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TITLE: Creation of New Crown Corporation

ISSUE:

Creation of a new Crown Corporation, provisionally named Holdco, to facilitate the conversion of Newfoundland and Labrador Hydro into an energy company in fulfillment of the new mandate provided in 2006.

RECOMMENDATIONS

1. It is recommended that Legislative Counsel be directed to draft legislation, for the approval of Cabinet prior to its introduction into the House of Assembly, in consultation with the Departments of Natural Resources, Finance and Justice, and Hydro, to create a new crown corporation (yet to be named so referenced in this paper as Holdco). Holdco will implement Government's intended activities in the energy sector, and hold the shares of Newfoundland and Labrador Hydroelectric Corporation (Hydro), which will continue to provide regulated electricity services to provincial customers, and Hydro's existing subsidiaries (Churchill Falls Labrador Corporation, Gull Island Power Corporation and Lower Churchill Development Corporation). Specifically it is recommended that:

   a. Holdco have substantially the same powers and objects as those currently stated for Hydro and be subject to legislative provisions similar to all of the provisions of Hydro with the exception of those proposed in Annex 1;

   b. The *Hydro Corporation Act* be amended with the changes proposed in Annex II attached;

   c. Hydro's objects be amended to limit its activities to those of a regulated electrical utility, primarily the production and delivery of power for use by customers in the Province;

   d. Notwithstanding the *Corporations Act*, provision be made that Government be able to issue specific direction to the Board of Directors of Hydro, despite not being the legal shareholder, provided that the Board of Directors of Holdco is appropriately informed, and that such direction would relieve the boards of both companies from relevant fiduciary duty;

   e. The legislation incorporating Holdco specify that its activities will not be subject to the *Public Utilities Act*. This will ensure that Holdco has the flexibility to pursue its objectives on the basis of commercial and economic development considerations. The Electrical Power Control Act will apply to Holdco;

f. Hydro be authorized to transfer all assets and liabilities pertaining to activities not subject to the purview of the Public Utilities Board to Holdco at a value equal to their net book value at the time of transfer;

g. Holdco's total borrowing be limited to $600 million. This amount is additional to Hydro's current incremental borrowing limit of $600 million as outlined in Section 38 of the *Hydro Corporation Act;*

h. Holdco's short-term borrowing be limited by the Lieutenant-Governor in Council (LGIC), and initially set at $300 million. This amount is additional to the $300 million short –term borrowing limit currently imposed on Hydro by LGIC under Section 33(2) of the Hydro Act. These short-term borrowings comprise part of the $600 million limits referenced in (g) above;

i. For Holdco and each of its subsidiaries, the maximum number of directors be 14 (the Board of Directors of Hydro is currently limited to no more than 10);

j. The Hydro Board of Directors be appointed as directors of Holdco as well until such time as it is deemed appropriate by the LGIC to appoint separate boards for each company;

k. The appointment of the Chief Executive Officer of both Holdco and Hydro be done by the LGIC and not the shareholder, and Hydro's Chief Executive Officer (CEO) be appointed immediately as CEO of Holdco as well, until such time as it is deemed appropriate by the LGIC to nominate a separate CEO for each company.

l. Both former employees of Hydro, and new employees of Holdco as appropriate, be included in the Public Service Pension Plan; and

m. Other legislative provisions flowing from Hydro's ongoing review of the *Corporations Act.*

2. It is further recommended that the following items be adopted as Cabinet policy:

a. A Committee of the Holdco Board of Directors be responsible for the nomination of potential directors for Holdco and its wholly-owned subsidiaries (including Hydro), and Holdco's representatives on the Boards of subsidiaries that have third-party shareholders for consideration by the Shareholder. The Committee would give consideration to the skills, experience and other factors necessary on the Board in preparing the list of potential candidates. While the Committee of the Board would recommend candidates, the final decision on Board appointments would remain rest with Government through the Lieutenant-Governor in Council, and would not be limited to those individuals recommended by the Committee.

b. Criteria for independence, consistent with practices in publicly-traded companies, be introduced for directors of Holdco and its wholly-owned subsidiaries (including Hydro), and that a majority of the members of the Board of Directors (including the Board Chair) should satisfy the following criteria:

i. Is not employed by the Corporation or any of its subsidiaries or affiliates (now or in the past two years).
ii. Does not have a family member employed in a senior management position at the Corporation or its subsidiaries.
iii. Did not benefit from a business relationship with the Corporation in the past year that could impair the independent judgment of the director.
iv. Did not receive remuneration from Holdco or any of its subsidiaries, except for directors' fees or post-retirement benefits during the past year.
v. Was not a partner or employee of the current external auditor during the previous two years.

c. For future director appointments, the appointing OC shall specify that the director will continue to serve after the expiration of his/her term until a replacement is appointed. This will ensure continuity on the Board while director replacements are being identified and appointed.

BACKGROUND

When the Newfoundland and Labrador Hydroelectric Corporation (Hydro) was formed in 1975, it became the holder, on behalf of the Province, of shares bought by Government from Brinco in the Gull Island Power Corporation (100%) and Churchill Falls (Labrador) Corporation (65.8%). When the Lower Churchill Development Corporation was formed in 1978, Hydro also became the holder of the Province's 51% of shares in that Corporation.

In the 2003 election, the Conservative Party platform included the commitment that Hydro would be restructured with a new mandate to support the development of the province's energy sector, or a new "energy corporation" would be formed. In September, 2004, Premier Williams announced that Newfoundland and Labrador would be the platform for this development, with some of its key priorities being the development of the Lower Churchill, exploration of partnerships with the private sector concerning natural gas, wind energy, geothermal heat pump technology, and the possible acquisition of ownership interests in our offshore oil and gas resources.

In accordance with [redacted] the Hydro Corporation Act was amended by Bill 1 to enable Hydro to "...engage in activities related to the exploration for, development, production, refining, marketing and transportation of, hydrocarbons and products from hydrocarbons." The amendment also contains a provision that will allow for further expansion of this mandate as approved by the Lieutenant-Governor in Council. The Bill received Royal Assent on May 26, 2006.

Hydro has completed the internal reorganization of its operating departments, and the leadership team is now in place. A three-phase, long-term plan has been developed to fulfill the new mandate and meet the expectations of Government. The plan is outlined in Annex V. This proposed legislation is the first phase of that plan.

Hydro's business development opportunities are already under discussion, and a preliminary assessment of capital needs over the next ten years includes possible investments in the oil and gas sector, wind development and the Lower Churchill. Hydro has determined that to pursue these opportunities, it needs to ensure that the Hydro group has a corporate structure that will best provide the capability to meet the challenges ahead. Key objectives include:

- Availability of a financing platform and establishment of financial flexibility to support investment and growth (Lower Churchill, wind, natural gas, oil & gas)
- Separate non-regulated businesses from the regulated business to facilitate rate regulation
- To preserve the Provincial borrowing capacity
- To ensure that control of both Hydro and Holdco rests with Government
- To ensure that the transparency and accountability initiatives of Government are maintained in relation to Holdco and wholly-owned subsidiaries
- Protect individual business units from financing and other risks incurred by other business units
- Closer alignment of business units and corporate structure
- Constructing a governance, corporate and financial structure that ensures timely and effective decision-making in a competitive business environment

The current structure does not support the achievement of these objectives.

Financing Platform
As Hydro examined its current and future expanded non-regulated operations, it became apparent that financing needs would increase. Traditionally Hydro has issued debt guaranteed by Government in order to finance its operations. While in the shorter term this is expected to continue, the longer-term plan contemplates large infrastructure projects that could significantly increase the amount of debt guaranteed by Government unless alternate means of non-recourse financing are found. Holdco will need the flexibility to be able to create corporate and financing structures that avoid, to the extent possible, encumbering the borrowing capacity of the Province as a whole.

Holdco's financing needs will be driven by a requirement to extinguish the intercompany debt that will arise from the transfer of non-regulated assets and liabilities from Hydro. Holdco will have additional financing needs for its non-regulated activities going forward. Hydro proposes that Holdco's funding requirements be satisfied initially by the issuance of debt in the capital markets carrying the guarantee of the Province, and by earnings reinvestment. Direct equity infusion by Government may become necessary as potential projects ramp up.

Hydro recommends that Holdco be allowed to borrow up to $600 million with no more than $300 million of that total in short-term debt. This will effectively increase by $600 million the amount of debt that can be guaranteed by the Province.

The need for incremental equity investment by the Province in Holdco will depend upon the desired financial parameters such as debt to capital and debt service coverage ratios that the financial markets set for the company in order that Holdco's guaranteed debt would be viewed as self-supporting. It is important that Holdco's debt be viewed in this manner because it impacts on the rating agency view of the Province's overall debt load. Guaranteed debt that is self-supporting is viewed as having its own source of funding and thus not simply considered as an add-on to the total provincial debt.

Preliminary projections for Holdco's balance sheet in the first two to three years indicate low levels of debt in the capital structure and levels that are well within those that would generally render the debt as being self-supporting. No direct equity investment by the Province during this time frame appears necessary, other than the reinvestment of earnings which will consist largely of earnings from recall and the investment in CF(L)Co.

Regulatory Issues
As Hydro expands into new non-regulated opportunity areas, the segregation of costs between regulated and non-regulated operations becomes more complex. At the most recent rate hearing, a considerable number of requests for information were received from interveners questioning Hydro's proposed methodology for assigning such costs. Hydro believes that this might explain why the review of circumstances in other jurisdictions revealed that it is common practice for significant unregulated business activities to be carried out by a separate entity or entities.

Employees and Pensions
Currently employees of Hydro are not agents of the Crown, and this would apply similarly to employees of Holdco. However, Hydro employees are members of the Public Service Pension Plan, and Hydro recommends this provision be extended where applicable to employees of Holdco, with mutual recognition of service.

Isolating Business Risk
The pursuit of any business opportunity entails the assumption of some measure of risk. It is inappropriate to expose Hydro's regulated customers to the risks associated with its non-regulated business ventures. To do so may result in an increased cost of service that is related to non-regulated operations, which would attract considerable negative attention in the regulated forum.

Business Alignment and Governance
Hydro's organizational structure is increasingly being segregated along regulated and non-regulated lines. This same alignment should be reflected in Hydro's corporate structure in order to provide better business focus and a more effective pursuit of both the regulated and non-regulated business objectives.

The pursuit of business opportunities in a competitive environment will require timely decision-making within well defined parameters. An independent Board of Directors is essential to this process, bearing in mind that certain decisions because of their magnitude and potential impact on the shareholder will always require Cabinet approval.

Application of the *Corporations Act*

There is a lack of clarity regarding the current applicability of the Corporations Act to Hydro. Hydro considers that certain provisions of that act could bring greater clarity in areas where the current Hydro Corporation Act is silent, such as shareholder control and the enforceability of contractual documents. Hydro and Department of Justice are reviewing whether to recommend that the Corporations Act should generally apply to Holdco and Hydro with exceptions where appropriate, or whether to incorporate desired provisions into the legislation covering the two Crown corporations and other Holdco subsidiaries. The results of this review will shape the drafting of the legislation proposed by this memorandum.

Provincial Control

It is important that control over Holdco and Hydro remain with the Province. It is therefore the intention that Holdco would be 100% owned by the Province of Newfoundland and Labrador and that Hydro would be a wholly-owned subsidiary of Holdco. Government may consider it appropriate to be allowed to issue specific direction to both Holdco and Hydro, provided that directors are not put in a position of being asked to approve something that they believe is contrary to the best interest of the corporation they direct without protection of a written directive which also relieves them of normal fiduciary duty. This would be a normal provision for Holdco under the *Corporations Act*, but not directly for Hydro as Government will no longer be the legal shareholder.

With respect to the other corporations of which Hydro is currently a shareholder, initially the Province's shares in each will be transferred to Holdco. Recommendations on the longer-term future of GIPCo and LCDC will be made in conjunction with those related to development of Lower Churchill. Ownership of CF(L)Co will continue unchanged.

It is recognized that in some cases, it may make sense to permit third party equity investment as a source of financing with respect to subsidiary corporations. The recommended corporate structure facilitates this form of financing without relinquishing Government's control over the parent. It is the intent that Holdco would be provided the same flexibility in the organization of subsidiaries as is currently available to Hydro; that is with the approval of the Lieutenant Governor in Council.

Transitional Arrangements

In order to allow continuity of authority and responsibility, transitional arrangements are required. Hydro proposes that the current Board of Directors and Chief Executive Officer of Hydro be automatically appointed to the equivalent positions for Holdco, until such time as alternative directors and/or a CEO are appointed through due process.

Summary

Hydro is proposing the formation of a new non-regulated parent company to undertake all non-regulated activity and to assume all non-regulated assets and liabilities. Annex VI contains a copy of the presentation provided to the credit rating agencies during the first quarter 2007 which provides an overview of Hydro's short and longer term plans. Cabinet authority is being sought for the related legislative changes that will be required to implement Phase I of this plan. Hydro has considered other alternatives such as leaving the structure as it is at present, or having the existing Hydro Corporation as the parent with a non-regulated subsidiary below it. Neither of these alternatives is considered as desirable for reasons as outlined in the Alternatives Section below. It is Hydro's opinion that failure to adopt this recommendation will hamper its ability to effectively realize its new mandate and as time passes, will expose Hydro to increasing levels of regulatory risk.

