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April 13, 2015

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

Dear Mr. Moist:

**Re: Opinion on Lawfulness of Potential Privatization of Hydro One**

You have asked for our assessment of whether there would be legal grounds for challenging a plan by the Liberal government to sell some part of its interest in Hydro One.

As the government has yet to declare its intentions in this regard, it is obviously not possible to provide a definitive view of whether the government would have the legal authority for any particular privatization scheme. Nevertheless, in our opinion, there are reasonable grounds for arguing that the sale of securities, debt or other interests in Hydro One would be subject to challenge, on the following bases:

i) the government has no lawful authority to use the proceeds from such a sale to fund transit infrastructure, as it has declared its intention to do. Regardless of whether the sale itself is lawful, if the government fails to pay the net proceeds from any such sale to the Ontario Electricity Financial Corporation, it would be in breach of the explicit requirements of the *Electricity Act*;

ii) the government's professed reasons for authorizing a privatization of Hydro One (in particular, in order to fund transit infrastructure) are entirely extraneous purposes not authorized by the purposes of the *Electricity Act*; and

iii) the exercise of a statutory discretion to privatize Hydro One could be challenged on administrative law grounds of unreasonableness or irrationality.

As well, there is a very serious concern with respect to the impacts of privatizing Hydro One, in light of Canada's obligations to foreign investors and service providers under international trade

law. These may limit the government's future policy and regulatory options in respect of the electricity transmission and distribution sectors.

## *FACTUAL BACKGROUND*

In 1999, the government of Ontario re-structured the generation, transmission and distribution of electricity in the province. Ontario Hydro was technically continued as the Ontario Electricity Financial Corporation (OEFC), though most of its assets, liabilities (other than debts), employees, rights and obligations were transferred to:

- **Ontario Power Generation (OPG)**, which was responsible for power generation;
- **Hydro One**, which handled transmission and distribution of electricity; and
- **Independent Electricity System Operator (IESO)**, responsible for directing system operations and operating the electricity market.

This new structure included a fairly complex allocation of debt. Ontario Hydro was continued as the OEFC, which took on most of Ontario Hydro's debt, offset by certain of Ontario Hydro's receivables and other assets assigned to it. The difference between these liabilities and assets was labelled the "stranded debt", and totalled $19.4 billion in 1999. A substantial portion of this debt remains to be paid, as does the obligation of ratepayers to pay Debt Retirement Charges.

### *The Conservative Government's Attempt to Privatize Hydro One*

In March 2002, the Ernie Eves government attempted to privatize Hydro One by offering to sell all of its shares through an Initial Public Offering (IPO)[1] for a putative value of $4.5 billion. However, on the eve of the issuance of what would have been the largest IPO in Canadian history, the Canadian Union of Public Employees (CUPE) and the Communications, Energy and Paperworkers Union (CEP) obtained a declaration from the Ontario Superior Court that the province lacked the statutory authority to effect the sale. Justice Gans concluded that:

> The legislature, in its wisdom, did not intend to embark upon a privatization program at this stage in the reorganization and corporatization of Ontario Hydro. I need therefore not go so far as to say that if a corporation is owned solely by the Crown and created solely for the public benefit, with roots deep in the fabric of the community, public ownership cannot be relinquished absent express language.[2]

The Conservative government subsequently introduced a series of amendments to the *Electricity Act*. For present purposes, these amendments did two things. First, they accorded to government

[1] *Payne v. Ontario (Minister of Energy, Science and Technology)*, [2002] OJ No. 1450, at para. 5.
[2] *Payne, supra,* at para. 38.

the discretionary authority to dispose of its interest in Hydro One. Section 49(1) was amended to provide the Minister with the following statutory discretion:

> The Minister, on behalf of Her Majesty in right of Ontario, may acquire, hold, dispose of and otherwise deal with securities or debt obligations of, or any other interest in, Hydro One Inc. or any of its subsidiaries.

