Confidential and Privileged Legal Advice

The below note is a summary of preliminary concerns with the draft term sheet for a Provincial Support Agreement (the "Guarantee") raised by MOF LSB, Ministry of Energy LSB and the Province's outside counsel, Blakes. The concerns are grouped in categories for convenience.

Beneficiaries – The Guarantee's description of proposed beneficiaries is very broad. The Guarantee provides that the legal beneficiary is the Indenture Trustee under the Master Trust Indenture on behalf of itself and all persons that have claims against the Financing Entity secured under the master trust indenture. This would include persons ranging from the Financial Services Manager (OPG) to holders of various types of debt and hedge counterparties. Because we have not seen a term sheet for the Master Trust Indenture, we cannot be sure of the actual extent of beneficiaries.

- Need to clarify which obligations the Province is being requested to guarantee and under what various agreements to determine scope and limit of guarantee.
- Should the subordinated notes (held by OPG) be guaranteed?
- Should the beneficiaries be limited to holders of the notes issued by the financing entity?
- Is there a term sheet for the proposed financing to be issued by the Financing Entity?
- Is there a request for a guarantee of payment on other back-up or ancillary borrowing and obligations other than those issued in the market?
- Is there a draft of the Master Trust Indenture?

Scope of Financial Guarantee – The proposed Guarantee is not restricted to any particular debt offering or related transaction. Rather, it is currently framed as a "program-wide" guarantee that encompasses any and all future transactions undertaken by OPG in connection with this initiative. This is too broad and the Guarantee should be limited to individual transactions and specified creditors, negotiated at the time of each transaction.

Term of Guarantee – Currently the Guarantee continues for one year beyond the last obligation to be repaid. This does not seem necessary and it should end when the last repayment is made.

Performance Guarantee – The province does not typically provide performance guarantees. Blakes noted that performance guarantees are quite typical in structured finance offerings and that they are generally regarded as being less onerous than an outright payment guarantee (because the guarantor is only guaranteeing the performance of certain specified obligations, as opposed to the payment of the underlying obligation). Ultimately the performance guarantee may result in a payment if the Province cannot compel performance.

Usually a performance guarantee is given by a parent, where some of the obligations rely on the actions of subsidiaries. However, under the current structure of the Term Sheet, Ontario would be guaranteeing the performance obligations of Local Distribution Companies (LDCs) directly and since these are not akin to subsidiaries and the Province has very little authority to compel performance by LDCs, this type of guarantee could expose the Province to some difficulty if an LDC ever failed to perform. Therefore, it would be appropriate that the performance guarantee should be limited to the performance of the Independent Electricity System Operator (IESO). The IESO, on the other hand, may have direct relationships with the LDCs, and it may be more appropriate for some type of commitment for the performance of the LDCs to be made by the IESO.

Payment Guarantee – There are three triggers of this part of the guarantee: (1) changing the legislation or regulations to undermine the future payment stream constituting the regulatory asset; (2) the legislation and/or the fair hydro plan being deemed by a court to be unconstitutional or unenforceable; and (3) a liquidity problem that makes it impossible to continue financing the structure or to refinance maturing debt.

With respect to the changes in law, because the Fair Hydro Plan is modelled on some US transactions, a concern has arisen that there is no legal barrier in Canada to changing the law or passing a law that undermines the value of the regulatory asset and the repayment of the obligations. Therefore, it may be that a payment guarantee triggered by adverse legislative action would go a long way to reassure potential investors and he thought that this kind of assurance (at least in some form) will be necessary to support any transaction. However, the kinds of future legislative actions that would trigger a Payment Guarantee Event are framed in vague terms. This could mean that a Beneficiary of the guarantee would try to trigger the guarantee even where there was no repayment failure, but only upon a theoretical diminution in the value of the regulatory asset or some kind of timing issue that delays payment, but not in a material way that undermines the repayment capacity of the Financing Entity.

The second trigger, arising from a finding that the structure is unconstitutional or otherwise unenforceable at law, should also be narrowed to only apply to a "final, non-appealable decision", otherwise a lower court ruling that is not upheld and does not unwind the structure could trigger a claim on the guarantee even where there is no risk of payment default.

Similarly, Blakes suggested that the concept of “market disruption” in the Term Sheet is also too vague and would unreasonably expose the government to risks around future refinancing transactions (*i.e.*, by effectively requiring Ontario to be the “standby purchaser” of any securities in the case of a lack of liquidity in the financial markets). This is the type of risk that is probably best addressed at the time such a risk arises, as it is impossible to predict the context and effect of such an event.

The put option is of particular concern because the current model might allow noteholders to require the province to buy back their investments in response to regulatory amendments affecting the value of their investments in only incidental or immaterial ways. Blakes cautioned that we need to guard against providing a form of assurance that enables U.S. hedge funds to hold the government hostage for the next 30 years.

Further action items and questions:

- **Time Lines and Communication with OPG** – We need to understand where this Guarantee fits into the transaction and find out why it is moving forward at this early stage. The Province needs to communicate to OPG that the Province does not agree with this draft term sheet and is not implied to be something the Province is agreeing to at such a preliminary stage.

- **Market Demands** –What precisely is the market going to demand to support the transaction? The Province’s interest would seem to be in providing the most limited guarantee that is both (i) necessary to support the transaction; and (ii) ensures the highest value for both ratepayers and taxpayers.

Ministry of Finance LSB
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