ALTERNATIVES

The following alternatives are offered for consideration:

1. Create a new Crown Corporation to own Hydro (which would become a regulated electrical utility only) and other companies currently owned by Hydro, as well as future subsidiaries undertaking additional ventures, and amend the *Hydro Corporation Act*. This is the recommended alternative.

Passage of such legislation, with the various provisions described in this Memorandum and annexes, would permit the fulfillment of what is currently Hydro's mandate, by facilitating the expansion of its corporate activities and business ventures. It would simultaneously provide regulatory clarity and improved isolation of regulated activities from business and financial risks associated with unregulated activities. It would allow Hydro and Holdco to capture synergies related to human and technical resources, and provide Holdco with access, in the first instance, to Hydro's available dividends, but it may raise questions about the separation of Hydro ownership from Government directly.

2. Create a separate new Crown corporation charged with all of Hydro's existing mandate except those aspects related to the provision of regulated electricity service in the province and transfer to its ownership the present unregulated subsidiaries of Hydro. This alternative is not recommended.

This would remove the issue of indirect government ownership, but would constrain the operational synergies available, remove Holdco's access to Hydro's dividends, and make contracting between the companies more complex.

3. Take no action This alternative is not recommended.

Hydro would continue to undertake both regulated and non-regulated activities (Lower Churchill, oil & gas, Labrador Wind) either in the existing entity or through existing and/or new subsidiaries of Hydro. This alternative is subject to a number of limitations, including continuing difficulties in separating regulated and non-regulated activities for the Public Utilities Board. In addition, the credit rating agencies have advised that Lower Churchill will need to be in a separate legal entity to obtain project financing, and that this entity should not be a subsidiary of the regulated business.

[redacted]

The *Corporations Act* is being reviewed for the necessary exclusions from its general application to Hydro and Holdco, and the outcome incorporated into the draft legislation.

At this point, the only potential requirements for consequential amendments appear to be to the *Public Utilities Act* or the *Electrical Power Control Ac1994*, to ensure clarity in their application or otherwise to entities within the recommended corporate structure.

[redacted]

[redacted]

FINANCIAL CONSIDERATIONS

Long-term debt issues to Holdco would require LGIC approval and be limited by the legislation to $600 million. A short-term borrowing limit would also be set by the LGIC, initially at $300 million. These short-term borrowings comprise part of the $600 million limits referenced above. Any Holdco borrowing not offset by debt retirement by Hydro will increase the overall indebtedness of the Province. However, both Hydro and Holdco would be governed by a supportive dividend policy that is reflective of targeted debt to capital ratios.

While there will be changes in the financial profile of Hydro on a non-consolidated basis as some assets are transferred to Holdco and liabilities reduced, on a consolidated basis Holdco's financial profile will effectively mirror the current consolidated profile of Hydro..

With regard to Hydro non-consolidated, the debt to capital will increase by virtue of the transfer of the net investment in CF(L)Co to Holdco, but with a supportive dividend policy, it is expected that Hydro can achieve an 80% debt to capital target by the 2009/10 period. Generally the credit rating agencies are familiar with Hydro's stated goal of an 80% debt to capital ratio for the regulated utility and a move from 70% debt to 80% debt in the capital structure is not expected to have an appreciable impact on the credit rating agency view of Hydro's debt as being self supporting.

Net income for the remaining Hydro will be impacted significantly by the removal of earnings from its ownership interest in CF(L)Co and the sale of recall power, but these revenues would in future flow to Holdco. Hydro net income would drop from $70 million back to about $10 million. However, again on a consolidated basis, there will be no overall change. With respect to the drop in Hydro's income from $70 million to $10 million, Hydro will be a purely regulated company with significant protection for its net income including protections against the following risks:

- Oil prices
- Hydrology
- Load

On this basis, the credit rating agencies have expressed comfort that the negative impact of Hydro's reduced earnings levels would be offset by the relative stability and certainty of those earnings in a regulated environment.

Holdco will have a healthy debt to capital ratio. The only immediate borrowing needs will be to purchase Hydro's unregulated assets (recommended to be at net book value) and working capital. Earnings from recall power sales CF(L)Co are expected to partially fund non-regulated activities in the short-term. The intent is that Holdco would have its own credit rating and that it would issue government-guaranteed debt to support its non-regulated activities with conversion to non-recourse debt as and when the maturity of a given project warrants.

INTERDEPARTMENTAL CONSIDERATIONS

The Departments of Justice and Finance have been consulted and support the recommendations.

LABRADOR OR ABORIGINAL CONSIDERATIONS

Holdco will assume responsibility for the Lower Churchill Project and associated matters. Hydro will continue to be responsible for regulated services, including distribution in Labrador West, Upper Lake Melville and coastal communities.

The recommended action would result in the obligation to consult with aboriginal parties and to engage the Innu Nation on commercial matters being transferred from Hydro to Holdco. With appropriate communication, this should be acceptable to these parties.

INTERGOVERNMENTAL CONSIDERATIONS

In terms of the legislation, there are no intergovernmental considerations. However, some of the contemplated transfers of contracts and agreements from Hydro to Holdco may require the consent of Hydro Quebec, and thus the Quebec government.

OTHER JURISDICTIONS

During 2006 Hydro engaged Deloitte to perform a comprehensive Jurisdictional Review that included a review of corporate structures used by other electric utilities. The review focused on utilities that undertake both regulated and non-regulated activities, including those that undertake activities in multiple businesses. The following criteria were used to reduce the set of over 320 US and European companies to a Long List of comparable companies for detailed analysis. Broad identification criteria included:

1. Be owned by Government;
2. Have electricity as core business;
3. Include transmission, generation and distribution; and
4. Be diversified in energy or utilities.

Companies were selected for the Short List on the basis of their comparability to the 2010 and 2020 future desired states of NL Hydro. Details of these criteria are contained in Annex IV.

Four major areas were examined:

1. Corporate Structure
2. Financial Structure
3. Governance
4. Other matters

A table containing the results of this review are contained in Annex V. The results of this work indicated that the corporate structures used in other jurisdictions generally include the following components:

1. A parent company usually holds the investments in individual subsidiaries.
2. There is usually a separation of regulated and non-regulated activities into separate legal entities.
3. Regulated entities rarely have non-regulated subsidiaries.
4. For all the selected companies, there is a separation of electric utility and other businesses.

CONSULTATIONS

Hydro's consultations in regard to this proposal covered the following:

Departments of Natural Resources, Finance and Justice
Lead Managers of Hydro's Borrowing Syndicate
Credit Rating Agencies
Benchmarking of practices in other utilities

Provincial Departments of Natural Resources, Finance, and Justice
Information sessions were held with senior representatives from all three of these departments. Details of the restructuring plan were communicated and feedback obtained as to matters to consider. Generally there was agreement as to the merits and rationale for the plan. All three departments were involved in the drafting of this paper.

Lead Managers of Hydro's Borrowing Syndicate
Details of the restructuring plan were reviewed with Hydro's lead managers. They were supportive of the concept and agree that it will facilitate Hydro's pursuit of its new mandate. They also confirmed that the structure whereby the regulated operations are separated corporately from other non-regulated activities is the preferred model in both Canada and the United States.

Credit Rating Agencies
Hydro conducted meetings with three key rating agencies; Dominion Bond Rating Service who rate both Hydro's and the Provinces debt; Standard and Poors who rate the Provinces debt and provide commentary on the Hydro component; and finally Moody's. All three were provided copies of the presentation as contained in Annex VI. Feedback was that the changes as outlined in Phase 1 would be supportive of the nature of the financing required by Hydro for its new mandate and would not have an appreciable impact on the Hydro' rating or that of the Province. On a consolidated basis, the general profile of the Holdco would be reflective of Hydro's currently and hence no substantive change in financial profile is deemed to have occurred. It was generally understood that further consultation would be required prior to moving forward with subsequent phases.

Benchmarking of Practices in Other Utilities
See commentary above with respect to "other jurisdictions".

ENVIRONMENTAL CONSIDERATIONS

The Provincial Department of Environment and Conservation and the Federal Department of Fisheries and Oceans were consulted with respect to whether they would have any concerns with a change to Hydro's corporate structure as contemplated herein. Neither Department has any concerns.

COMMUNICATIONS AND CONSULATION SYNOPSIS

Issue: Government will pass legislation this spring to enable the corporate restructuring of Newfoundland and Labrador Hydro. The initial stage of restructuring will involve the creation of a holding company to implement the Crown's intended activities in the energy sector, as well as holding the shares of Newfoundland and Labrador Hydroelectric Corporation (Hydro) which will continue to provide regulated electricity services to provincial customers.

Consulted with:	Date Drafted:	Anticipated Announcement:
Chris Kieley, DM, NR Ed Martin, CEO, NLH Charles Bown, ADM, NR David Bazeley, NR Terry Paddon, DM, Fin Derrick Sturge, CFO, NLH Mark Bradbury, NLH Dave Bazeley, NR Todd Stanley, Justice Dawn Dalley, NLH	March 31, 2007	April 2007

Public Environment

In the 2003 election platform document, the government committed to expanding the mandate of Newfoundland and Labrador Hydro to enable the company to retain equity in the province's oil and gas revenues. The policy position at the time was to ensure that the province, through the expanded mandate of Hydro, would have the capacity and expertise to participate in and benefit from decisions regarding exploration, production, and processing of oil and gas in the province. Hydro would be mandated to work with the major oil companies to develop natural gas as a competitively priced alternative energy source for the province and for transportation and Canadian and U.S. markets.

Since elected to government in November 2003, the Premier and Ministers' of Natural Resources have reiterated the policy position of government to transform and broaden the mandate of Newfoundland and Labrador Hydro to have a more direct role in the development of petroleum resources and play and enhanced role in electricity. Government clearly stated that expanding the mandate of Hydro is not about privatization; rather it's about having Hydro play a greater role in the development of the province's energy resources.

In November 2005, government released a public discussion paper, "Developing an Energy Plan for Newfoundland and Labrador", and embarked on an extensive consultation process to assist in the development of a comprehensive energy plan for the province. It included consultations with interest groups, industry and the public. Those consultations have been completed and the Energy Plan is in the final stages of development and will be released later this Spring. The stated policy objective of the government to expand the role of Newfoundland and Labrador Hydro to assist the province in getting the best possible returns from the development of our resources is defined in the Energy Plan.

Overall, the public have been generally supportive of expanding the role of Hydro, in absence of the specific details as to how that would occur, to enable the province to get the best possible deals in the development of its energy resources. The industry and business community has expressed concern over the lack of detail around the scope of Hydro's new role.

Hydro has now completed the internal reorganization of its operating departments, and the leadership team is now in place. Business development opportunities are already under discussion, and a preliminary assessment of its capital needs over the next five years includes possible investments in the oil and gas sector, wind development and the Lower Churchill. In preparing to pursue these opportunities, Hydro needs to ensure that it is structured for success, by considering the larger question of the Hydro Group corporate and financial structures that will best ensure our success in meeting the challenges ahead and still protect the regulated utility that is the cornerstone of its success to date.

Target Audiences

- Board of Trade
- Chambers of Commerce
- Newfoundland Ocean Industries Association
- Canadian Association of Petroleum Producers
- Oil and Gas companies
- Public Utilities Board
- Caucus
- Rating Agencies/Financial Stakeholders
- Industrial customers
- Newfoundland Power
- Innu Nation
- Taxpayers
- Electricity Consumers/Hydro Rural Customers
- Opposition parties
- MPs
- Media

Consultations

The Department of Natural Resources released a discussion paper in November 2005 on the development of an energy plan, which formed the basis of industry and public consultations on the development of an energy plan for the province.

Credit Rating Agencies and members of Hydro's Borrowing Syndicate have been consulted on the proposed restructuring and an independent review has been conducted of other energy company/electrical utility structures.

Communications Objectives

- To communicate that government is changing legislation to allow Newfoundland and Labrador Hydro to restructure so the company can explore business opportunities in the energy sector
- To reiterate that the expanded mandate of Newfoundland and Labrador Hydro enables the Crown Corporation to carry out government's stated policy objectives.

Messages

- The legislative changes will enable Newfoundland and Labrador Hydro to comply with the direction of government to pursue broader opportunities in the energy sector in relation to the expanded role and mandate of Hydro and in alignment with the province's Energy Plan.
- Government, as part of its election platform, saw an opportunity to have Newfoundland and Labrador Hydro do more in the development of our energy sector. We are moving to enable Hydro to explore broader opportunities for development in the best interest of the province.
- Part of the restructuring involves clearly separating the core regulated utility business from the new businesses Hydro will be pursuing to facilitate business development, control risk and promote efficient rate regulation.
- We are not privatizing Newfoundland and Labrador Hydro. This is about enabling Hydro to play a greater role in the development of our energy resources and final control remains with the Government of Newfoundland and Labrador, as the shareholder of Newfoundland and Labrador Hydro.

- The province will continue to retain ownership over Newfoundland and Labrador Hydro. It is a valuable asset to the people of Newfoundland and Labrador.