As well, the following clause was added to the purposes of the Act in s. 1:

> (f.1) to facilitate the alteration or ownership structures of, and the disposition of, publicly-owned corporations that transmit, distribute or retail electricity;[3]

The second amendment restricted the use of proceeds from such a sale, requiring the government to pay such proceeds to the OEFC, less certain related expenses and costs. This restriction was set out in Part V, s. 50.3(1) of the *Act*, which provided that "All proceeds payable to Her Majesty in right of Ontario in respect of the disposition of any securities or debt obligations of, or any other interest in, Hydro One Inc., . . . shall be paid to the Financial Corporation."

The purpose of s. 50.3 was made clear in an Explanatory Note released by the government on first reading:

> If the Crown disposes of the securities or debt obligations of Hydro One Inc. or any of these corporations or entities, or disposes of any other interest in them, the net proceeds must be paid to the Financial Corporation. Net payments in respect of capital must also be paid to the Financial Corporation. These obligations are set out in section 50.3 of the Act. They terminate when Part V of the Act is repealed.[4]

As well, s. 84.1(3) of the *Electricity Act* provides that: "No proclamation shall be issued [to repeal Part V]… unless, in the opinion of the Minister of Finance, substantially all the debts and other liabilities of the Financial Corporation have been retired or defeased". Under this Act, repeal of Part V also has the effect that a number of charges that currently go to the OEFC (i.e. annual payments in lieu of taxes, revenues from a sale, etc.) would revert to the Consolidated Revenue Fund.

On introducing the legislation at first reading, the Minister of Environment and Energy confirmed this same legislative intention, when he stated that "the bill reinforces the government's commitment to ensuring that the net proceeds of any disposition option would go toward paying down the Hydro debt."[5] At third reading, he added:

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[3] *Reliable Energy and Consumer Protection Act*, 2002, S.O. 2002, C.1 – Bill 58, Schedule A

[4] Bill 58, Reliable Energy and Consumer Protection Act, 2002, *Explanatory Note*, available online: http://www.ontla.on.ca/web/bills/bills_detail.do?locale=en&BillID=1204&isCurrent=false&detailPage=bills_detail_about

[5] Ontario Legislative Assembly, *Debates*, 37th Parliament, 3rd Session, Wednesday 29 May 2002.

> After listening to [the people of Ontario's] views, our government has made it clear that we will hold on to at least 51% of Hydro One. We are still considering how best to bring private sector discipline to Hydro One. The net proceeds -- that is, the proceeds less the cost of the transaction -- from any sale of the shares will go toward paying down the old Ontario Hydro debt of $38 billion.[6] [Emphasis added]

It would seem that widespread public opposition to the sale of Hydro One, fueled in part by the notoriety of the attempted but unlawful IPO, deterred subsequent governments from acting on any inclination they might have to sell this critical public infrastructure.

*Present Proposals to Privatize Hydro One*

In advance of the 2014 provincial election, Premier Kathleen Wynne created the Premier's Advisory Council on Government Assets, headed by former TD Bank CEO, Ed Clark. The mandate of the Council is to advise the government on how best to maximize the value and performance of government business enterprises.

Announcing this initiative in the 2014 Provincial Budget, the government committed to "give preference to continued government ownership of all core strategic assets."

In November 2014, Council chair Ed Clark issued his preliminary Report, "Retain and Gain: Making Ontario's Assets Work Better for Taxpayers and Consumers." With respect to Hydro One, the Report recommended that the transmission and distribution businesses of Hydro One be separated, and that the province retain ownership of the transmission business, while diluting its share of the resulting distribution company. The Report also recommended that the province dilute its interest in Hydro Brampton by merging it with some other Local Distribution Companies (LDC's). As these distribution services represent 41% of the Hydro One enterprise, the Council has recommended a significant privatization of Hydro One's business.

In making these recommendations, the Council also acknowledged that "current barriers and incentives, such as taxes, which impede consolidation should be reviewed during Phase II [of the Council]". We understand that the Phase II Report will be made public in the near future.

