TREASURY BOARD / MANAGEMENT BOARD OF CABINET
REQUEST ASSESSMENT NOTE

Ministry:	Finance
Meeting Date:	May 9, 2017
Agenda Class:	Consensus (In-Camera)
Last reviewed by: N/A	**Tracking to:** Cabinet, May 17, 2017

SUBMISSION TITLE:	Ontario Electricity Financial Corporation Post Year-End Transactions

I. DECISION BEFORE THE BOARD

- The Ministry of Finance is requesting fiscally neutral statutory appropriation increases to reflect the financial benefit and corporate income tax provision owed to the Ontario Electricity Financial Corporation (OEFC) for the 2016-17 year.

II. RECOMMENDATIONS:

• Receive a report back from the Ministry of Finance on statutory appropriations for OEFC Financial Benefit and Hydro One Provincial Corporate Tax Provision.	*Receive*
• Approve an increase in statutory appropriation of $411.2M in 2016-17 for OEFC Financial Benefit under the *Electricity Act*, 1998.	*Approve*
• Approve an increase in statutory appropriation of $24.8M in 2016-17 for the Hydro One Provincial Corporate Tax Provision under the *Electricity Act*, 1998.	*Approve*
• Note that the increases in statutory appropriation will be fiscally neutral upon consolidation.	*Note*

III. FINANCIAL SUMMARY

$ Millions	**2016-17**	**2017-18**	**2018-19**
Initiative cost requested	436.0	0.0	0.0
Initiative cost recommended	436.0	0.0	0.0
Recommended program base	436.0	0.0	0.0
Offset Recommended – Increase in Consolidated Revenue	(436.0)	0.0	0.0
Total Fiscal Impact	0.0	0.0	0.0

IV. KEY COMMENTS AND CONSIDERATIONS

The Ministry of Finance (MOF) is seeking approval for two post year-end transactions in 2016-17 related to the Ontario Electricity Financial Corporation (OEFC) including:

1. The financial benefit of $411.2M owed to OEFC as a result of the Hydro One secondary share offering (see *Appendix C* for details on the components of the calculation); and
2. The Corporate Income Tax (CIT) provision of $24.8M owed to OEFC.

Both payments are required under amendments made to the *Electricity Act, 1998* in the 2015 Budget to support the sale of Hydro One share offerings (see *Appendix D* for the relevant excerpts from the *Electricity Act*).

<u>Payment 1: Financial Benefit from the Sale of Hydro One Shares</u>

In April 2016, through the secondary share offering, the Province sold 14 per cent of Hydro One's common shares at a price of $23.65 per share generating gross proceeds of approximately $2B. The financial benefit to be allocated to OEFC regarding the 2016-17 Hydro One share sales would be $411,152,733 (See *Appendix C* for calculation details).

The payment to OEFC would be made by granting a remission of debt owed by OEFC (a non-cash payment). This reflects Section 50.3 of the Electricity Act, which allows for the Minister of Finance to make the payments to OEFC in cash, or by set off, through the issuance of securities or debt obligations, debt remission, or in another form as determined by the Minister.

The Ontario Financing Authority is aware that there will be a requirement for the Minister to select debt obligations owed by OEFC to the Province for remission.

<u>Payment 2: Provincial Corporate Income Tax Provision</u>

Under the amendments made to the *Electricity Act, 1998* in the 2015 Budget, the Minister of Finance has a statutory requirement to pay OEFC in each fiscal year an amount equal to tax payable under the *Taxation Act, 2007* (i.e., the provincial corporate income tax (CIT)) by Hydro One Inc. and its subsidiaries for the taxation year ending in each fiscal year, to continue to help service and pay down the electricity sector stranded debt.

Hydro One's taxation year is from January 1 to December 31, which differs from the Province's fiscal year from April 1 to March 31. The CIT for Hydro One and its subsidiaries for 2016-17 (from January 1 to December 31, 2016) is $24.8M, provided by Hydro One and is unaudited.

Fiscal Impact

Both these transactions are fiscally neutral for the Province upon consolidation of OEFC in the Public Accounts of Ontario as these payments to OEFC would be recorded as an expense for the Ministry and as revenue by OEFC. OEFC is an agency of MOF, and is fully consolidated into Public Accounts.