Strategic Considerations

- The oil and gas industry, specifically the Canadian Association of Petroleum Producers, will likely again question the benefit to industry of having Hydro involved in energy projects at this time. They will question the expertise within the company.
- Given the lack of detail of the new role for Hydro when it comes to partnering on projects, the business community have expressed concern as to whether Newfoundland and Labrador Hydro would compromise private companies. They may charge that Hydro is using taxpayers' dollars to compete with private industry.
- The Newfoundland Ocean Industries Association has expressed concern over the lack of detail on government's plan for Hydro. Given the broad nature of the legislative amendments, they may criticize the lack of transparency as to what government actually intends for Hydro to do.
- The Public Utilities Board, as well as Industrial Customers and Newfoundland Power, will question the impact of any restructuring on the regulated operations from a financial and cost of service perspective. This will need to be communicated clearly by Hydro to these audiences.
- The changes will need to be considered and communicated to the Innu Nation, and other Lower Churchill stakeholders, in the context of the IBA negotiations for the Lower Churchill.
- The Liberal Opposition will question government's motives for the legislative change and what protection exists for taxpayers. It will need to be made clear that government is enabling Hydro to carry out the stated policy objectives of government, and that Hydro will still be publicly accountable to Government and the mechanisms are in place to ensure this.
- NDP Leader Lorraine Michaels is generally supportive of the concept of a greater role for Newfoundland and Labrador Hydro, although the party platform would like to see the company expand into areas of energy efficiency and conservation as well.
- The media and the Liberal Opposition will likely question the motive of government in relation to the Lower Churchill development, and whether something is in the works that has not been made public. Government needs to be clear that this has been a stated policy objective of the government since November 2003, and that any deal that Hydro may explore in relation to the Lower Churchill would have to go back to Cabinet for approval.
- Criticism that may carry legs with the public will be whether Hydro is being given blanket powers to enter into deals on behalf of the people of the province.

Interdepartmental Coordination
The Department of Natural Resources is coordinating the restructuring with Newfoundland and Labrador Hydro, the Department of Finance and Department of Justice, in consultation with the Premier's Office.

The Announcement
The Minister will speak to the legislation in the House of Assembly.

A news release will be issued once the legislation is introduced in the House outlining government's intention.

Minister's Involvement
Minister Dunderdale will be the lead for the government on the announcement, while Newfoundland and Labrador Hydro will speak to technical details about their organization that may arise as a result of the announcement.

Materials
A detailed questions and answers will be prepared for the Minister for use in the House of Assembly and in interviews to address the above strategic considerations and other issues that may arise.

Follow-up Activities
The media will be monitored for the reaction of the public, interest groups and other stakeholders, and the Minister will respond accordingly.

Prepared by: Tracy Barron, Communications, 729-5282 or 690-1703

ANNEXES:

ANNEX I – List of Provisions of Hydro Corporation Act not required for Holdco

ANNEX II – Changes to Hydro Corporation Act

ANNEX III – Summary of Implementation Plan

ANNEX IV - Guideline For Selection of Benchmark Companies

ANNEX V – Summary Table of Benchmarking Results

ANNEX VI - Schematic Representation of Reorganization Proposal

KATHY DUNDERDALE
Minister of Natural Resources

April 11 2007

ANNEX I

Preliminary List of Provisions of Hydro Corporation Act not required for Holdco

ss. 2(j)	–	definition of "president" - not required
ss. 3(1)		continue Hydro as a corporation - not required, but provision required **creating** Holdco as a corporation
ss. 3(2)	-	passes liabilities etc. of NL Power Corporation and Power Commission to Hydro - not required *Confirm thatnone of the assets being transferred from Hydro to Holdco relate to the old Power Commission and Power Corporation, and as such Holdco does not need sections 3(2), 16(2)(b) and 51.*
ss. 3(8)	-	permits Hydro to be referred to as Newfoundland and Labrador Hydro - not required
ss. 5(4)	-	remuneration of Directors shall be determined by LGIC rather than by shareholders
ss. 6(1)	-	provides for appointment of president and Chairperson by LGIC - delete reference to president
ss. 6(2)	-	terms and conditions of holding office for president and Chairperson to be determined by LGIC - delete reference to president
ss. 6(3)	-	appointment of CEO by shareholders – change to appointment by LGIC
ss. 6(5)	-	delete reference to "President" and state that the offices of Chairperson and Chief Executive Officer cannot be held by the same person
ss. 6(6)	-	deals with what happens if vacancy in office of president - not required *Why not – removes uncertainty in event of temporary or acting replacement*
ss. 7(1)	-	should provide that the Chairperson shall ensure that regular minutes of meetings of the Board are kept
ss. 8(1)	-	relates to approval by shareholders of service contract with president, CEO or Chairperson - delete "President" and "or all or 2 of those offices" and give LGIC authority to approve
ss. 9	-	management of corporation - the wording of this section should reflect that of s. 167 of the Corporations Act – *If Corporations Act applies, this amendment arguably not needed*

ss. 13 - relates to requirement of customers to provide future power demand forecast - not required *Why not – Holdco may be providing power to customers in non-regulated areas?*

ss. 15(1) - delete reference to Section 26 as is incorrect

ss. 16(2)(b) - relates to Power Commission and Power Corporation - not required

ANNEX I

List of Provisions of Hydro Corporation Act not required for Holdco

ss. 17 - deals with accounting methods and rate stabilization plan for regulatory purposes - not required . Include a section in the Act stating that the Public Utilities Act does not apply to activities of Holdco – *Ok, but raises the issue of whether Holdco will be expressly held to accounting standards in its legislation*

ss. 18 - gives Hydro authority to establish its own pension plan - not required. Include a section providing that employees of Holdco shall participate in the Public Service Pension Plan

ss. 19(4) - deals with Public Sector Restraint Act, 1992 - not required – *Presumably no remaining affected labour contracts*

ss. 19(5) - deals with essential employees - not required – *If Holdco is operating non-regulated electricity operations, would not essential worker provisions be required? Are they not taking the union in this clause with them?*

ss. 38(1)&(2) - sets borrowing and guarantee limits based on amount borrowed by Hydro up to after July 8, 1988. Revise such that Holdco borrowing be limited in total to an amount equal to Hydro's current incremental borrowing limit of $600 million.

s 47 - relates to limitation of actions on anything done by Hydro under sections 45 and 46 which have been repealed - not required

s 51 - relates to assets and liabilities of Power Distribution District - not required

ANNEX II

Changes to Hydro Corporation Act

ss. 2(j)	-	definition of "president" – not required
ss. 4(2)	-	provides Hydro with power to engage in activities related to oil and gas – not required
ss. 4(3)	-	delete reference to ss. 4(2)
ss. 5(1)	-	amend to increase the maximum number of Directors to 14
ss. 5(4)	-	provide LGIC with authority to set remuneration of Directors rather than Shareholders having this authority
ss. 6(1)	-	eliminate reference to president
ss. 6(3)	-	provide LGIC with power to appoint CEO rather than Shareholders having this authority
ss. 6(5)	-	delete reference to president and provide that Chairperson and Chief Executive Officer cannot be the same person
ss. 6(6)	-	relates to president – not required
ss. 8(1)	-	provide Shareholders with authority to enter into agreement with a person to provide for his/her appointment to the office of president, chairperson or CEO; delete references to president and chairperson and give authority to LGIC
ss. 15(1)	-	delete reference to Section 26 as is incorrect
ss. 41(1)(a)	-	insert "audited consolidated" before "financial statements"

ANNEX III

Summary of Implementation Plan

1. The Minister of Natural Resources will have primary responsibility for responding to questions with respect to this legislative change during debate in the House of Assembly. The Legislative Counsel office will be responsible for working with the Hydro Legal team and the Department of Justice in the drafting of legislative changes. The Minister of Finance will be responsible for responding to questions from the financial community on any perceived financial implications for Province.

Immediate Steps Following Proclamation of Changes to the Hydro Act

1. Minister of Finance executes the transfer of shares in Hydro to Holdco and is provided with 100% of the shares issued by Holdco.

2. Chief Executive Officer of Holdco appointed by Lieutenant Governor in Council.

3. Hydro's existing Board assumes the role of the Holdco Board and proceeds to appoint Holdco officers.

4. Hydro's existing Chief Executive Officer assumes the role of CEO of Holdco and proceeds to appoint the Leadership Team.

Longer Term Steps

1. Transfer Hydro's common and preferred shares in the Churchill Falls (Labrador) Corporation Limited (CF(L)Co) and its common shares in the Lower Churchill Development Corporation Limited and the Gull Island Power Company Limited to Holdco

2. Transfer contracts from Hydro to Holdco, including contracts for power sales to parties other than those in the Province whose rates are subject to the purview of the Public Utilities Board, employment contracts of employees involved in non-regulated activities, various service contracts involving non-regulated activities, etc.

3. Ensure that the directors of Holdco may also serve as directors of the subsidiary companies or as representatives of the Corporation on the Boards where there are third-party shareholders, giving consideration to standards of independence as noted in policy recommendation 2 (b) above.

ANNEX IV
Guideline For Selection of Benchmark Companies
Desired Future States for Hydro 2010 and 2020

2010

Category	Criteria	Factors
Ownership Structure	Government Ownership	• The extent to which the company is owned by a Government entity
Nature of Operations	Diversification and Scope of Services	• Core business is electricity with some diversification
	Regulatory Regime of Market	• Revenue generated primarily from regulated rate base with minimal exposure to market factors
Size	Customer Base	• In the order of 500,000 electricity customers (direct and indirect)
	Revenues	• Total revenues in the order of $650 M
	Capacity	• Total electricity generation capacity in the order of 10,000 MW
Financial and Strategic Position	Debt Rating	• The extent to which the company is an independent entity with strong governance and acceptable risk profile

2020

Category	Criteria	Factors
Ownership Structure	Government Ownership	• The extent to which the company is owned by a Government entity
Nature of Operations	Diversification and Scope of Services	[redacted]
	Regulatory Regime of Market	[redacted]
Size	Customer Base	[redacted]
	Revenues	[redacted]
	Capacity	• Total electricity generation capacity in the order of 10,000 MW
Financial and Strategic Position	Debt Rating	• The extent to which the company is an independent entity with strong governance and acceptable risk profile

ANNEX V
Summary of Benchmarking Results
Deloitte Jurisdictional Analysis

#	Question	Nature
1	Government Ownership	Corporate Structure
2	Are regulated and non-regulated businesses resident in separate corporate entities	
3	Do regulated activities take place in the parent or the subs or both?	
4	Debt: Equity ratio	Financial Structure
5	Is capital structure of the parent mirrored in that of the subs?	
6	Do subsidiaries issue their own debt to third parties?	
7	Is debt guaranteed?	
8	Credit Ratings - Short Term (S&P, Moody's, DBRS)	
9	Credit Ratings - Long Term (S&P, Moody', DBRS)	
10	Are subsidiaries rated independent of the parent?	
11	What is the perceived level of Board independence from the shareholder?	Governance
12	What is the perceived level of Board independence from Management?	
13	Is there a governance agreement between Management, Board and Shareholders?	
14	Dividend Policy	
15	What is the approved ROE for regulated entities?	
16	Is there a shared services agreement among the group?	

Notes:
In the case of HydroOne and Ontario Power Generation (OPG) questions have been answered from the perspective of the former Ontario's Hydro Corporation (Considering HydroOne and OPG as subsidiaries of Ontario Hydro)

The above questions were addressed to each of the selected utilities. The results are contained in the following ANNEX IV tables:

ANNEX V (CONT'D)
Summary Table of Benchmarking Results
Deloitte Jurisdictional Analysis

Question # Company	1 Ownership	2 Separate Regulated Entities?	3 Regulated Activities in Parent/Subs
BC Hydro	Provincial Crown Corporation	Partially (1)	Mostly in the Parent
EPCOR	Private company owned by the City of Edmonton	Mostly	Mostly in subsidiaries
Hydro One	Private company owned by the Province of Ontario	Yes	Subsidiaries
Hydro Quebec	Private company owned by the Province of Quebec	Yes	Mostly in subsidiaries
NB Power	Provincial Crown Corporation, owned through the Electric Finance Corp. (another provincial crown corporation)	Yes	Subsidiaries
OPG	Private company owned by the Province of Ontario	Yes	Subsidiaries
Enel	Public Corporation, 21.4% directly owned by the Italian Government, 10.2% indirectly owned by the Italian Government, 58.4% owned by the public	Mostly	Subsidiaries
NORSK	Public Corporation, 43.8% owned by the Government of Norway	Mostly unregulated with some level of separation	Subsidiaries
TVA	U.S. Government agency	No	No subsidiaries
OPPD	Public Corporation operating as a Political subdivision of the State of Nebraska	No	No Subsidiaries

Notes:
(1) Partially means Separate Business Lines and not necessarily separate entities

ANNEX V (CONT'D)
Summary Table of Benchmarking Results
Deloitte Jurisdictional Analysis