In recent weeks, however, there has been speculation in the media that instead of following the Council's advice to balkanize Hydro One but retain undiluted ownership of its transmission business, the government may instead sell a 15-20% stake in an intact Hydro One.

Importantly, the current government has been explicit that the purpose of any sale of its interest in Hydro One would be to generate funds for infrastructure projects in Ontario, namely transit and transportation. The government's announcement of the establishment of the Advisory Council in the 2014 budget laid out the government's intended uses of any revenues from the planned asset recycling: the need for revenues to pay for infrastructure were the impetus for the

[6] Ontario Legislative Assembly, *Debates*, 37th Parliament, 3rd Session, Thursday 27 June 2002.

Council's review. In turn, the Council refers to the objective of funding for transit and transportation infrastructure throughout its Report.

*ANALYSIS*

*i) Can the Revenues from the Sale of Any Shares, Debt or Other Government Interest in Hydro One Be Used to Fund Transit Infrastructure?*

**Short answer: The *Electricity Act* requires that the net proceeds from the sale of any part of the provincial interest in Hydro One be paid to the Ontario Electricity Financial Corporation. These proceeds cannot therefore be used to fund transit infrastructure.**

This disposition of proceeds from the sale of electricity sector assets was in fact an issue considered by Justice Gans in the *Payne* decision. He pointed out that the *Electricity Act*, as it existed at the time, included provisions stipulating that if any municipality were to sell assets or shares from a local electrical utility, the proceeds must be paid to the OEFC and used to retire the stranded debt.

As noted above, the *Act* was amended in 2002 to provide the Minister with the discretion to authorize the sale of Hydro One, and to provide express restrictions on the disposition of the proceeds from any such sale. Section 50.3(1) provides:

> 50.3 (1) All proceeds payable to Her Majesty in right of Ontario in respect of the disposition of any securities or debt obligations of, or any other interest in, Hydro One Inc., a corporation established under section 50, a corporation or other entity established under section 50.1 or an arrangement made under section 50.1 shall be paid to the Financial Corporation,
>
> > (a) less any amount that the Minister of Finance considers advisable in connection with the acquisition of such securities, debt obligations or interest, including the amount of the purchase price, any obligations assumed and any other costs incurred by Her Majesty in right of Ontario; and
> >
> > (b) less the amount of any costs incurred by Her Majesty in right of Ontario in disposing of the securities, debt obligations or other interest.
>
> [Emphasis added]

The meaning of s. 50.3(1) could not be any clearer: all net proceeds from the disposition of Hydro One assets must be paid to the Financial Corporation (the OEFC as defined in s. 2 of the *Act*).

Section 50.3(1) provides for specific exceptions in clauses (a) and (b). However, based on the language of the provision, the purposes of the *Act*, and the legislative history discussed above, these exceptions only allow for the deduction of legitimate costs relating to the sale or related to purchasing some part of Hydro One at the same time, and certainly not for the diversion of sale proceeds from the OEFC to fund transit infrastructure.

*ii) Is it Lawful for the Provincial Government to Privatize Hydro One to "Free Up" Funds to Finance Transportation Infrastructure?*

**Short answer: there are substantial grounds for challenging, as unlawful, a decision to privatize Hydro One for the purpose of "freeing-up" funds to invest in transit and transportation infrastructure.**

The Council Report is explicit that implementing the privatization proposals it recommends (in the beverage alcohol and electricity sectors) would "free up funding for much-needed transit and transportation infrastructure investment". It estimates that "between $2 billion and $3 billion, depending on market conditions at the time, can be realized and invested in Ontario's transit and transportation infrastructure."

No account is provided of how this estimate was derived or what portion might relate to Hydro One. As we have explained, the net proceeds of any sale of securities, debt or other interest in Hydro One must be paid to the OEFC, so "freed-up" funds are not to be found there. But Mr. Clark argues that privatizing Hydro One's distribution assets will obviate the requirement for *future* public investment in this infrastructure. We assume that it is the alleviation of these future capital demands that would ultimately "free-up" resources to invest in transit.

