TORYS LLP

MEMORANDUM

To	Premier's Advisory Council	**Date**	January 20, 2015
From	Torys LLP		
Re	Proposed 2002 Initial Public Offering of Hydro One Inc.		

Introduction

In March 2002, Hydro One Inc. ("**HOI**") filed a preliminary prospectus for a proposed initial public offering (the "**Proposed IPO**") of the common shares of HOI. At that time, the Government of Ontario intended to sell all of the common shares of HOI, however, as described below under "Opposition", the Government ultimately committed to retain at least 51% of HOI. The Government stated that the Proposed IPO was designed to bring private sector discipline to HOI and the proposed use of proceeds was to pay down a portion of the Ontario Hydro stranded debt. See Schedule A to this memorandum for a more detailed review of the terms of the Proposed IPO.

The Proposed IPO faced opposition from certain unions and the opposition parties and ultimately was not pursued. In this memorandum, we discuss the opposition that the Government faced as well as the Government's response. We also discuss what proposals have been made in respect of HOI in the years following the decision to not proceed with the Proposed IPO.

Opposition to the Proposed IPO

The Communications, Energy, and Paperworkers Union of Canada (CEP) and The Canadian Union of Public Employees (CUPE) (together, the "**Unions**") challenged the ability of the Province to sell the common shares of HOI. Note that the Power Workers Union (PWU) opposed the application by the Unions.

The *Electricity Act, 1998* (Ontario)[1] (the "**EA**") was enacted in 1998 as Schedule A to the *Energy Competition Act* (Ontario).[2] Among other things, the EA provided that the Lieutenant Governor in Council could cause two corporations to be incorporated under the *Business Corporations Act* (Ontario)[3] (the "**OBCA**") and shares in those corporations may be "acquired and held" in

[1] S.O. 1998, c. 15, Sch. A.

[2] S.O. 1998, c. 15.

[3] R.S.O. 1990, c. B.16.

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the name of Her Majesty in right of Ontario ("**Her Majesty**") by a designated Minister.[4] These corporations were incorporated and were designated as HOI and Ontario Power Generation Inc., respectively, under s. 48(2). The EA further provided that no corporation could be designated unless, at the time of designation, all voting securities of the corporation are "held" by or on behalf of Her Majesty or an agent thereof.[5]

The Unions challenged the Proposed IPO on the ground that under the EA the Province did not have the power to sell the shares of HOI. In a decision rendered on April 19, 2002 in *Payne v. Ontario (Minister of Energy, Science and Technology)*[6] (S.C.J.), the Court held that, under applicable principles of statutory interpretation, the EA did not expressly or by implication permit the Province to sell shares in HOI. The Court concluded that neither the words, the object, the purpose or the intent of the EA supported such a power, and the legislative history of the EA was consistent with that conclusion.

Following this decision, the Province took three actions. First, on April 25, 2002 it appealed the *Payne* decision to the Court of Appeal. The appeal was expedited and heard on June 19, 2002. Second, it introduced Bill 58, Schedule A of which amended the EA, on May 29, 2002.[7] Bill 58 was intended to reverse the *Payne* decision by expressly providing that the Province had the power to dispose of the shares of HOI. In particular, it provided that the Minister, on behalf of Her Majesty, may "acquire, hold, <u>dispose of or otherwise deal with</u> securities or debt obligations, or any other interest in" HOI or any of its subsidiaries.[8] Third, the Government undertook a public consultations process to solicit feedback from the public in Ontario about the Proposed IPO.

As mentioned, the appeal of the *Payne* decision was heard by the Court of Appeal on June 19, 2002. By that time, Bill 58 was only days away from being enacted (it was ultimately enacted, and Schedule A came into force, on June 27). The principal issue before the Court of Appeal was one of mootness: had the question decided at trial become moot because of the (impending) enactment of Bill 58? In a decision released on July 4, 2002, the Court held that the appeal was moot.

The public consultations held in April and May 2002 and the legislative committee hearings held in June 2002 resulted in the following changes to the Proposed IPO:

- The Province would own the transmission corridor lands previously owned by HOI or its subsidiaries.

- The Province would continue to own at least 51% of HOI.

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[4] EA, s. 48(1).

[5] *Ibid.*, s. 48(3).

[6] [2002] O.J. No. 1450 (S.C.J.), appeal dismissed [2002] O.J. No. 2566 (C.A.).

[7] S.O. 2002, c. 1, Sch. A. This Act was called the *Reliable Energy and Consumer Protection Act, 2002*.