Question #	4	5	6	7	8	9	
Company	Debt-Equity	Mirrored Capital Structure?	Subs issuing own debt?	Guaranteed Debt	Credit Ratings ST	Credit Ratings LT	Independent Rating
BC Hydro	81:19	Not Available / No Comment	No	Yes, by the Province	A-1/Prime-1/R-1 (Middle)	AA-/AA2/AA	No
EPCOR	51:49[2]	Separate entities separate levels of debt	Some (EPCOR Power (L.P.)	No	A-1/Prime-1/R-1 (Low)	BBB=/NA/A(L)	readies, preferred shares of subsidiaries
Hydro One	53:47	No	Yes	No	A-1/Prime-1/R-1 (Middle)	A/Aa3/A	Yes
Hydro-Quebec	65:35	Not Available / No comment	No	Yes, by the Province	A-1+/P-1/R-1(Low)	A+/A1/A	No
NB Power	100:0[3]	Yes, except for TransCo	No, not yet.	Yes, by the Province (Mostly)	NA/NA/R-1 (Low)	NA/NA/A	No. Not yet.
OPG	39:61	No	Yes (it has the ability)	No	A-1/NA/R-1 (Low)	BBB+/NA/A(L)	Yes
Enel	41:59	No	Some (mostly, they have the ability)	Partial by the Italian Government (Only 12.5% of Debt)	Not available	A+/Aa3/NA	Not available
NORSK	22:78	Not Available / No Comment	Some	No, but debt issues are regarded as Government Related Issues	Not available	A-/A1/NA	Not available
TVA	90:10	No subsidiaries	No subsidiaries	No, but there is implicit federal support	Not available	AAA/Aaa/NA	No subsidiaries
OPPD	45:55	No subsidiaries	No subsidiaries	Through an Insurance Policy	Not available	AAA/Aa3/NA	No subsidiaries

Notes:
(2) Target capital structure is 65:35
(3) NB Power capital structure, except for the transmission component which is 60:40

ANNEX V (CONT'D)
Summary Table of Benchmarking Results
Deloitte Jurisdictional Analysis

Question #	11	12	13
Company	Board Independence From Shareholder?	Board Indep. From Management?	Governance Agreement?
BC Hydro	3 (Appointed by the Lieutenant Governor, but constitute a range of backgrounds and perspectives)	4 (Board oversight)	Yes, Letter of Expectations
EPCOR	5	5	Specific conditions are stipulated in shareholder agreements
Hydro One	3	3	Shareholder agreement
Hydro-Quebec	3 (Appointed by the Lieutenant Governor, but constitute a range of backgrounds and perspectives)	3 (Includes CEO and President)	Not really, only a Code of Ethics applicable to the Board and Management.
NB Power	2	3	Yes, There is a Governance manual
OPG	4	4	Shareholder agreement
Enel	4	3	Shareholder agreement
NORSK	4	2	Shareholder agreement
TVA	2	4	Yes, the TVA Act
OPPD	5	4	Not available / No Comment

Independence Scale of 1 to 5, 5 being Most Independent

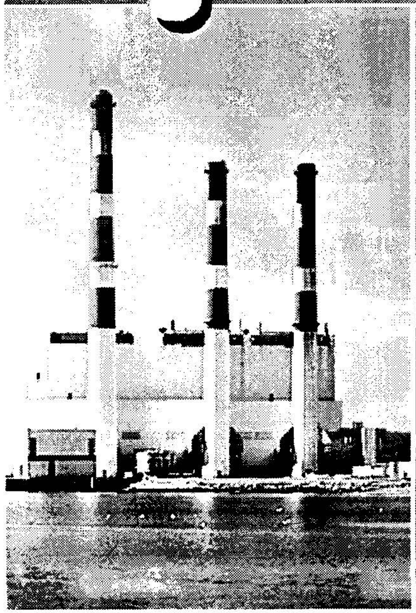
ANNEX V (CONT'D)
Summary Table of Benchmarking Results
Deloitte Jurisdictional Analysis

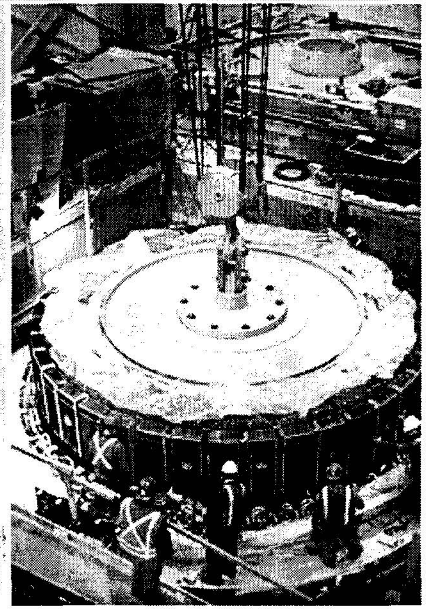
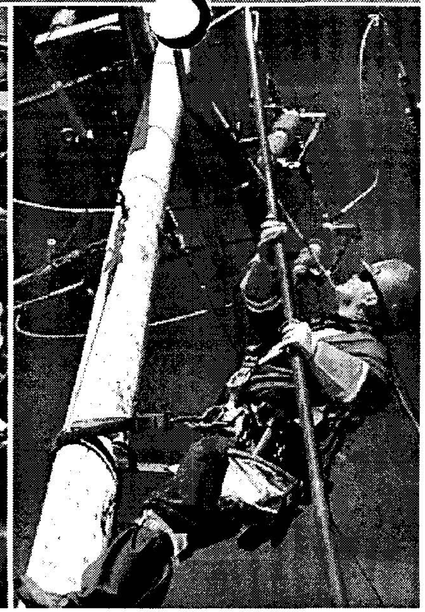
Company	Dividend Policy Question # 14
BC Hydro	BC Hydro is required to pay 85% of distributable surplus each year to the Province of British Columbia, subject to maintaining a $0:20 debt ratio.
EPCOR	Current annual dividend is set at the greater of the previous year's dividend adjusted for the forecasted change in the consumer price indexes per cent of earnings available to common shares of EPCOR in the applicable year. Dividends for the year are generally established in the fall of the pervious year based on forecasted earnings. The dividend policy is subject to amendment in the event of a significant change in EPCOR's business or financial condition.
Hydro One	Common dividends are declared at the sole discretion of the Hydro One Board of Directors, and are recommended by management based on results of operations, financial condition, cash requirements and other relevant factors such as industry practice and shareholder expectations. The preferred shares are entitled to an annual cumulative dividend of $18 million, which is payable on a quarterly basis.
Hydro-Quebec	Dividends to be paid by the Corporation are declared once a year by the Quebec government, which also determines the terms and conditions of payment. For a given fiscal year, they cannot exceed the distributable surplus, equal to 75% of the year's operating income and net investment income, less interest on debt securities and amortization of discounts and borrowing expenses. Also, in respect of a given fiscal year, no dividend may be declared in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year.
NB Power	Electric Finance Corp., as sole shareholder, is entitled to receive dividends when declared by the Corporation's Boards of Directors. The designated percentage of the dividends declared may vary based upon the discretion of the Shareholder and the financial position of the Corporation. The holder of the Class A shares cannot be paid dividends until such time that there are no longer any Class B shares outstanding. Dividends are declared and paid at an individual company level.
OPG	The declaration and payment of dividends are at the sole discretion of the Corporation's Board of Directors and will be dependent upon the Corporation's results of operations, financial condition, cash requirements, securities legislation and other factors considered relevant by the Corporation's Board of Directors. The Corporation's policy is to declare and pay regular dividends on its common shares held by the Province to approximately 35% of its net income from time to time. In addition, the Corporation may from time to time declare special dividends on of any portion of the proceeds of any decontrol transactions. For fiscal year ended 2005, there were no dividends declared or paid.
Enel	Enel's shareholders are entitled to receive interim or annual dividends that the Company's board of directors recommends and, in the case of dividends, that the Company's shareholders approve. The amount of the aggregate of dividend for each of 2001, 2002, 2003, 2004 and 2005 equal to approximately 52%, 109%, 87%, 162% and 100% of its consolidated net income for the relevant year, respectively.
NORSK	Norsk Hydro targets a 30% dividend payout over time.
TVA	TVA makes payments in lieu of taxes to states and countries in which the Corporation conducts power operations and in which the Corporation has acquired properties previously subject to state and local taxation. The basic amount of these payments is 5% of gross revenues from the sale of power during the preceding year.
OPPD	The District is not liable for federal or state income or ad valorem taxes. However, as required by State law, the District makes payments in lieu of taxes and the County Treasurer of each county in which it sets electricity equal to 5% of its gross revenues derived from sales within the incorporated cities and villages in such country.

ANNEX V (CONT'D)
Summary Table of Benchmarking Results
Deloitte Jurisdictional Analysis

Question # Company	15 Regulated ROE	16 Shared Services Agreement?
BC Hydro	8.29% Plus Risk Premium	One entity only
EPCOR	Generation: ROE = 4.5% above LT Canada Bond	Not specifically mentioned but companies share some corporate services and have several intercompany transactions
Hydro One	9.88%	Yes
Hydro-Quebec	Transmission 9.72% Distribution 8.4%, Actual ROE =13.45%	Yes
NB Power	It is defined, but is not available	Yes, to some extent
OPG	5%	Yes
Enel	Not available / No Comment	Yes
NORSK	Not available / No Comment	Yes
TVA	Electricity prices set at a rate to generate revenue enough to cover debt and interest payments in addition to Operating Costs	One entity only
OPPD	Not available / No Comment	One entity only

ANNEX VI
Presentation to Credit Rating Agencies



HYDRO
THE POWER OF COMMITMENT

Corporate Structure

May 2007

Preparing Hydro for Growth

Board & Shareholder Support
Access to Financing
Effective Decision Making
Clear and Focused Strategy
"Commercial" Focus
Facilitate Economic Development
Proactive Business Development

Success Factors

Decision Gate Process

Successful Growth =

- Return on Investment
- Economic Benefits to the Province
- Leverage the Value of Energy Resources

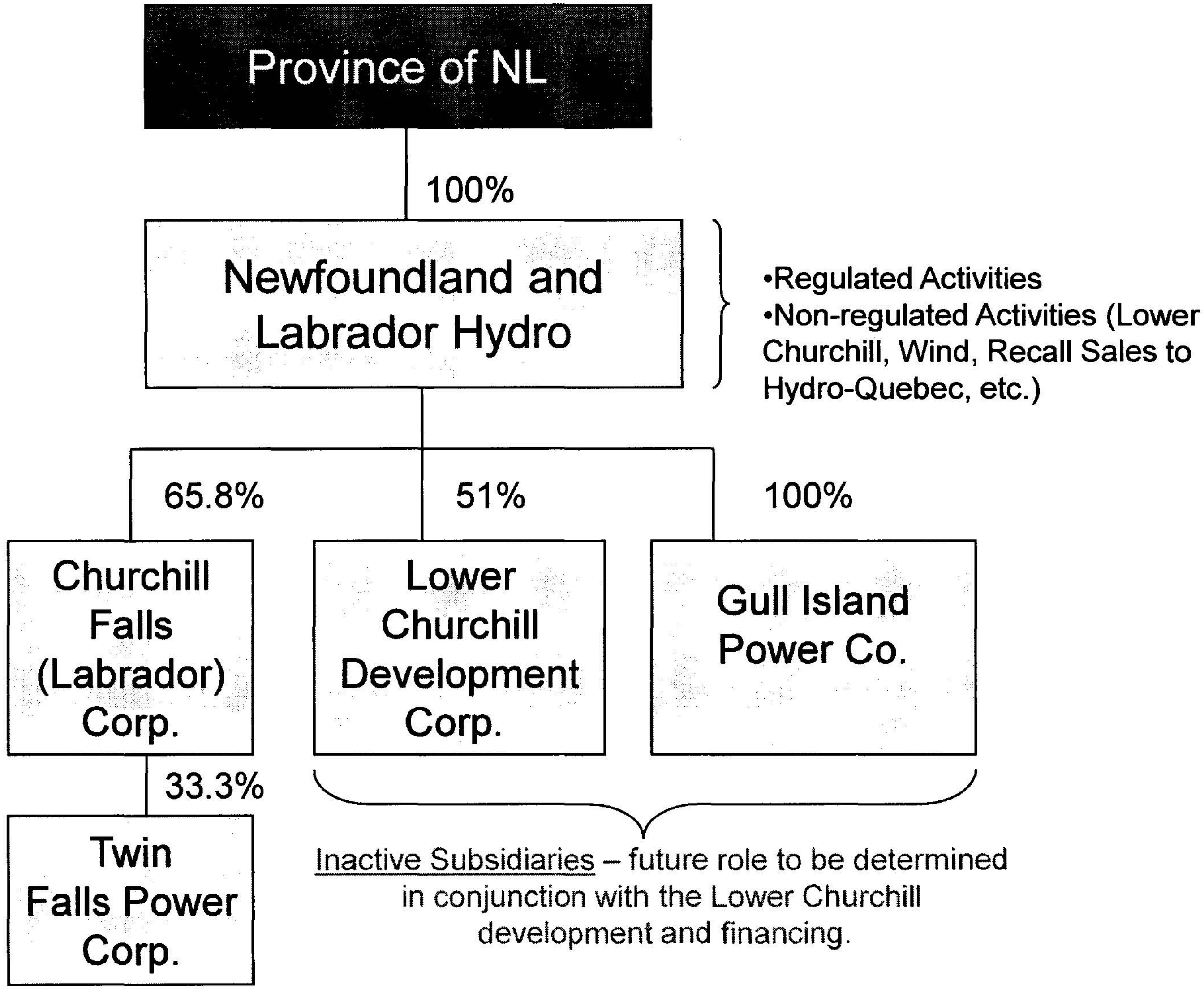
Building Blocks

Corporate Governance
Investment Evaluation
Risk Management
Corporate Structure
Capital Structure / Financing
Business and Financial Planning
Shareholder Relations
Financial Reporting

Objectives

- Develop a corporate structure that supports investment and growth opportunities (Lower Churchill, Wind, Oil & Gas)
- Maintain Government's control of Hydro and its subsidiaries
- Separate regulated and non-regulated activities to facilitate rate regulation by the Public Utilities Board
- Preserve the Provincial borrowing capacity
- Isolate business units from financing and other risks incurred by other business units

Current Corporate Structure



Why Changes are Required Now

- Hydro is in the process of developing plans for the sanction of the Lower Churchill in 2009. This may require the creation of new subsidiaries in 2007 and 2008 to facilitate market access and financing.
- Hydro continues to evaluate opportunities to acquire equity interests in offshore oil & gas projects. Hydro will need the flexibility to create new subsidiaries in order to acquire and finance these investments.
- The ability to separate regulated and non-regulated activities in Hydro is becoming increasingly complex. The proposed revisions to the corporate structure are necessary now in order to be ready for the next rate application preparation and filing (expected to be filed in 2008).
- To establish borrowing capacity for Holdco to facilitate borrowing for potential oil & gas and Lower Churchill investments in 2007 and 2008.