While the *Electricity Act* allows the government to dispose of its interest in Hydro One, it has been a longstanding principle of administrative law and judicial review that any discretionary power given to a government cannot "be taken to contemplate an unlimited arbitrary power exercisable for any purpose, however capricious or irrelevant, regardless of the nature or purpose of the statute." To that end, the government cannot exercise a statutory power in a way that is improper, fraudulent, or (most importantly or the purposes of this opinion) clearly outside of the objects of the enabling statute:

> "Discretion" necessarily implies good faith in discharging public duty; there is always a perspective within which a statute is intended to operate; and any clear departure from its lines or objects is just as objectionable as fraud or corruption.[7]

Thus, it is well-established that, in the exercise of a statutory power or discretion, a Minister of the Crown must exercise that discretion in a manner consistent with the purposes and objects of the statute conferring the power.[8]

[7] *Roncarelli v. Duplessis*, [1959] S.C.R. 121, at p. 140. See also generally D. Brown & J.M. Evans, *Judicial Review of Administrative Action in Canada*, looseleaf (Carswell, 2013), at para. 15:2241.

Accordingly, courts have been willing to overrule government action where it is exercised for purposes that are extraneous to the enabling statute, or which run counter to the policy and objects of the statute.

For a specific illustration of this longstanding principle, reference can be made to the *Doctors Hospital* case, where the Ontario Divisional Court overturned a decision by the government to revoke approval for certain hospitals in an effort to reduce expenditures. The Court ruled that "the discretion granted to the Lieutenant-Governor in Council could only be used to pursue the policy and objects of the Act." The legislation in that case was primarily concerned with the staffing, management and operation of public hospitals, and not with financial or budgetary considerations, so the government's exercise of power was not authorized.[9]

On a similar basis, in the case of a proposed privatization of Hydro One, to the extent that it could be established that the Government's actual or primary purpose in privatizing Hydro One is to fund transit infrastructure, there would be a reasonable basis upon which to challenge any such decision. This is because the discretion granted to the Minister to sell or dispose of Hydro One must be exercised for the purposes delineated by the *Electricity Act.*

The purposes of the current *Act* were introduced in a 2004 amendment:

> (a) to ensure the adequacy, safety, sustainability and reliability of electricity supply in Ontario through responsible planning and management of electricity resources, supply and demand;
>
> (b) to encourage electricity conservation and the efficient use of electricity in a manner consistent with the policies of the Government of Ontario;
>
> (c) to facilitate load management in a manner consistent with the policies of the Government of Ontario;
>
> (d) to promote the use of cleaner energy sources and technologies, including alternative energy sources and renewable energy sources, in a manner consistent with the policies of the Government of Ontario;
>
> (e) to provide generators, retailers, market participants and consumers with non-discriminatory access to transmission and distribution systems in Ontario;
>
> (f) to protect the interests of consumers with respect to prices and the adequacy, reliability and quality of electricity service;
>
> (g) to promote economic efficiency and sustainability in the generation, transmission, distribution and sale of electricity;

[8] *CUPE v. (Ontario) Minister of Labour* , [2003] 1 S.C.R. 539.
[9] *Re Doctors Hospital and Minister of Health et al.*, 1976 CanLII 739 (ON SC).

> (h) to ensure that Ontario Hydro's debt is repaid in a prudent manner and that the burden of debt repayment is fairly distributed;
>
> (i) to facilitate the maintenance of a financially viable electricity industry; and
>
> (j) to protect corridor land so that it remains available for uses that benefit the public, while recognizing the primacy of transmission uses. 2004, c. 23, Sched. A, s. 1; 2014, c. 7, Sched. 7, s. 1.