[8] EA, s. 49(1).

Both the Liberals and the NDP were opposed to the Proposed IPO.[9] The Liberals had originally supported the deregulation of the electricity sector and the introduction of private sector competition, however, ultimately, the Liberals did not support the Proposed IPO. The Liberals expressed concern about whether the Proposed IPO would affect the affordability and reliability of the electricity transmission grid.

The Proposed IPO also highlighted the compensation and benefits payable to HOI's officers and, in particular, its CEO. In June 2002, then Premier Ernie Eves ordered HOI's board of directors to rescind some of the compensation and benefits payable to the officers. When the board did not respond with sufficient commitment to do this, the Government introduced legislation to remove the board and decrease five executives' salaries and eliminate certain severance packages (while also barring these individuals from taking action against the Province). As a result the board resigned en masse (other than the CEO). Shortly thereafter the Proposed IPO was cancelled and a few weeks thereafter, the CEO was terminated.

Aftermath

Following the Government's decision to not proceed with the Proposed IPO, the Government initiated a process in the Fall of 2002 to select private investors to acquire a minority interest in HOI. Press reports at the time indicated that Borealis Infrastructure and Ontario Teachers' Pension Plan Board were in talks with the Government to acquire a 49% interest, however, governance arrangements could not be agreed and the Government halted the process.

During the 2003 election, the Liberals' campaign included a commitment to not sell the transmission grid (or any publicly owned generation station).

In 2009 and 2010, the Government undertook an asset review and considered creating a corporation which would hold the Province's interests in HOI, OPG, LCBO and OLG; shares of that corporation would then be sold to the public. However, it was announced in 2010 that the Government would not proceed with this proposal for a variety of reasons, including accounting, legal, taxation, valuation and transaction issues.

[9] Note that we have not undertaken a review of the Ontario Legislative Assembly Hansard with respect to debates in relation to HOI as we understand that Ministry of Energy employees will complete this work. However, in the course of preparing this memorandum, we did note the items referred to herein in relation to political opposition to the Proposed IPO.

Schedule A

Relevant Details of Proposed 2002 Hydro One Inc. (“**Hydro One**”) Common Share Equity Public Offering[10]

Key Term	Summary
Proportion of common shares sold to public	All common shares of Hydro One were to be sold in the offering (assuming exercise of the underwriters’ overallotment option in full). In other words, the Province would no longer own any common shares of Hydro One.
Offering Jurisdictions and Listing	Common shares offered in Canada, the United States and internationally. Shares were to be listed on TSX and NYSE.
Instalment Payments	A portion of the offered shares were to be made available to Ontario residents to purchase on an instalment basis, with the first instalment of the purchase price to be paid on closing of the offering and the final instalment to be paid the following year.
Privatization Protections - Special Share	The Province was to be issued one special share which would allow the Province to veto any proposal to (i) amend the articles of Hydro One to relocate its head office outside of Ontario, (ii) change the jurisdiction of Hydro One’s incorporation; or (iii) alter the rights attached to the special share.
Privatization Protections - Ownership Restrictions	As required by a regulation to be made effective under the *Electricity Act, 1998*, immediately prior to completion of the offering, the articles of Hydro One were to be amended to include a 15% ownership limitation on any one shareholder or groups of associated shareholder.[11]
Regulatory Oversight Post-Offering	It was noted that Hydro One’s transmission and distribution businesses are subject to regulation, principally by the Ontario Energy Board. It was also noted that the Province has the power to issue general policy directives to the Ontario Energy Board and that the Ontario Energy Board approves Hydro One’s revenue requirements for its transmission and distribution business.
Use of Proceeds	The Province will receive all proceeds from the sale of the common shares in the offering.
Payment of PILT	The Province agreed up front to the amount of the payments in lieu of corporate taxes payable by Hydro One in respect of certain deemed dispositions associated with the offering ($440 million). Hydro One agreed not to request to have such amount included in rate recovery.
Redemption of Preferred Shares	Hydro One would be obligated to redeem outstanding preferred shares held by the Province within 120 days of completion of the offering, for an aggregate redemption amount of $323 million, together with accrued dividends.

[10] Based on Hydro One’s Preliminary Prospectus dated March 28, 2002.

[11] Note that the relevant section of the *Electricity Act, 1998* (Section 48(2)) also overrides the provisions of the OBCA that prohibit ownership restrictions in respect of companies doing public offerings.