

May13, 2015

Mr. Paul Moist
National President
Canadian Union of Public Employees
1375 St. Laurent
Ottawa, Ontario
K1G 0Z7

Dear Mr. Moist:

Re: Assessment of Bill 91

You have asked for our review of Bill 91 – An Act to implement Budget Measures and to enact and amend various Acts. The scope of this review is focused on those amendments to legislation that will have the most significant impact on public ownership and control of Hydro One Inc. (Hydro One), as well as on the disposition of proceeds that may accrue from the sale of shares in Hydro One if it privatized. In this regard, we summarize our conclusions as follows:

- Public control of Hydro One is effectively abandoned;
- Access to information on Hydro One activities will be limited on and after April 23, 2015 thereby ensuring that the steps taken to facilitate privatization will not be open to public scrutiny;
- Hydro One will cease to be a public entity irrespective of its ownership status thereby exempting Hydro One from the reporting, oversight and disclosure requirements that attach to status as a public entity. Moreover, the ability of the Auditor General and Ombudsman, among others, to respond to legitimate concerns respecting Hydro One activities are curtailed and, in some instances, completely eliminated. Public entity caps on executive compensation will no longer apply.
- It is open to Hydro One to sell off the majority of its transmission and distribution assets without ownership safeguards;
- Regulatory oversight of Hydro One will be significantly curtailed; and

- Proceeds from the sale of Hydro One assets are now to be deposited in the Consolidated Revenue Fund potentially undermining the commitment to retire debt of the Financial Corporation with any sale proceeds.

1. Loss of Public Control of Hydro One

The Government has indicated that it intends to initially sell off a 15% ownership interest in Hydro One through an initial public share offering. The amendments to the *Electricity Act* contemplate a sale of 60% of the voting shares but with an individual purchase limit of 10%. However, the proposed amendments contained in the *Electricity Act* do not effectively limit the dilution of public ownership in Hydro One nor does it prevent assets sales that could effectively leave the distribution and transmission systems in private hands.

a) Fundamental Changes to the Purposes of Hydro One

The Government proposes altering the purposes of the *Electricity Act* in fundamental ways. First, the Purposes of the Act are no longer exhaustive. The listed purposes are inclusions as opposed to a closed list. Arguably, an action may now be taken that is not explicitly in support of a purpose enunciated in the Act. This creates ambiguity that could affect the mandates of those entities and individuals subject to the Act. Second, the Act now contemplates alterations of ownership structures of publicly-owned corporations including “to facilitate the disposition, in whole or in part, of the Crown’s interest in corporations that transmit, distribute or retail electricity, and to make the proceeds of any such disposition available to be appropriated for any Government of Ontario purpose”.¹ Consequently, the proposed revisions to the Act would expressly permit the wholesale disposition of the Crown’s interest in entities engaging in the transmission, distribution and retail of electricity.

b) Piecemeal Dismantling Authorized

With respect to asset sales, proposed section 48.1 of the *Electricity Act* defines the scope of what can be sold by Hydro One. The key provisions are in subsections 5 through 7. While Hydro One is prohibited from selling all or substantially all of its transmission or distribution systems, it is authorized to sell, lease, divest or otherwise dispose of significant parts of either system.² Furthermore nothing prevents Hydro One from authorizing successive asset sales that may in aggregate represent substantially all of its assets. This means Hydro One can be effectively dismantled through a series of asset sales with or without engaging in a public offering of its shares. The asset sale decision rests with Hydro One. Since it will no longer be considered a “public entity” as discussed further along in this opinion, such asset sales can occur without independent Government oversight.

¹ Bill 91, Schedule 9, section 1

² Bill 91, Schedule 9, section 2

c) Government Loss of Control Contemplated

The Government has spoken about the sale of a minority interest in the shares of Hydro One through an initial public offering of shares (IPO). At first glance, one might conclude that effective public control of Hydro One will be preserved despite the above-noted changes to the purposes of the Act. Proposed section 48.2 of the *Electricity Act* prevents an entity or group of entities from acting jointly to control more than 10 percent of the voting shares of Hydro One.³ However, nothing in the proposed amendments will prevent groups of shareholders that each control up to 10% of voting shares from voting in concert to override a position adopted by the Crown as a Hydro One shareholder. In other words, even if a 40% stake is preserved, effective control can shift to the private sector.