Restructuring Principles

- Changes to corporate structure will be driven by financing, regulatory, and business needs.
- Restructuring will take a “phased” approach – to ensure changes occur only as required.
- The corporate structure changes will provide appropriate flexibility to address future financing and growth need.
- Once the initial corporate structure changes are made, the creation of any new subsidiaries will require Cabinet approval.
- Hydro will obtain Board of Directors and Government approval for each phase of the restructuring plan.

Consultations

External

- Credit Rating Agencies
- Lenders
- Deloitte:
  - Report on oil & gas structures
  - Review of Corporate Structures in other Jurisdictions
- Fasken Martineau – report on corporate structure for U.S. market access.

Internal

- Hydro's Board of Directors
- Government Departments
  - Natural Resources
  - Finance
  - Justice

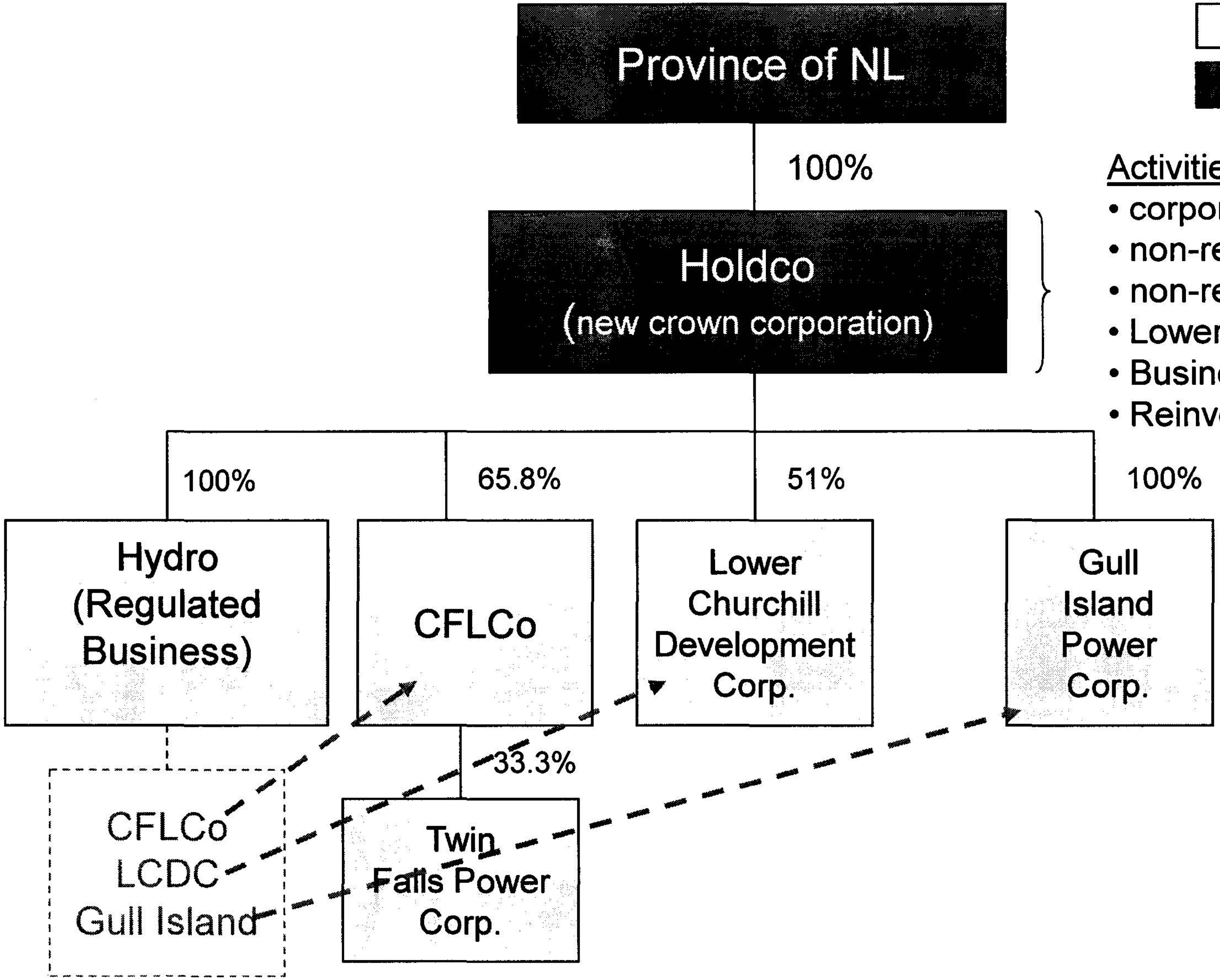
Recommended Corporate Structure

- A new 100% owned crown corporation, referred to as Holdco (name to be determined) be created.
- The existing Board of Directors of Hydro would serve as the Board of Directors for Holdco.
- The non-regulated assets and liabilities in Hydro related to CF(L)Co., the Lower Churchill, and other non-regulated activities will be transferred to Holdco at net book value.
- The existing Hydro will continue to operate as the regulated electric utility.
- Borrowing limits will be established for Holdco.
- New subsidiaries (with Cabinet approval) will be established as necessary.
- All existing legislation such as *Access to Information, Public Tender Act, and Transparency & Accountability* will also apply to Holdco.

Financial Impacts

- There will be no net impact on the consolidated financial position of the Hydro Group as a result of this restructuring.
- Holdco and Hydro will continue to borrow with a Government guarantee – other options to be considered for major new investments.
- Additional borrowing limits ($600 million) are being proposed for Holdco to facilitate potential oil & gas and Lower Churchill investments over the next two years - this additional borrowing limit could increase the level of debt guaranteed by the Province.
- The Regulated utility (Hydro) will have a net income of $8 million based on the return on equity approved by the Public Utilities Board. This is the lowest of any utility in Canada. Hydro plans to address this at the next rate hearing.
- During the implementation phase, Hydro will work with rating agencies to ensure that the movement of activities, assets and liabilities between Hydro and Holdco are structured to minimize any negative impacts on the Group or Government.

Current Corporate Structure Changes



Existing Companies

New Companies

Activities:
- corporate activities
- non-regulated activities,
- non-regulated financing activities,
- Lower Churchill activities,
- Business Development activities
- Reinvestment of dividends

Corporate Governance

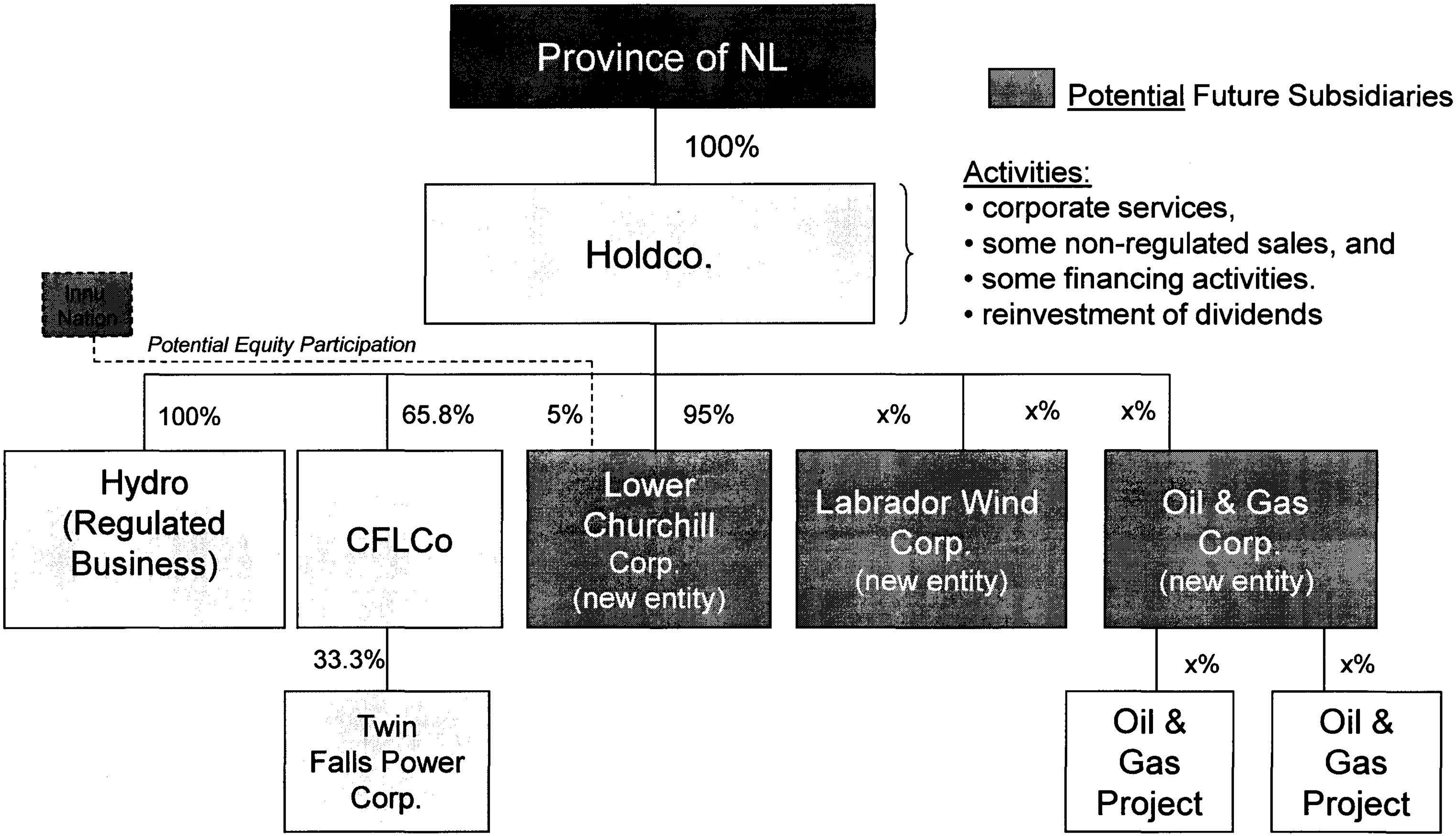
- In 2006, Hydro's Board of Directors established a Corporate Governance Committee to review and recommend corporate governance practices.
- The objective was to bring Hydro's corporate governance practices to a standard consistent with practices in publicly-traded companies.
- The Committee was comprised of the following directors: Tom Clift (Chair), Gerry Shortall, Edna Turpin, and Craig Tucker
- The review resulted in changes to Board Committee mandates and policies.
- In addition, the Board recommended that the following issues be considered by Government:
    - The size of the Board of Directors
    - Process for nomination of new directors
    - Independence of directors
    - Director terms