Relation to Trillium Trust

The calculation and payment of the transactions are separate and distinct from the Province's commitment to dedicating the net revenue gains from broadening Hydro One ownership to the Trillium Trust. While both calculations include components related to the sale of Hydro One, the two calculations are separately determined and follow different legislative guidelines.

The Ministry indicates that by providing a non-cash benefit under Section 50.3 of the Electricity Act, this form of payment allows for net cash proceeds from the sale to be dedicated to the Trillium Trust while ensuring that a financial benefit can be provided to OEFC. The Ministry indicates that this approach provides support that the Province is not “double counting” the proceeds from selling Hydro One shares and also supports the government’s commitment to Trillium Trust (See *Appendix E* for details on the Trillium Trust calculations).

Risks

The Office of the Auditor General (OAG) would likely have interest in these determinations, given that the OAG review transactions related to Hydro One share sales, especially more now because of the recent reforms in the electricity sector. In addition, the OAG audits both the MOF’s and OEFC’s financial statements.

The Office of the Provincial Controller (OPCD), Ontario Financing Authority (OFA), and MOF have worked together to address concerns around the timing of the benefit, and its relation to the Hydro One file. All parties are supportive of this transaction being brought to TB/MBC at this time, separate from other post year-end transactions, in order to ensure that the amount can be included in the Ministry’s and OEFC’s audited financial statements with enough time to allow for audit review and consideration.

Proceeding at this time also proactively mitigates stakeholders concerns regarding why OEFC has not yet received a benefit associated with the secondary share offering that occurred in April 2016.

The Ministry indicates that the financial benefit may be seen as relatively low compared to the gain on sale and net cash proceeds amount to be dedicated to the Trillium Trust. There may also be a risk that stakeholders may view the financial benefit to OEFC and the net proceeds credited to the Trillium Trust as double counting.

The Ministry indicates that these risks would be mitigated through a communication plan which would focus on the various upfront benefits to OEFC from the broadening of ownership of Hydro One and the fact that the government has effectively been dedicating the net gains from the Province’s ownership of Hydro One to OEFC over time, for many years, through the Electricity Sector Dedicated Income.

Communication materials would also note that the financial benefit to OEFC resulting from the secondary offering is significantly higher than the financial benefit resulting from the Initial Public Offering, driven primarily by the higher share price achieved by the Province in the secondary offering.

Proposed Timeline

Both transactions would be implemented as a post year-end adjustment, with the payment amount to appear in 2016-17 Public Accounts and OEFC’s financial statements.

As flagged under Risks (above), MOF indicates that deferring the submission to a later date, such as after Public Accounts are signed off on by the Auditor General, would create sequencing and timing challenge.

Minister's determination is required for the purposes of including the amounts in the OEFC financial statements and would need to be reviewed by OEFC's Audit Committee/Board and the Office of the Auditor General prior to being published in the Public Accounts.

Name of analyst:	Sohaeb Raashid	**Phone number:**	416-327-2067
Date:	May 5, 2017	**Log number:**	
Branch / Division:	GGPR, PEMD		

APPENDIX A: PROPOSED MINUTE

Receive a report from the Ministry of Finance on statutory appropriations for Ontario Electricity Financial Corporation (OEFC) Financial Benefit and the Hydro One Inc. Provincial Corporate Tax Provision for 2016-17.

In this regard, the Board:

i) Approve an increase of $411,152,733 in statutory appropriation for "Ontario Electricity Financial Corporation Financial Benefit – Asset Optimization, the Electricity Act, 1998", under the Economic, Fiscal and Financial Policy Program (Vote/Item 1203-S), in 2016-17;

ii) Approve an increase of $24,800,000 in statutory appropriation for "Hydro One Inc., Provincial Corporate Tax Provision, the Electricity Act, 1998", under the Economic, Fiscal and Financial Policy Program (Vote/Item 1203-S), in 2016-17.

iii) Note that the increases in statutory appropriation will be fiscally neutral upon consolidation.

