered its role in the Fair Hydro Plan. Are there any concerns with this broader language?

OPG's Response: The Protected Persons need to be fully protected as a result of any claim connected to the Fair Hydro Plan. Having regard to this general principle, OPG would be happy to consider other drafting for this recital if desired by the Province.

ENERGY's Response: We note that the actual text of the indemnities state that indemnification would be triggered for certain losses/claims arising "as a result of the Corporation's, [any of the Corporation's subsidiaries in the case of OPG] and/or any such other Protected Person's *activities, acts and/or omissions in the implementation of, or otherwise relating to, the Fair Hydro Plan*. In this way the indemnity is restricted to acts/omissions of a Protected Person in the implementation or relating to the Fair Hydro Plan rather than claims due to or resulting from the Fair Hydro Plan in and of itself. However, we are happy to re-draft this provision to address OFA/MOF's concerns.

13. 9(c) – Should this also reference that certain remedies such as specific performance etc. not available against the Crown? Suggest reviewing against representations given in other agreements, etc.

ENERGY's Response: We are open to putting this into the current draft before sending back to OPG/IESO for final review.

14. Contingent Liability chart may need to be made more consistent with business case.

ENERGY's Response: we can make those changes – could you please further specify what changes you are referring to?

15. Assume any payments under the indemnity would be made by the Ministry of Energy from its allocations.

ENERGY's Response: ENERGY's allocation will not be able to support payments under the indemnity in the event that the contingent liability materialises. Should the payment be required, the Ministry will need to return to TB/MBC for an increase in its allocation. This would be under Vote/Item 2905 - 01.

As background, ENERGY only has control of about 2% of its allocation to deliver on its mandate and commitments (i.e., payroll, ODOEs and ad hoc transfer payments). The largest component of ENERGY's allocation is for the rate mitigation programs that are demand-driven entitlement programs. Spending is non-discretionary and the Ministry does not have control over this allocation.