Notably, these amendments removed the following clauses, which, as noted above, had formed part of the *Act* prior to the 2004 amendments:

> (a) to facilitate competition in the generation and sale of electricity and to facilitate a smooth transition to competition;

and

> (f.1) to facilitate the alteration of ownership structures of, and the disposition of, publicly-owned corporations that transmit, distribute or retail electricity;

None of the purposes in the current *Act* would support to privatization of Ontario Hydro for the purpose of funding transit or other public infrastructure. Moreover, any assessment of whether the Minister had acted for extraneous purposes would also have to take into account the pointed removal in 2004 of the earlier 2002 purposes that had focused on disposing of and privatizing energy assets. At the very least, the deletion of the 2002 purposes imposes further constraints on the Minister's discretion to privatize Hydro One than existed at the time he was first accorded the right to dispose of Hydro One in 2002.

In our view, if it could be established that the discretion granted to the Minister under the *Act* were being exercised for purposes extraneous to the legislature's clear purposes for the *Act*, there would be a strong argument before a reviewing court that the privatization of Hydro One is unlawful. Put another way, none of the purposes set out in the *Electricity Act* extend to privatizing Hydro One to fund another public infrastructure. To the extent a court were persuaded that this was the Government's purpose, there would be reasonable grounds for a court to find the privatization to be unlawful.

*iii)* *Can a Decision to Privatize Hydro One Be Challenged as an Unreasonable/Irrational Exercise of The Minister's Discretion?*

**Short Answer: It is our view that, separate and apart from a challenge based on unlawful purpose, there are also grounds to challenge a decision by the Minister of Energy to sell securities, debt or any provincial interest in Hydro One as being an unreasonable or irrational exercise of the Minister's discretion under the *Electricity Act*.**

Section 49(1) of the *Act* empowers the Minister of Energy to "acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, Hydro One Inc." However, under administrative principles, apart from the requirement that the discretion be exercised consistent with the purposes of the legislation and that extraneous considerations not be taken into account, any such statutory discretion is also subject to judicial review where it can be established that it has been exercised unreasonably or irrationally.[10]

The provisions of the *Electricity Act* itself lend further support to the legislative recognition and intention that a Ministerial decision under s. 50.2 to privatize Ontario Hydro would be reviewable in the courts. Thus, while other provisions of the legislation prescribe that a Ministerial determination is "final and conclusive", and that it "shall not be stayed, varied or set aside by any court" (see s. 53.20(3), s. 84.1(4) and s. 85(7)), there is no such protection from judicial review accorded to the exercise of a Ministerial discretion under s. 49(1) as to whether or not to privatize Ontario Hydro.

In our view, there are substantial grounds for challenging a decision to privatize Hydro One as being unreasonable and indeed arbitrary. In addition to the fallacy of supposing that privatization will generate revenue for investment in transit infrastructure, these grounds include the following:

1. Privatization Will Adversely Impact Ontario Finances

Our understanding is that the sale of a portion of Hydro One's distribution business would decidedly be a bad financial decision because private investors would require a far higher rate of return (8%) to invest in that business than the cost of Ontario's long-term bonds, currently 2.9%.

We are advised that that the sale of 60% of the distribution assets of Hydro is likely to raise approximately $2.5 billion. The return on this investment to private investors would be in excess of $200 million/yr, and decrease dividends paid to the province by this amount. Applying the proceeds of the sale to reduce OEFC debt would save the Province (which is ultimately responsible for that debt) less than $75 million in interest costs. Thus the net loss of income to the Province of Ontario would be $133.7 million per year.

[10] This is made clear by the Supreme Court' of Canada's most recent decisions on the standard of judicial review, holding that all exercises of statutory discretion must be held to a minimum standard of reasonableness. These decisions include *R. v. Dunsmuir*, [2008] 1 S.C.R. 190; *Agraira v. Canada*, [2013] 2 S.C.R. 559; *Catalyst Paper v. North Cowichan*, 2012 SCC 2, [2012] 1 S.C.R. 5; *CNR v. Canada*, [2014] 2 S.C.R. 135, at para 54, "The precedents instruct that the *Dunsmuir* framework applies to administrative decision makers generally and not just to administrative tribunals."