APPENDIX B: FINANCIAL IMPACTS

FINANCIAL IMPACTS: CHANGES TO EXPENSE AND REVENUE					TABLE B1
		Fiscal Plan Basis			Appropriations Basis
$ Millions		**2016-17**	**2017-18**	**2018-19**	**2016-17**
Initiative cost recommended		436.0	0.0	0.0	
Expense changes:					
Statutory Appropriation	Oper	436.0	0.0	0.0	436.0
Revenue changes:					
Revenue increase (Consolidation)		436.0	0.0	0.0	
Revenue decrease		0.0	0.0	0.0	
Total Fiscal Impact		**0.0**	**0.0**	**0.0**	**0.0**

APPENDIX C: ONTARIO ELECTRICITY FINANCING CORPORATION BENEFIT CALCULATION

The following table provides the calculation of the benefit to the Ontario Electricity Financial Corporation.

Proposed payment pursuant to subsection 50.3(2) of the *Electricity Act, 1998*	$
Total proceeds paid to the Crown in respect of the 2016 disposition of 83,300,000 common shares of Hydro One Limited (the "subject securities")	$1,970,045,000
Less: purchase price of the subject securities associated with the original acquisition of common shares of Ontario Hydro Services Company Inc. (subsequently converted into common shares of Hydro One Limited)	$481,040,000
Less: purchase price of the subject securities associated with the 2015 acquisition of common shares in Hydro One Limited	$364,014,000
Less: Electricity Sector Dedicated Income amounts that have been allocated by the Crown to the Ontario Electricity Financial Corporation as of March 31, 2016, which are attributable to the subject securities	$673,320,304
Less: costs incurred by the Crown in disposing of the subject securities	$40,517,963
Payment to Ontario Electricity Financial Corporation	$411,152,733

APPENDIX D: EXTRACT OF THE ELECTRICITY ACT, 1998

Financial Benefit from the sale of Hydro One Initial Public Offering (IPO)

Proceeds of disposition

50.3 (1) This section applies if an amount is payable into the Consolidated Revenue Fund in respect of,

(a) the disposition of any securities or debt obligations of, or other interest in, Hydro One Inc. or any of its subsidiaries, a corporation established under section 50, a corporation or other entity established under section 50.1 or an arrangement made under section 50.1; or

(b) capital for any shares of Hydro One Inc. 2015, c. 20, Sched. 9, s. 7.

Payment to Financial Corporation

(2) The Minister of Finance shall pay to the Financial Corporation an amount equal to the proceeds payable to the Crown in respect of the disposition of securities, debt obligations or other interest described in clause (1) (a),

(a) less any amount that the Minister considers advisable in connection with the acquisition of the securities, debt obligations or interest, including the amount of the purchase price, any obligations assumed and any other costs incurred by the Crown and any amounts which have been allocated by the Crown to the Financial Corporation in respect of the securities; and

(b) less the amount of any costs incurred by the Crown in disposing of the securities, debt obligation or interest. 2015, c. 20, Sched. 9, s. 7.

Same

(3) The Minister of Finance shall pay to the Financial Corporation an amount equal to the amount payable to the Crown in respect of capital for any shares of Hydro One Inc. less any amount that the Minister considers advisable in connection with the acquisition of the shares, including the amount of the purchase price, any obligations assumed and any other costs incurred by the Crown. 2015, c. 20, Sched. 9, s. 7.

Payment methods

(4) The amounts payable to the Financial Corporation under subsections (2) and (3) are payable out of the Consolidated Revenue Fund and the Minister of Finance shall make the payments in cash, by set off, through the issuance of securities or debt obligations or in another form as determined by the Minister. 2015, c. 20, Sched. 9, s. 7.

Same

(5) The Minister's authority under subsection (4) to make a payment through the issuance of securities or debt obligations includes the authority to determine their terms and conditions. 2015, c. 20, Sched. 9, s. 7.

Same

(6) For greater certainty, the Minister's authority under subsection (4) includes making a payment by granting a remission of all or part of a debt owed by the Financial Corporation to Her Majesty in right of Ontario, and any remission so granted shall be reported to the Legislature in the Public Accounts. 2015, c. 20, Sched. 9, s. 7.

Provincial Corporate Income Tax Payable

Payment to Financial Corporation

91.2 (1) In each fiscal year of the Province, the Minister of Finance shall pay to the Financial Corporation from the Consolidated Revenue Fund an amount equal to the amount of tax payable under the *Taxation Act, 2007* by Hydro One Inc. or a subsidiary of Hydro One Inc. for the taxation year that ends in the fiscal year. 2015, c. 38, Sched. 3, s. 4.