The proposed revisions to the Act also recognize that this limit may be violated and, in instances where there is a violation, Hydro One is not explicitly required to suspend the voting rights or force the sale of voting shares of the violating entity or group of entities. Reading between the lines, Ontario acknowledges that there will not be effective controls on the sale of shares through an IPO and places the onus on Hydro One to take “corrective action”. In effect, Hydro One is asked to be its own policeman with regard to potential share purchase violations and the manner in which such violations will be dealt with. While Bill 91 lists the types of actions that may be rolled into the Articles of Incorporation to allow Hydro One to take corrective action, it is left to the discretion of Hydro One what tools will actually be deployed. There is no assurance that the tools chosen will effectively eliminate interests held by an entity or related group of entities that are in excess of 10% of voting shares outstanding.

Proposed section 48.2(5) prohibits the Government from selling common shares that would lead to it holding less than 40% of the common shares outstanding as of the date Bill 91 comes into force. However, proposed subsection (6) states that there should be adjustments to the Government’s holding if there are subsequent changes to Hydro One’s share structure. It does not state explicitly that the share percentage should be maintained at 40% after such changes to the share structure. In fact, the amendment explicitly recognizes the possibility that the Government interest can be diluted. Proposed subsection (7) subjects the Government to the normal holding requirements (i.e. a maximum holding of 10% of voting shares) if its interest is reduced to 10% or less. In other words, should its ownership of voting shares be reduced through dilution or other means to less than 10% of those shares, it is precluded from trying to recover the ‘public control’ it has lost.

Restrictions once Province owns no more than 10 per cent

(7) If, at any time, through the actions of any person other than the Minister on behalf of Her Majesty in right of Ontario, the number of common shares of Hydro One Inc. owned by the Minister on behalf of Her Majesty in right of Ontario ceases to be greater than 10 per cent of the outstanding common shares

³ *Ibid.*, Schedule 9, section 3

of Hydro One Inc., then on and from that time the share ownership restrictions provided for in subsection (1) apply to the Minister acting on behalf of Her Majesty in right of Ontario.

d) Dilution of Share Value to Win Employee Support

Under the Ontario *Business Corporations Act* (OBCA), shares can only be purchased for consideration. The Government has introduced an exception to this rule in proposed section 48.2 so that shares can be gifted to Hydro One employees or, alternatively, set at a purchase price that is lower than the shares' fair value. Exceptions to the OBCA are also incorporated to allow for an adjustment to Hydro One's stated capital account to reflect the increase in the number of issued shares. Increasing the number of outstanding shares without obtaining fair value for the subscription of those shares will dilute the value of the outstanding shares. This appears to be a blatant attempt on the part of the Government to purchase support for privatization from potentially hostile opposing groups.⁴

2. Barriers to Privatization Information

a) No Freedom of Information after April 23, 2015

From the date the Bill 91 receives Royal Assent, freedom of information requests (FOIs) will no longer be honoured. If an FOI request was submitted prior to Bill 91 receiving Royal Assent and the specified period for access expires after April 23rd, the specified period is deemed to have expired on April 23, 2015. In other words, the changes have retroactive effect to April 23rd, the date of release of Bill 91.⁵ Comparable changes have also been made to the *Municipal Freedom of Information and Protection of Privacy Act* to ensure that no new FOI requests can be made after April 23rd.⁶

The retroactive application of the FOI exemption is a thinly veiled attempt to block access to information regarding the privatization process whether connected to the potential sale of shares or assets. As is noted in the following section, public officials such as the Auditor General, the Financial Accountability Officer and the Ombudsman have their authority to investigate Hydro One terminated effectively on the date of Royal Assent with the exception of ongoing investigations. The blocking of FOI requests serves to prevent external third parties from inquiring and obtaining information. Both the internal and external checks on the activities of Hydro One have been diminished.

⁴ Section 48.2(8) of Section 3 of Schedule 9 places the authority to issue such shares for no consideration with the Hydro One Board of Directors. Depending on how and when these shares will be issued, the Board could be exposed to legal challenges from other shareholders whose share value may be negatively affected. Moreover, this opens the possibility of issuing shares to officers of Hydro One on the same or more generous basis to that of other Hydro One employees.