Moreover, as the Council notes, in addition to net income from Hydro One, the tax-exempt status of Hydro One means that annual payments in lieu of taxes (PILs) are made to the OEFC ($110 million in 2013). However if public ownership of Hydro is reduced below 90%, the tax exempt status of Hydro One will be partially or entirely lost (depending on whether Hydro One is kept intact). If this occurs, instead of flowing to the OEFC, these funds would be paid as taxes, including to the federal government.

2. Privatization Will Undermine Public Control of Core Assets

The Clark Report recommends retaining public ownership of the Hydro One transmission system as a core provincial asset in order to preserve provincial policy options in respect of this strategic public asset. A decision to sell a 10-15% interest in the transmission system would be entirely contrary to this key recommendation of the Report.

It is also unclear why it would be reasonable for the Minister to conclude that the transmission system is considered a core asset but the distribution system is not, when the overwhelming majority of industrial, commercial and individual consumers are served by distribution, not transmission systems. It is also unclear how the Minister could reasonably conclude that public ownership is more important for regional transit systems than for provincial electricity systems.

3. Public vs. Private Benefits

If taxpayers, ratepayers and public policy flexibility are the casualties of a Hydro One privatization scheme, it is reasonable to ask who the winners will be.

Mr. Clark's Report suggests that over time "Diluting the Province's ownership in the distribution business of Hydro One Networks would enable efficiency savings for electricity ratepayers, introduce additional private-sector capital into the distribution system and generate productivity improvements."

However, it is not at all apparent how the Minister could reasonably conclude, with private capital requiring an 8% return, how this would bring about these improvements more readily than public capital at 3%. Nor is it clear how, if that were true, Brampton Hydro, which is owned by Hydro One, is one of the lowest cost service providers in the province.

Whether one shares Mr. Clark's optimism about gains that may ultimately be achieved by privatization, it is clear that the immediate winners will be private investors and the legal and investment firms that will prepare and underwrite any IPO. The cost of legal and financial services for the previous attempt to privatize Hydro One, as disclosed by the IPO, was significantly in excess of $100 million. At least over the short term, and perhaps indefinitely, these imbalances between public and private benefits also call into question the reasonableness of any privatization decision.

What the Council is recommending for Hydro One distribution services is a form of public-private partnership. Ontario's recent experiences with Highway 407 and the gas power plants

debacle underscores the need for the utmost due diligence in adopting a similar model for infrastructure that is even more vital to the province.

4. In sum

The government, including a Minister exercising statutory discretion on behalf of the government, is entitled to make controversial and even imprudent policy decisions without acting unlawfully. However, what the Minister cannot do in the exercise of a statutory discretion is to fall below the standard of reasonableness or rationality.

In our view, if the facts set out above could be established, there would be reasonable grounds for arguing that a decision to dispose of Hydro One in the manner and for the reasons proposed would be an unreasonable exercise of discretion, and therefore reversible by a court on an application for judicial review.

In this respect, it can be argued that the decision to sell would be unreasonable to the extent that it is based on a state of facts or a factual prediction regarding financial consequences that is not reasonably open to the Minister.[11] While the courts show considerable deference in reviewing this kind of public policy decision, were a court persuaded that the decision was not rationally grounded, it would have the authority to quash it.

*Foreign Investor Rights Under NAFTA and Other Trade Agreements*

In our view, it is also incumbent on the government to take into account the potential consequences of privatizing Hydro One, in light of Canada's obligations under international trade law. These obligations impose serious constraints on public policy and law, including in respect of the electricity services and the environment. The 2012 decision by the World Trade Organization,[12] which found Ontario's Feed in Tariff program for renewable energy to be in breach of WTO rules, illustrates the problem of failing to properly take into account the limitations imposed by trade rules. In that case, Ontario's requirement for domestic content in renewable energy technology as the *quid pro quo* for being paid a tariff premium was found to offend WTO rules.