Recommended Corporate Governance Changes

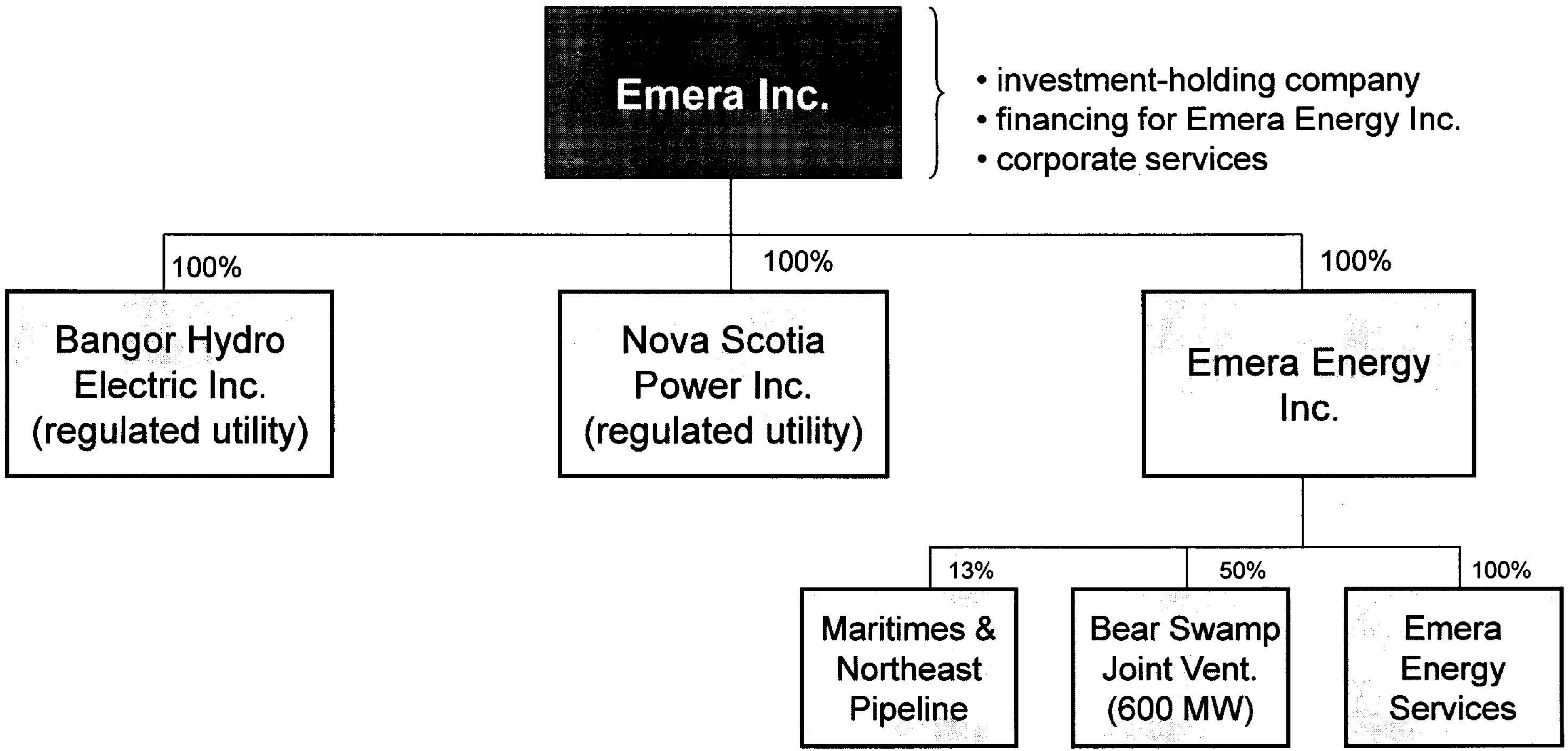
- **Legislation**
  - The maximum number of Directors be increased from 10 to 14.

- **Cabinet Policy**
  - Nomination of Directors - Holdco's Board of Directors would recommend potential new directors to Government, giving consideration to skills and experience requirements. Government retains final decision to choose directors from the proposed list or to select other directors not on the proposed list.
  - Independence - A majority of directors would be required to be "independent", as defined in specific criteria consistent with those used by publicly-traded companies. At present all directors except one would satisfy the proposed independence criteria.
  - Director Terms - To ensure continuity on the Board, a director will continue to serve after the expiration of his/her term until a replacement is appointed.

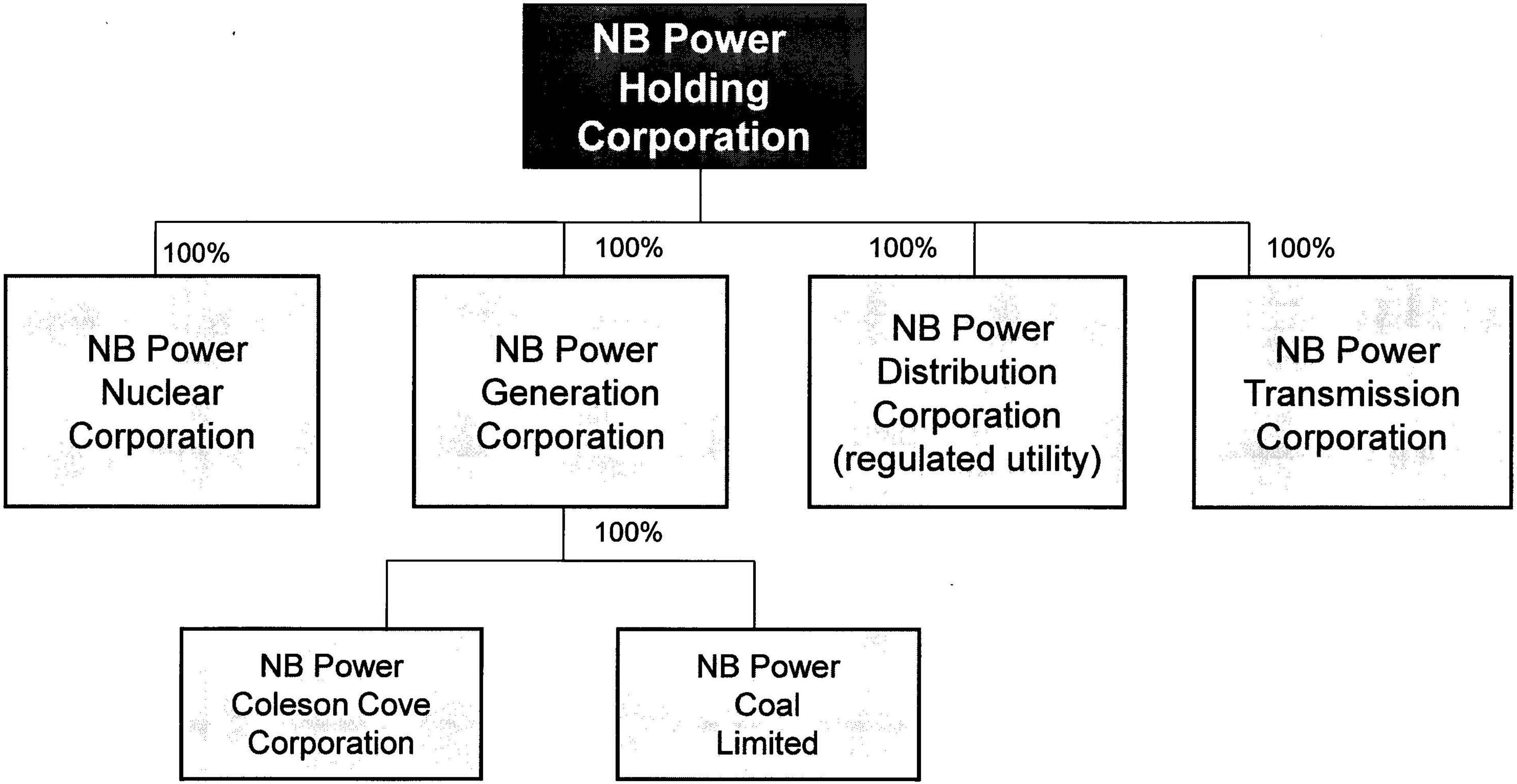
Future Corporate Structure



Example: Emera Inc.



Example: New Brunswick Power



Next Steps

- Seek approval from Cabinet to commence drafting legislation.
- Draft legislation to create Holdco and incorporate the other recommended changes.
- Seek approval of the legislative changes during the Spring legislative session.
- Commence execution of a plan to have Holdco and related structure changes fully implemented by January 1, 2008.
- Continue to engage with rating agencies during the implementation phase to ensure alignment.
- Identify and seek Cabinet approval for new subsidiaries required in 2007 to facilitate Lower Churchill market access and oil & gas investments.

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[redacted]

[redacted]

Attach to: **NR2007-[redacted]**
EPC2007-[redacted]

[redacted]

Title **Creation of New Crown Corporation**

Summary of Proposal

The Submission seeks authority for Legislative Counsel to draft legislation, for the approval of Cabinet prior to its introduction into the House of Assembly, in consultation with the Departments of Natural Resources, Finance and Justice, and Hydro, to create a new crown corporation (yet to be named so referenced in this paper as Holdco). Holdco will implement Government's intended activities in the energy sector, and hold the shares of Newfoundland and Labrador Hydroelectric Corporation (Hydro), which will continue to provide regulated electricity services to provincial customers, and Hydro's existing subsidiaries (Churchill Falls Labrador Corporation, Gull Island Power Corporation and Lower Churchill Development Corporation). Specifically it is recommended that:

a. Holdco have substantially the same powers and objects as those currently stated for Hydro and be subject to legislative provisions similar to all of the provisions of Hydro with the exception of those proposed in Annex 1;
b. The *Hydro Corporation Act* be amended with the changes proposed in Annex II attached;
c. Hydro's objects be amended to limit its activities to those of a regulated electrical utility, primarily the production and delivery of power for use by customers in the Province;
d. Notwithstanding the *Corporations Act*, provision be made that Government be able to issue specific direction to the Board of Directors of Hydro, despite not being the legal shareholder, provided that the Board of Directors of Holdco is appropriately informed, and that such direction would relieve the boards of both companies from relevant fiduciary duty;
e. The legislation incorporating Holdco specify that its activities will not be subject to the *Public Utilities Act*. This will ensure that Holdco has the flexibility to pursue its objectives on the basis of commercial and economic development considerations. The *Electrical Power Control Act* will apply to Holdco;
f. Hydro be authorized to transfer all assets and liabilities pertaining to activities not subject to the purview of the Public Utilities Board to Holdco at a value equal to their net book value at the time of transfer;
g. Holdco's total borrowing be limited to $600 million. This amount is additional to Hydro's current incremental borrowing limit of $600 million as outlined in Section 38 of the *Hydro Corporation Act;*
h. Holdco's short-term borrowing be limited by the Lieutenant-Governor in Council (LGIC), and initially set at $300 million. This amount is additional to the $300 million short –term borrowing limit currently imposed on Hydro by LGIC under Section 33(2) of the *Hydro Corporations Act*. These short-term borrowings comprise part of the $600 million limits referenced in (g) above;
i. For Holdco and each of its subsidiaries, the maximum number of directors be 14 (the Board of Directors of Hydro is currently limited to no more than 10);
j. The Hydro Board of Directors be appointed as directors of Holdco as well until such time as it is deemed appropriate by the LGIC to appoint separate boards for each company;
k. The appointment of the Chief Executive Officer of both Holdco and Hydro be done by the LGIC and not the shareholder, and Hydro's Chief Executive Officer (CEO) be appointed immediately as CEO of Holdco as well, until such time as it is deemed appropriate by the LGIC to nominate a separate CEO for each company.

l. Both former employees of Hydro, and new employees of Holdco as appropriate, be included in the Public Service Pension Plan; and
m. Other legislative provisions flowing from Hydro's ongoing review of the *Corporations Act.*
n. It is further recommended that the following items be adopted as Cabinet policy:
o. A Committee of the Holdco Board of Directors be responsible for the nomination of potential directors for Holdco and its wholly-owned subsidiaries (including Hydro), and Holdco's representatives on the Boards of subsidiaries that have third-party shareholders for consideration by the Shareholder. The Committee would give consideration to the skills, experience and other factors necessary on the Board in preparing the list of potential candidates. While the Committee of the Board would recommend candidates, the final decision on Board appointments would remain rest with Government through the Lieutenant-Governor in Council, and would not be limited to those individuals recommended by the Committee.
p. Criteria for independence, consistent with practices in publicly-traded companies, be introduced for directors of Holdco and its wholly-owned subsidiaries (including Hydro), and that a majority of the members of the Board of Directors (including the Board Chair) should satisfy the following criteria:
    i. Is not employed by the Corporation or any of its subsidiaries or affiliates (now or in the past two years).
    ii. Does not have a family member employed in a senior management position at the Corporation or its subsidiaries.
    iii. Did not benefit from a business relationship with the Corporation in the past year that could impair the independent judgment of the director.
    iv. Did not receive remuneration from Holdco or any of its subsidiaries, except for directors' fees or post-retirement benefits during the past year.
    v. Was not a partner or employee of the current external auditor during the previous two years.
q. For future director appointments, the appointing OC shall specify that the director will continue to serve after the expiration of his/her term until a replacement is appointed. This will ensure continuity on the Board while director replacements are being identified and appointed.

Secretariat Comment

1. The Blue Book commitment (NR-550) states the commitment that Hydro would be restructured with a new mandate to support the development of the province's energy sector, or a new "energy corporation" would be formed. In September 2004, Premier Williams stated that Hydro will be restructured with a mandate to support the development of the province's energy sector. Some of the key priorities of a new and improved Hydro will include the development of the Lower Churchill, exploration of partnerships with the private sector concerning natural gas, wind energy, geothermal heat pump technology, and the possible acquisition of ownership interests in our offshore oil and gas resources.

2. In 2006, the *Hydro Corporation Act* was amended to enable Hydro to engage in any activity related to hydrocarbons (which term encompasses petroleum, petroleum-related products and natural gas) either in the province or elsewhere under the leadership of its Board of Directors without further government approval. It also provides Hydro with the ability to engage in other activities with the prior approval of the Lieutenant-Governor-in-Council. The requirements for governmental approval of specific actions, such as establishing a subsidiary or borrowing amounts beyond existing approved amounts, would remain in place. [redacted]

3. Hydro has completed the internal reorganization of its operating departments, and the leadership team is now in place. A three-phase, long-term plan has been developed to fulfill the new mandate and meet the expectations of Government. **See attached description** .