Exception

(2) Subsection (1) does not apply in respect of tax payable by a prescribed subsidiary of Hydro One Inc. for a prescribed taxation year. 2015, c. 38, Sched. 3, s. 4.

Application of s. 50.2.1

(3) Section 50.2.1 does not apply to this section. 2015, c. 38, Sched. 3, s. 4.

Regulations

(4) The Minister of Finance may make regulations,

(a) prescribing subsidiaries of Hydro One Inc. for the purposes of subsection (2);

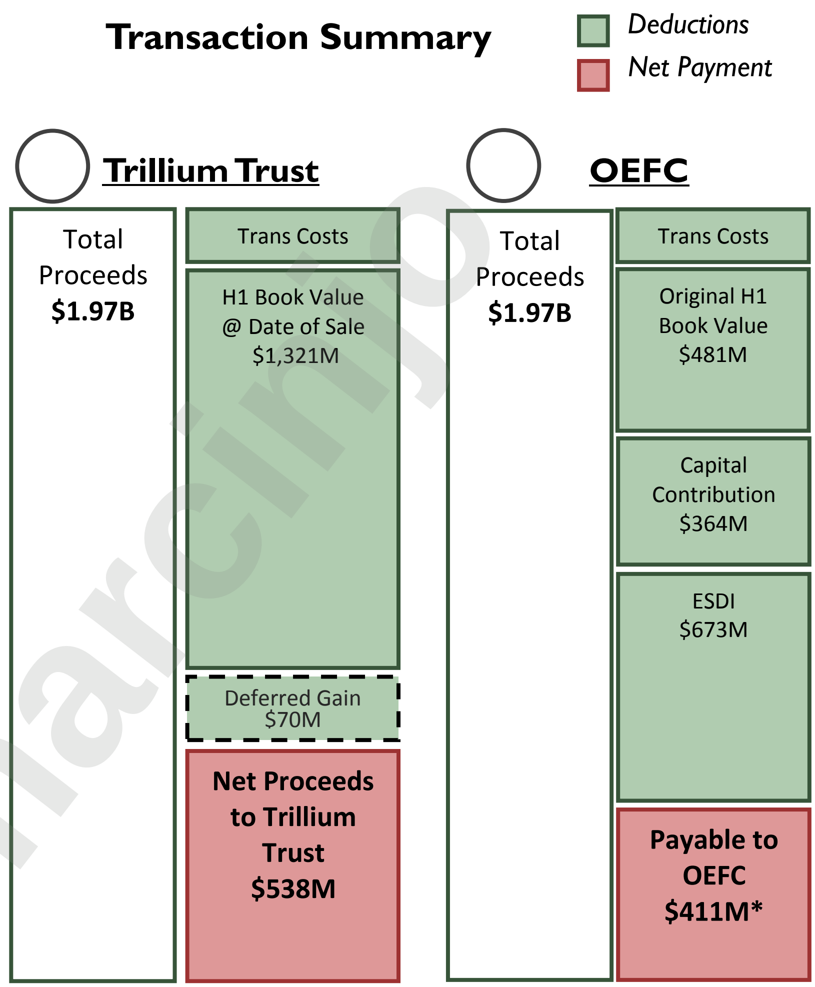
(b) prescribing taxation years for the purposes of subsection (2). 2015, c. 38, Sched. 3, s. 4.

Repeal

(5) **This section is repealed on the day on which Part V is repealed under section 84.1. 2015, c. 38, Sched. 3, s. 4.**

APPENDIX E: TRILLIUM TRUST & PAYMENT TO OEFC CALCULATIONS

- In March 2017, the government credited the Trillium Trust with $538M from the April 2016 secondary offering of Hydro One shares.
- The Province is now moving forward to provide OEFC with a financial benefit as required under section 50.3 of the Electricity Act and which will be recognized in OEFC's financial statements in fiscal 2016-17.
- The calculation and payment of this financial benefit to OEFC is separate and distinct from the Province's commitment to dedicating the net revenue gains from the Hydro One secondary offering to the Trillium Trust.
- While both calculations include, as components, amounts related to sale of Hydro One shares, the two calculations are separately determined and the calculations follow different legislative guidelines.



* Note: Subject to TB approval.