International trade rules are particularly corrosive when the trade agreement-based rights of foreign investors are engaged. Under NAFTA and other international treaties, these investors have the right to claim damages in proceedings before international arbitration when government actions interfere with the profitability of their investments. A recent successful claim against Newfoundland for measures which, *inter alia*, concerned water rights for power

[11] See also the decision of the English House of Lords in *Bromley LBC v. Greater London Council*, [1982] 2 WLR 62, where one of the bases of the decision was that the GLC had resolved to lower fares without regard to their statutory obligation to run the system on a business or economic basis.

[12] World Trade Organization. (2012). "Canada – Certain Measures Affecting The Renewable Energy Generation Sector And Canada – Measures Relating To The Feed-In Tariff Program. Reports of the Panels, 19 December 2012.

generation, and which was settled by the federal government for $130 million, illustrates the seriousness of offending the interests of foreign investors. [13]

There are few regulatory measures that cannot be challenged for offending broadly defined investor rights under international law, when a measure adversely affects the interests of foreign investors. In respect of transmission and distribution services, such measures could include a mandatory obligation to connect renewable energy generators, to prioritize interconnections with other provinces rather than the United States, to conduct environmental assessments for new facilities, or to protect habitat in citing or maintaining those facilities. Foreign investors are increasingly seeking recourse under international law when measures such as these interfere with the profitability of their investments, including against Canada.

If foreign investors are allowed to acquire investment interests in Hydro One, the province's policy and regulatory options in respect of privatized services would certainly be curtailed, and the balance between the public interest and the rights of foreign investors would be tipped decidedly in favour of the latter.

For this reason, we assume the province would attempt to limit foreign ownership in Hydro One. The question is whether it has the ability to do so given the overarching prohibition of NAFTA and GATs rules proscribing discriminatory treatment of foreign investors.

In order to preserve its prerogatives in respect of the electricity sector, both Canada and Ontario have declared certain reservations (exceptions) to the trade agreements they must observe.

However, by having corporatized and allowing private investment in the distribution service sector, Ontario may have abandoned any claim to the benefit of these safeguards. In this case the only way for Ontario to protect its policy and regulatory options in respect of Hydro One from foreign investor claims will be to maintain unadulterated public ownership of this *state owned enterprise* (to use the terminology of international trade law).

In other words, while Ontario is entitled to maintain Hydro One as a public monopoly, once private investment in Hydro One is allowed, Ontario cannot exclude the right of foreign investors to participate in the privatization unless the right to do so has been effectively reserved under the trade agreement. This question will require further investigation when the particulars of any privatization scheme become known.

Finally, even if Canadian safeguards are intact they may not remain so, because Canada's trading partners have declared their intention to seek the removal of such restrictions on foreign investment in future trade agreements.

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[13] Also see the decision by a NAFTA tribunal finding Nova Scotia to be in beach of investor rights by establishing an environmental protection measure that denied a U.S investor a permit for a rock quarry. NAFTA Award on Jurisdiction and Liability, *Clayton/Bilcon v. Government of Canada*, March 15, 2015, p. 219.

*SUMMARY AND CONCLUSION*

To summarize, for the reasons set out above, we believe that there are a number of potential grounds for challenging the use of any proceeds from the proposed privatization of Hydro One to fund transit or other public infrastructure, and for challenging a decision made by the government to privatize Hydro One.

The obvious caveat is that the analysis and opinions set out above will have to be revisited if and when any plans to privatize Hydro One are made more concrete. Our understanding is that the province has indicated that it will make Phase II of the Council's Report public in advance of the provincial budget, which we assume will declare the Government's intentions in respect of Hydro One. Indeed, the publication of the Phase II Report may be the occasion for that further analysis.

We trust that the opinion set out in this letter responds to the legal questions you have raised. Of course, should you have any further questions, please do not hesitate to contact us.

For Sack Goldblatt Mitchell,

Steven Shrybman
SS/lbr/cope 343

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