4. Hydro's key objectives to meet the challenges ahead include:

    - Availability of a financing platform and establishment of financial flexibility to support investment and growth (Lower Churchill, wind, natural gas, oil & gas)

- Separate non-regulated businesses from the regulated business to facilitate rate regulation
- To preserve the Provincial borrowing capacity
- To ensure that control of both Hydro and Holdco rests with Government
- To ensure that the transparency and accountability initiatives of Government are maintained in relation to Holdco and wholly-owned subsidiaries
- Protect individual business units from financing and other risks incurred by other business units
- Closer alignment of business units and corporate structure
- Constructing a governance, corporate and financial structure that ensures timely and effective decision-making in a competitive business environment

5. The submission notes that traditionally Hydro has issued debt guaranteed by Government in order to finance its operations. Hydro's longer-term plan contemplates large infrastructure projects that could significantly increase the amount of debt guaranteed by Government unless alternate means of non-recourse financing are found. Holdco will need the flexibility to be able to create corporate and financing structures that avoid, to the extent possible, encumbering the borrowing capacity of the Province as a whole.

6. Hydro proposes that Holdco's funding requirements be satisfied initially by the issuance of debt in the capital markets carrying the guarantee of the Province, and by earnings reinvestment. Direct equity infusion by Government may become necessary as potential projects ramp up. Hydro recommends that Holdco be allowed to borrow up to $600 million with no more than $300 million of that total in short-term debt. This will effectively increase by $600 million the amount of debt that can be guaranteed by the Province.

7. The submission notes there will be changes in the financial profile of Hydro on a non-consolidated basis as some assets are transferred to Holdco and liabilities reduced, on a consolidated basis Holdco's financial profile will effectively mirror the current consolidated profile of Hydro. Hydro's net income would drop from $70 million back to about $10 million as a result of removal of earnings from its ownership interest in CF(L)Co and the sale of recall power. As well Hydro's debt to capital will increase on an unconsolidated basis to 83%, but with a supportive dividend policy it is expected that Hydro can achieve 80% target by 2009/10. Presently, debt to capital is 70%. It is noted credit rating agencies have expressed comfort that the negative impact of Hydro's reduced earnings levels would be offset by the relative stability and certainty of those earnings in a regulated environment.

8. The creation of Holdco and the change of Hydro's status require legislative measures. The key items to be addressed at this stage are: (i) those required to facilitate the transition to the proposed new structure: (a) Holdco's designation as a Crown Corporation; (b) Holdco's mandate to pursue various energy sector related projects and undertakings; (c) basic corporate governance issues; and (d) Holdco's financial structure; and (ii) the *Hydro Corporation Act* should be amended to reduce Hydro's mandate to reflect that of a regulated electrical utility operating within the Province.

9. The submission notes Holdco will be 100% owned by the Province of Newfoundland and Labrador and that Hydro would be a wholly-owned subsidiary of Holdco. Under the *Corporations Act* Government will no longer be the legal shareholder of Hydro and, hence, would have to issue directives to Hydro through Holdco. However, Hydro notes it is the intent under recommendation "1.d" to allow Government to issue specific direction to Hydro directly.

10. Hydro advises the recommendation to change the number of board members from 10 to 14 is based largely on an anticipated need for a broader skill set on the Board in order to deal with and to address that broadened mandate.

11. The submission notes nomination of potential directors for Holdco and subsidiaries by a nominating committee from the Holdco board of directors is reflective of what typically happens with corporations; however, final authority for director appointments rests with Cabinet. Hydro

advises improving the corporate governance practices is seen as enabling the Board to operate more effectively, be more accountable to the Shareholder, and to support Hydro's eventual increased participation in the capital markets.

12. NR advises Hydro has indicated to the PUB that it will be seeking a higher return and, internally, are planning on filing for a market-based rate of return at its next General Rate Application. A market return would basically mean a doubling of the present return on equity of 4.5% and, based on current financial circumstances, mean an additional $8 million. This would result in forecast rate increases in the range of 1.5% to 2 %.

13. Communications Branch advises a revised communications plan will be completed that considers technical briefings and news conference; internal communications; development of communications collateral material and revising key messages to more accurately reflect the proposed new corporate structure.

[redacted]

15. PSS advises in Annex I, it is noted that Section 19 (4) of the *Hydro Corporations Act* would not be required by Holdco; however, it would be better to keep this provision in place. There is an MOU between Government and NAPE which indicates that if this provision is ever rescinded, removed, deleted, etc. affected employees would be entitled to receive the related wage increases retroactively. The PSS feels removal of this provision for Holdco could potentially mean affected employees would be entitled to the retroactive wage increases and it could be precedent setting for other groups.

Budget Division Consultation The Budget Division of the Department of Finance advises – *to be provided prior to EPC*

Secretariat Recommendation Cabinet Secretariat recommends approval of the Submission.

EOR/BP
May 7, 2007

HYDRO CORPORATE RESTRUCTURING
Phased Approach
May '07

Phase 1 -2007	Phase II – 2008/2009+	Phase III
Creation of Holdco, separate regulated and non-regulated	**New entities to facilitate financing and ownership requirements**	**Other potential subsidiaries**
New company formed (Holdco) – Parent of Hydro	Possible new entities include the Lower Churchill Project, large Labrador Wind Project or an oil and gas investment.	As Hydro continues its pursuit of its expanded mandate, new financing structures and legal entities may be required.
Purpose of Holdco is to oversee both the non-regulated and regulated activities of the Hydro Group and to facilitate pursuit of Hydro's new mandate. .	Given the "project" nature of these development opportunities, it is considered likely and advisable that they be funded via a project finance approach and under separate legal entities. Our goal would be to obtain debt that is investment grade and non-recourse to the Province.	Examples include: • new HVDC link to the Island • Transmission sub (to accommodate OATT requirements) • Maritime underwater cable (if third party equity investor required) • Energy marketing sub (to facilitate LHP access to markets) • Financing sub (should group borrowing requirements dictate). • Subsidiary to hold Holdco's potential oil & gas equity investments. These are examples of potential subsidiaries. The need and timing of these may change as business and financing plans mature.
Regulated and non-regulated activities of the Hydro Group are separated via corporate lines, with all non-regulated assets and activities of the current Hydro being transferred to Holdco	Holdco would fund development activities up to the time that these projects are deemed to have reached a stage in their maturity that supports the issuance of project specific debt instruments in the capital and possibly private debt markets. Development assets incurred by Holdco to that point would be transferred to the new entity and related Holdco debt extinguished via refinancing by the new entity.	The proposed restructuring plan provides the necessary flexibility to move forward with these development opportunities while achieving the original objectives.
Objectives include: • Develop structure in which regulated and non-regulated activities can co-exist. • Flexibility to enter into joint ventures, partnerships, and obtain third party equity. • Protect business units from financing and other risks incurred by other business units. • Facilitate project financing and other financing alternatives. • Transparency, accountability and	A decision to form these new entities will be driven by the business case and significant development activities would require shareholder support from an equity investment perspective. All new long-term borrowings would require LGIC approval.	Prior to the formation of any new entity, full discussion with stakeholders would be required to ensure a valid business case.

Phase 1 -2007	**Phase II – 2008/2009+**	**Phase III**
Creation of Holdco, separate regulated and non-regulated	**New entities to facilitate financing and ownership requirements**	**Other potential subsidiaries**
governance.		
Hydro will continue to issue guaranteed debt as at present to fund its regulated operations. Holdco will also issue guaranteed debt under its name to pay for assets transferred from Hydro and to fund business development activities.	Some third party equity investment may be contemplated as a means of financing these new infrastructure projects. Hydro's proposed restructuring plan is designed to accommodate this possibility without adversely impacting the other Group activities.	Each new entity will require individual consideration as to its funding needs which may be addressed by a combination of debt, equity from the Province, or third party investment for example. The financial position of not only the Hydro Group, but also the Province are of primary concern.
Non-regulated entities currently owned by Hydro will be transferred to Holdco (CF(L)Co, LCDC and GIPCO.	A decision as to the continuing need for the existing LCDC and GIPCo entities will be made as part of the Phase II process.	Our primary goal would be to minimize the amount of guaranteed debt required and instead focus on meeting financial parameters for each new entity that support an investment grade credit rating and the issuance of non-recourse debt.
Hydro will continue as a regulated entity in the Province with a focus solely on regulated activities.		
Organizational analysis is still underway, but it is expected that while most staff will remain with Hydro, there will be some transfer of staff to Holdco, relating largely to the delivery of corporate services and non-regulated activities.		
Dividend policy in both companies will be driven by the need to preserve a characterization of debt by credit rating agencies as self-supporting.		

[redacted]

[redacted]

Revised

Attach to: **NR2007**[redacted]
EPC2007[redacted]

[redacted]

Title **<u>Creation of New Crown Corporation</u>**

Summary of Proposal

The Submission seeks authority for Legislative Counsel to draft legislation, for the approval of Cabinet prior to its introduction into the House of Assembly, in consultation with the Departments of Natural Resources, Finance and Justice, and Hydro, to create a new crown corporation (yet to be named so referenced in this paper as Holdco). Holdco will implement Government's intended activities in the energy sector, and hold the shares of Newfoundland and Labrador Hydroelectric Corporation (Hydro), which will continue to provide regulated electricity services to provincial customers, and Hydro's existing subsidiaries (Churchill Falls Labrador Corporation, Gull Island Power Corporation and Lower Churchill Development Corporation). Specifically it is recommended that:

a. Holdco have substantially the same powers and objects as those currently stated for Hydro and be subject to legislative provisions similar to all of the provisions of Hydro with the exception of those proposed in Annex 1;
b. The *Hydro Corporation Act* be amended with the changes proposed in Annex II attached;
c. Hydro's objects be amended to limit its activities to those of a regulated electrical utility, primarily the production and delivery of power for use by customers in the Province;
d. Notwithstanding the *Corporations Act*, provision be made that Government be able to issue specific direction to the Board of Directors of Hydro, despite not being the legal shareholder, provided that the Board of Directors of Holdco is appropriately informed, and that such direction would relieve the boards of both companies from relevant fiduciary duty;
e. The legislation incorporating Holdco specify that its activities will not be subject to the *Public Utilities Act*. This will ensure that Holdco has the flexibility to pursue its objectives on the basis of commercial and economic development considerations. The *Electrical Power Control Act* will apply to Holdco;
f. Hydro be authorized to transfer all assets and liabilities pertaining to activities not subject to the purview of the Public Utilities Board to Holdco at a value equal to their net book value at the time of transfer;
g. Holdco's total borrowing be limited to $600 million. This amount is additional to Hydro's current incremental borrowing limit of $600 million as outlined in Section 38 of the *Hydro Corporation Act;*
h. Holdco's short-term borrowing be limited by the Lieutenant-Governor in Council (LGIC), and initially set at $300 million. This amount is additional to the $300 million short –term borrowing limit currently imposed on Hydro by LGIC under Section 33(2) of the *Hydro Corporations Act*. These short-term borrowings comprise part of the $600 million limits referenced in (g) above;
i. For Holdco and each of its subsidiaries, the maximum number of directors be 14 (the Board of Directors of Hydro is currently limited to no more than 10);
j. The Hydro Board of Directors be appointed as directors of Holdco as well until such time as it is deemed appropriate by the LGIC to appoint separate boards for each company;
k. The appointment of the Chief Executive Officer of both Holdco and Hydro be done by the LGIC and not the shareholder, and Hydro's Chief Executive Officer (CEO) be appointed immediately as CEO of Holdco as well, until such time as it is deemed appropriate by the LGIC to nominate a separate CEO for each company.

l. Both former employees of Hydro, and new employees of Holdco as appropriate, be included in the Public Service Pension Plan; and
m. Other legislative provisions flowing from Hydro's ongoing review of the *Corporations Act.*
n. It is further recommended that the following items be adopted as Cabinet policy:
o. A Committee of the Holdco Board of Directors be responsible for the nomination of potential directors for Holdco and its wholly-owned subsidiaries (including Hydro), and Holdco's representatives on the Boards of subsidiaries that have third-party shareholders for consideration by the Shareholder. The Committee would give consideration to the skills, experience and other factors necessary on the Board in preparing the list of potential candidates. While the Committee of the Board would recommend candidates, the final decision on Board appointments would remain rest with Government through the Lieutenant-Governor in Council, and would not be limited to those individuals recommended by the Committee.
p. Criteria for independence, consistent with practices in publicly-traded companies, be introduced for directors of Holdco and its wholly-owned subsidiaries (including Hydro), and that a majority of the members of the Board of Directors (including the Board Chair) should satisfy the following criteria:
    i. Is not employed by the Corporation or any of its subsidiaries or affiliates (now or in the past two years).
    ii. Does not have a family member employed in a senior management position at the Corporation or its subsidiaries.
    iii. Did not benefit from a business relationship with the Corporation in the past year that could impair the independent judgment of the director.
    iv. Did not receive remuneration from Holdco or any of its subsidiaries, except for directors' fees or post-retirement benefits during the past year.
    v. Was not a partner or employee of the current external auditor during the previous two years.
q. For future director appointments, the appointing OC shall specify that the director will continue to serve after the expiration of his/her term until a replacement is appointed. This will ensure continuity on the Board while director replacements are being identified and appointed.