⁵ Bill 91, Schedule 13, section 2

⁶ Bill 91, Schedule 28

3. Loss of Public Entity Status

One might presume that Hydro One would cease to be a public entity when the Crown ceases to hold a controlling interest in the Corporation. If Bill 91 is enacted as drafted, there will be no linkage between Crown control of Hydro One and its status as a broader public entity or public entity. Ontario has ensured that the accountabilities normally associated with Crown ownership are diminished and/or eliminated.

a) Changes to the Scope of the Auditor General's Authority

Proposed revisions to the *Auditor General Act* deems Hydro One and its subsidiaries not to be agencies of the Crown or Crown controlled corporations for purposes of the Act effective upon Royal Assent of Bill 91. While Hydro One is required to provide sufficient information to the Auditor General to enable completion of the public accounts, such information cannot be compelled prior to the public release of Hydro One's financial statements. The Auditor General is given six months from the date of the Act's Royal Assent to complete any special audits or assignments and the consolidated financial statements for 2014-2015. However, there is no scope for future special audits or assignments, thereby significantly curtailing the government's ability to inquire into Hydro One's affairs.⁷

The Auditor General is also required under proposed provisions to provide an advance copy of findings to the chief executive officer of an entity subject to his or her report.

Same

(6) If an entity other than a ministry is the subject of an annual report or a special report, the Auditor General shall give a copy of the relevant excerpt from the report to the chief executive officer of the entity or to a person who holds a similar position before giving the report to the Speaker.⁸

Similarly, an advance copy must be provided to the relevant minister of any ministry which is the subject of a report.

b) No Broader Sector Accountability

Hydro One cannot be prescribed as a "designated broader public sector organization" or "publicly funded organization" for purposes of the Act. Hydro One employees will no longer be required to disclose salaries and are exempted from the temporary provisions of the Act limiting salary increases.⁹ Moreover, Hydro One will now also be permitted to hire lobbyists.¹⁰ As a public entity, it was prohibited from using public funds or the revenue it generates from

⁷ Bill 91, Schedule 3

⁸⁸ Bill 91, Schedule 3, section 1

⁹ Bill 91, Schedule 4, sections 3 and 5

¹⁰ *Ibid.*, section 2

operations to hire lobbyists. The exemption shields disclosure of compensation, enables compensation increases in excess of what would have been permitted from a public entity and enables Hydro One to use its revenues to purchase services for the purposes of government relations as opposed to deploying resources directly on operational matters.¹¹

c) Limits on Scope of the Financial Accountability Officer

As with the Auditor General, because Hydro One will no longer be considered a public entity, the Financial Accountability Officer will have no ability to exercise his or her powers with respect to Hydro One. Six months from the date of Royal Assent is the window provided to complete work already underway. But there can be no new work embarked upon.¹²

d) Exclusion of Financial Administration Act Provisions

The Government cedes control over Hydro One accounting policies and practices. It will no longer be able to prescribe such regulations related to Hydro One accounting. As with the Auditor General, provision of information is restricted to that necessary to complete the consolidated financial statements set out in the Public Accounts. Provision of information to the Minister of Finance is restricted to that which has already been made public. Hydro One cannot be compelled to provide information prior to the release of its financial statements.¹³

e) No Role for the Ombudsman

Hydro One is deemed not to be a governmental entity and is therefore exempt from the powers of the Ombudsman. Investigations may continue up to six months after Bill 91 receives Royal Assent on ongoing matters but no new investigation may be undertaken regardless of whether the matter occurred before, on or after the date Bill 91 receives Royal Assent.¹⁴

The Ontario Government may argue that it has instituted an alternative ombudsman model. Under the proposed revisions to the *Electricity Act*, Hydro One will be mandated to establish its own ombudsman.

Office of the ombudsman

48.3 The board of directors of Hydro One Inc. shall appoint an ombudsman for Hydro One Inc. and its subsidiaries to act as a liaison with customers and shall establish procedures for the ombudsman to inquire into and report to the board of directors of Hydro One Inc. on matters raised with the ombudsman by or on behalf of customers.

¹¹ Bill 91, Schedule 5

¹² Bill 91, Schedule 10, section 1

¹³ Bill 91, Schedule 11

¹⁴ Bill 91, Schedule 30

Of course, there is a fundamental difference between having an arm's length ombudsman with powers and authority to act on Hydro One matters and an ombudsman that is appointed by the very Board it is expected to monitor. In the absence of an arm's length arbiter, there is no assurance that the Corporation will be responsive to consumer complaints.

f) Exclusion of Integrity Commissioner

As a public entity, Hydro One has been subject to public expenses review by the Integrity Commissioner. Since Hydro One will be deemed not to be a public entity, the authority of the Integrity Commissioner to investigate expenses is terminated. As with other oversight positions, there is a six month window following Royal Assent of Bill 91 for the Integrity Commissioner to complete investigations respecting expenses incurred prior to April 1, 2015. Reporting obligations continue for Hydro One through to May 31, 2015. Afterward, the *Public Sector Expenses Review Act, 2009* no longer applies.¹⁵

g) Restrictions on scope of Lieutenant Governor in Council Authority

The Lieutenant Governor in Council can no longer make regulations prescribing mandatory provisions to be included in Hydro One's articles of incorporation. Among the authorities repealed, the LGC can no longer mandate:

- (a) the mandatory disclosure of information in documents issued or published by the applicable corporation;
- (b) the duties and powers of the directors to refuse to issue or register transfers of shares in accordance with the articles of the corporation;
- (c) the limitations on voting rights of any shares held contrary to the articles of the corporation;
- (d) the powers of the directors to require disclosure of beneficial ownership of shares of the corporation and the rights of the corporation and its directors, employees or agents to rely on the disclosure and the effects of the reliance;
- (e) the manner of determining how much of the equity of a corporation a person or class of persons owns.

Discretion now rests with the Hydro Board for much of these authorities.

4. Removing the Link between Proceeds and Debt Reduction

¹⁵ Bill 91, Schedule 37

The Government has stated its intention to use privatization revenue to fund transit infrastructure. Under Bill 91, if Hydro One sells any assets, the proceeds are not payable to the Ontario Hydro Financial Corporation (i.e. the current requirement). Instead, the proceeds go to the Consolidated Revenue Fund. We have not assessed the potential impact of these arrangements on the obligations of the Financial Corporation to its bond holders, or on ratepayers who will continue to be pay debt recovery charges.

There is also a distinct possibility that an IPO will result in the sale of Ontario Hydro shares at a considerable discount. Bill 91 provides an exemption to section 42 of the OBCA so that there can be a public offering of shares despite placing restrictions on the share offering. These restrictions combined with the fact that the initial public offering is contemplated to represent only 15% of Hydro One's equity will likely be viewed by the market as reasons to downgrade pricing. Consequently, less money may be generated than expected on the sale of shares.

Further, the follow-on risk is that private investors will expect an ongoing higher rate of return on their investment compared to under the public ownership model. This will mean that more money will be paid in dividends to meet that return expectation than would have been incurred in servicing debt under public ownership. We are not in a position to assess the potential impact of investor expectations for higher returns, on the availability of funds required to maintain or improve the transmission and distribution systems.

The cost of Government borrowing continues to be at historically low interest rates. The end result translates into the Government receiving less than the true value of shares at the time of the share offering and receiving less in revenue distribution from operations year over year since more resources will be devoted to ensuring that investors are satisfied with their rate of return.

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.

The Minister is not obliged to transfer the money into the Trillium Trust or spend it on infrastructure. While the Minister is responsible to pay (or offset) an equivalent amount to that of the proceeds received from the sale to the Finance Corporation, the form of payment is discretionary and the determination of the amount is open to manipulation.

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.

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.

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.

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.

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.

The proposed payment requirement allows the Minister to exercise broad discretion in determining what amounts constitute proceeds associated with the sale and then, once determined, allows the Minister to define the manner of payment to the Finance Corporation,

which may include simply remission of a debt owed by the Financial Corporation or, *inter alia*, issuing more debt. The end result is removal of the direct linkage between proceeds from Hydro One and debt retirement. The losers could be rate payers if Government proceeds are used for other purposes and simply replaced by the issuance of more debt and/or increases in rates to cover shortfalls in the debt reduction.

5. Conclusion

Bill 91 goes further than providing a scheme for privatization. It is drafted to remove accountability, regulatory authority and to present roadblocks to access to information precisely at the time plans are being put in place to sell assets and shares in Hydro One. The Government's duty with respect to the stewardship of Hydro One is, in part, to ensure that the management decisions that are made are reasonable and in the best interest of its ownership – namely, the public. Decisions that are crafted behind a wall of secrecy will prevent scrutiny during the privatization process.

There is an inherent contradiction in the approach adopted. On the one hand, Ontario has taken great pains to ensure that private investors will be given a free hand. That is, that the oversight typically associated with a publicly-owned enterprise will be eliminated to assure potential investors that the privatized Hydro One will be insulated from government interference. At the same time, Ontario has placed provisions in Bill 91 to create the façade that the public sector will retain control, implying that public stewardship will also be retained. Obviously, the two models cannot co-exist. The underlying elimination of checks and balances in the system reveals the Government's true intent – to relinquish control and stewardship of the electricity market. The provision for the purported retention of 40% public ownership is essentially a marketing ploy for legislative reforms that will certainly abandon public control of Hydro One, and may ultimately reduce the public share in Hydro One to no more than a marginal interest.

Sincerely,



Darrell Brown
ER/cope 343

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