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Fiscal Flash

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Proposals for Ontario's Electricity Sector and Beer Retailing

The Premier's Advisory Council on Government Assets provided its final report today for Hydro One and Hydro One Brampton and for beer retailing and distribution. Summarized below are "top line" Council recommendations, with the government indicating its acceptance of the entire report.

The fiscal impact: The proposed changes to Hydro One, including an initial IPO of 15% of its shares, and eventually selling down the government's remaining shares to a 40% position, is estimated to raise $9 billion, based on the Council's valuation of Hydro One at $13½ -$15 billion, excluding Hydro One Brampton. Of these proceeds, about $5 billion represents the shares' book value.

The remaining realized gain of roughly $4 billion plus $1.7 billion of other asset sales (that includes the net proceeds of $1.1 billion from the disposition of Ontario's remaining GM shares) totals $5.7 billion of net asset sale revenue. This represents a $2.6 billion addition to the $3.1 billion of net asset sale revenue that the government already had assumed in its *2014 Budget* estimates. Ontario's *Electricity Act* will require amendment by the government to adjust current debt retirement provisions.

For the two ten-year dedicated infrastructure plans announced in the *2014 Budget,* this will add $1.4 billion to the $15.0 billion already dedicated to Greater Toronto and Hamilton Area (GTHA) transit/ transportation and $1.2 billion to the $13.9 billion for infrastructure investment across the rest of Ontario. The revised total for these two dedicated funding plans rises from $28.9 billion to $31½ billion from fiscal 2014-15 (FY15) to FY24.

For the electricity sector the Council recommends the following changes.

- **For Hydro One Brampton Networks,** after intensive negotiations between a consortium of three existing GTHA local distribution companies and the Province, the consortium has the option to acquire Hydro One's interest in Hydro One Brampton for either a 17% interest in the new consolidated entity or for an enterprise value of $0.6 billion in cash. The objective is to create a large urban distribution entity as a catalyst to drive further consolidation and efficiencies in Ontario's local power distribution.

- **The current transfer tax and departure tax rules** should be amended on a time-limited basis.

- **A partial sale of Hydro One** (excluding Hydro One Brampton Networks) *as an integrated entity* including both the transmission and distribution businesses should begin with a 15% IPO, and the sale of another 45% in stages is proposed. Any one of the new shareholders will not be allowed an ownership position greater than 10%.

- **Hydro One's head office,** and substantially all of its strategic management functions, must be retained in Ontario.

- **To further ensure that the Province has additional powers** to protect the public interest and its investment through this company in Ontario's transmission and distribution systems, Hydro One should not be allowed to sell all, or substantially all of the Ontario-based company transmission or distribution assets or change the jurisdiction of incorporation of the company.

- **Importantly, the Council recommends** that Hydro One management and the unions finalize agreements on pensions and salaries in advance of the Hydro One IPO to address the issues raised by the Leech Commission and the Ontario Energy Board.

- **For the Ontario Energy Board,** the Council recommends strengthening its mandate and powers to ensure that the changes in the industry structure do not put upward pressure on rates.

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- **The governance of Hydro One** should be adjusted to meet the requirements of a widely-held public company, with a Board of independent, experienced directors with fiduciary responsibility.

For beer retailing, very brief highlights of the Council's recommendations are below.

- **A new Beer Framework Agreement** will open up ownership of the Beer Store to small brewers, with a new recycling agreement saving the Province money.

- A new levy, phased in at 25 cents each November for the next four years on beer sold through any source, is expected to eventually raise $100 million annually for the government. To prevent this new levy being passed on to consumers, a general price freeze for some of the most popular brands (with due regard to changes in minimum retail beer prices or extraordinary events) would be adopted until May 1, 2017, representing about 50% of the Beer Store's sales. For subsequent years, increased competition from the proposed restructuring is expected to limit the levy pass through.

- Retaining the Beer Store framework is intended to keep Ontario beer prices below the national average.

- **Licenses** will eventually be auctioned to 450 grocery stores across Ontario, raising the number of Ontario outlets selling beer to more than 1,800, an increase over 30%.

The timeline for all these changes will obviously evolve. The Advisory Council is expected to continue working on several remaining issues, such as potential changes to liquor retailing and the Liquor Control Board of Ontario.

More details and clarification will be released in a Fiscal Pulse report.

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