Secretariat Comment

1. The Blue Book commitment (NR-550) states the commitment that Hydro would be restructured with a new mandate to support the development of the province's energy sector, or a new "energy corporation" would be formed. In September 2004, Premier Williams stated that Hydro will be restructured with a mandate to support the development of the province's energy sector. Some of the key priorities of a new and improved Hydro will include the development of the Lower Churchill, exploration of partnerships with the private sector concerning natural gas, wind energy, geothermal heat pump technology, and the possible acquisition of ownership interests in our offshore oil and gas resources.

2. In 2006, the *Hydro Corporation Act* was amended to enable Hydro to engage in any activity related to hydrocarbons (which term encompasses petroleum, petroleum-related products and natural gas) either in the province or elsewhere under the leadership of its Board of Directors without further government approval. It also provides Hydro with the ability to engage in other activities with the prior approval of the Lieutenant-Governor-in-Council. The requirements for governmental approval of specific actions, such as establishing a subsidiary or borrowing amounts beyond existing approved amounts, would remain in place. (MC2006-0154 refers)

3. Hydro has completed the internal reorganization of its operating departments, and the leadership team is now in place. A three-phase, long-term plan has been developed to fulfill the new mandate and meet the expectations of Government. **See attached description** .

4. Hydro's key objectives to meet the challenges ahead include:

    - Availability of a financing platform and establishment of financial flexibility to support investment and growth (Lower Churchill, wind, natural gas, oil & gas)

- Separate non-regulated businesses from the regulated business to facilitate rate regulation
- To preserve the Provincial borrowing capacity
- To ensure that control of both Hydro and Holdco rests with Government
- To ensure that the transparency and accountability initiatives of Government are maintained in relation to Holdco and wholly-owned subsidiaries
- Protect individual business units from financing and other risks incurred by other business units
- Closer alignment of business units and corporate structure
- Constructing a governance, corporate and financial structure that ensures timely and effective decision-making in a competitive business environment

5. The submission notes that traditionally Hydro has issued debt guaranteed by Government in order to finance its operations. Hydro's longer-term plan contemplates large infrastructure projects that could significantly increase the amount of debt guaranteed by Government unless alternate means of non-recourse financing are found. Holdco will need the flexibility to be able to create corporate and financing structures that avoid, to the extent possible, encumbering the borrowing capacity of the Province as a whole.

6. Hydro proposes that Holdco's funding requirements be satisfied initially by the issuance of debt in the capital markets carrying the guarantee of the Province, and by earnings reinvestment. Direct equity infusion by Government may become necessary as potential projects ramp up. Hydro recommends that Holdco be allowed to borrow up to $600 million with no more than $300 million of that total in short-term debt. This will effectively increase by $600 million the amount of debt that can be guaranteed by the Province.

7. The submission notes there will be changes in the financial profile of Hydro on a non-consolidated basis as some assets are transferred to Holdco and liabilities reduced, on a consolidated basis Holdco's financial profile will effectively mirror the current consolidated profile of Hydro. Hydro's net income would drop from $70 million back to about $10 million as a result of removal of earnings from its ownership interest in CF(L)Co and the sale of recall power. As well Hydro's debt to capital will increase on an unconsolidated basis to 83%, but with a supportive dividend policy it is expected that Hydro can achieve 80% target by 2009/10. Presently, debt to capital is 70%. It is noted credit rating agencies have expressed comfort that the negative impact of Hydro's reduced earnings levels would be offset by the relative stability and certainty of those earnings in a regulated environment.

8. The creation of Holdco and the change of Hydro's status require legislative measures. The key items to be addressed at this stage are: (i) those required to facilitate the transition to the proposed new structure: (a) Holdco's designation as a Crown Corporation; (b) Holdco's mandate to pursue various energy sector related projects and undertakings; (c) basic corporate governance issues; and (d) Holdco's financial structure; and (ii) the *Hydro Corporation Act* should be amended to reduce Hydro's mandate to reflect that of a regulated electrical utility operating within the Province.

9. The submission notes Holdco will be 100% owned by the Province of Newfoundland and Labrador and that Hydro would be a wholly-owned subsidiary of Holdco. Under the *Corporations Act* Government will no longer be the legal shareholder of Hydro and, hence, would have to issue directives to Hydro through Holdco. However, Hydro notes it is the intent under recommendation "1.d" to allow Government to issue specific direction to Hydro directly.

10. Hydro advises the recommendation to change the number of board members from 10 to 14 is based largely on an anticipated need for a broader skill set on the Board in order to deal with and to address that broadened mandate.

11. The submission notes nomination of potential directors for Holdco and subsidiaries by a nominating committee from the Holdco board of directors is reflective of what typically happens with corporations; however, final authority for director appointments rests with Cabinet. Hydro

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[redacted]

15. PSS advises in Annex I, it is noted that Section 19 (4) of the *Hydro Corporations Act* would not be required by Holdco; however, it would be better to keep this provision in place. There is an MOU between Government and NAPE which indicates that if this provision is ever rescinded, removed, deleted, etc. affected employees would be entitled to receive the related wage increases retroactively. The PSS feels removal of this provision for Holdco could potentially mean affected employees would be entitled to the retroactive wage increases and it could be precedent setting for other groups.

Budget Division Consultation

The Budget Division of the Department of Finance advises that the proposed restructuring will not have a significant impact on the Province's credit rating because the extra debt will be self-supporting. It also indicates that there will not be a significant financial impact to the Province because no significant equity infusions are required in the initial two to three year period. While both of these points are valid in the short term, there could be potential impacts on the Province's credit rating in the medium to long term. The consolidated Hydro/Holdco will be taking on a significant increase in debt and there may not be a significant increase in revenues in the medium to long term to help service this extra debt. Some of the activities envisaged for Holdco may take some time to generate revenue but there will be significant up-front costs. This could have an impact from the rating agencies perspective but will depend on the type, magnitude and timing of the activity being contemplated. As well, given the extra debt, there could be a significant requirement for direct equity infusions into the consolidated entity in the medium to long term in order to maintain debt to capital and debt servicing ratios prior to Holdco/Hydro generating increased self supporting revenues. A down grade in the credit rating for Hydro/Holdco, a significant increase in its debt and significant equity infusions could have a significant direct and/or indirect financial impact on the Province. The potential impact on credit ratings can only be assessed in the context of any future potential activity which Hydro/Holdco engage in. Ministers should be aware of these considerations as they assess this submission.

Secretariat Recommendation

Cabinet Secretariat recommends approval of the Submission.

EOR/BP
May 7, 2007

HYDRO CORPORATE RESTRUCTURING
Phased Approach
May '07

Phase 1 -2007	Phase II – 2008/2009+	Phase III
Creation of Holdco, separate regulated and non-regulated	**New entities to facilitate financing and ownership requirements**	**Other potential subsidiaries**
New company formed (Holdco) – Parent of Hydro	Possible new entities include the Lower Churchill Project, large Labrador Wind Project or an oil and gas investment.	As Hydro continues its pursuit of its expanded mandate, new financing structures and legal entities may be required.
Purpose of Holdco is to oversee both the non-regulated and regulated activities of the Hydro Group and to facilitate pursuit of Hydro's new mandate. .	Given the "project" nature of these development opportunities, it is considered likely and advisable that they be funded via a project finance approach and under separate legal entities. Our goal would be to obtain debt that is investment grade and non-recourse to the Province.	Examples include: • new HVDC link to the Island • Transmission sub (to accommodate OATT requirements) • Maritime underwater cable (if third party equity investor required) • Energy marketing sub (to facilitate LHP access to markets) • Financing sub (should group borrowing requirements dictate). • Subsidiary to hold Holdco's potential oil & gas equity investments. These are examples of potential subsidiaries. The need and timing of these may change as business and financing plans mature.
Regulated and non-regulated activities of the Hydro Group are separated via corporate lines, with all non-regulated assets and activities of the current Hydro being transferred to Holdco	Holdco would fund development activities up to the time that these projects are deemed to have reached a stage in their maturity that supports the issuance of project specific debt instruments in the capital and possibly private debt markets. Development assets incurred by Holdco to that point would be transferred to the new entity and related Holdco debt extinguished via refinancing by the new entity.	The proposed restructuring plan provides the necessary flexibility to move forward with these development opportunities while achieving the original objectives.
Objectives include: • Develop structure in which regulated and non-regulated activities can co-exist. • Flexibility to enter into joint ventures, partnerships, and obtain third party equity. • Protect business units from financing and other risks incurred by other business units. • Facilitate project financing and other financing alternatives. • Transparency, accountability and	A decision to form these new entities will be driven by the business case and significant development activities would require shareholder support from an equity investment perspective. All new long-term borrowings would require LGIC approval.	Prior to the formation of any new entity, full discussion with stakeholders would be required to ensure a valid business case.

Phase 1 -2007 Creation of Holdco, separate regulated and non-regulated	Phase II – 2008/2009+ New entities to facilitate financing and ownership requirements	Phase III Other potential subsidiaries
governance.		
Hydro will continue to issue guaranteed debt as at present to fund its regulated operations. Holdco will also issue guaranteed debt under its name to pay for assets transferred from Hydro and to fund business development activities.	Some third party equity investment may be contemplated as a means of financing these new infrastructure projects. Hydro's proposed restructuring plan is designed to accommodate this possibility without adversely impacting the other Group activities.	Each new entity will require individual consideration as to its funding needs which may be addressed by a combination of debt, equity from the Province, or third party investment for example. The financial position of not only the Hydro Group, but also the Province are of primary concern.
Non-regulated entities currently owned by Hydro will be transferred to Holdco (CF(L)Co, LCDC and GIPCO.	A decision as to the continuing need for the existing LCDC and GIPCo entities will be made as part of the Phase II process.	Our primary goal would be to minimize the amount of guaranteed debt required and instead focus on meeting financial parameters for each new entity that support an investment grade credit rating and the issuance of non-recourse debt.
Hydro will continue as a regulated entity in the Province with a focus solely on regulated activities.		
Organizational analysis is still underway, but it is expected that while most staff will remain with Hydro, there will be some transfer of staff to Holdco, relating largely to the delivery of corporate services and non-regulated activities.		
Dividend policy in both companies will be driven by the need to preserve a characterization of debt by credit rating agencies as self-supporting.		

[redacted] [redacted]

Attach to: **NR2007-[redacted]**
EPC2007-[redacted]

[redacted]

Creation of New Crown Corporation

The Submission of the Minister of Natural Resources seeking approval of Creation of New Crown Corporation was considered by the Economic Policy Committee.

The Minister recommends as follows:

1. It is recommended that Legislative Counsel be directed to draft legislation, for the approval of Cabinet prior to its introduction into the House of Assembly, in consultation with the Departments of Natural Resources, Finance and Justice, and Hydro, to create a new crown corporation (yet to be named so referenced in this paper as Holdco). Holdco will implement Government's intended activities in the energy sector, and hold the shares of Newfoundland and Labrador Hydroelectric Corporation (Hydro), which will continue to provide regulated electricity services to provincial customers, and Hydro's existing subsidiaries (Churchill Falls Labrador Corporation, Gull Island Power Corporation and Lower Churchill Development Corporation). Specifically it is recommended that:

   a. Holdco have substantially the same powers and objects as those currently stated for Hydro and be subject to legislative provisions similar to all of the provisions of Hydro with the exception of those proposed in Annex 1;

   b. The *Hydro Corporation Act* be amended with the changes proposed in Annex II attached;

   c. Hydro's objects be amended to limit its activities to those of a regulated electrical utility, primarily the production and delivery of power for use by customers in the Province;

   d. Notwithstanding the *Corporations Act*, provision be made that Government be able to issue specific direction to the Board of Directors of Hydro, despite not being the legal shareholder, provided that the Board of Directors of Holdco is appropriately informed, and that such direction would relieve the boards of both companies from relevant fiduciary duty;

   e. The legislation incorporating Holdco specify that its activities will not be subject to the *Public Utilities Act*. This will ensure that Holdco has the flexibility to pursue its objectives on the basis of commercial and economic development considerations. The Electrical Power Control Act will apply to Holdco;

f. Hydro be authorized to transfer all assets and liabilities pertaining to activities not subject to the purview of the Public Utilities Board to Holdco at a value equal to their net book value at the time of transfer;

g. Holdco's total borrowing be limited to $600 million. This amount is additional to Hydro's current incremental borrowing limit of $600 million as outlined in Section 38 of the *Hydro Corporation Act;*

h. Holdco's short-term borrowing be limited by the Lieutenant-Governor in Council (LGIC), and initially set at $300 million. This amount is additional to the $300 million short –term borrowing limit currently imposed on Hydro by LGIC under Section 33(2) of the Hydro Act. These short-term borrowings comprise part of the $600 million limits referenced in (g) above;

i. For Holdco and each of its subsidiaries, the maximum number of directors be 14 (the Board of Directors of Hydro is currently limited to no more than 10);

j. The Hydro Board of Directors be appointed as directors of Holdco as well until such time as it is deemed appropriate by the LGIC to appoint separate boards for each company;

k. The appointment of the Chief Executive Officer of both Holdco and Hydro be done by the LGIC and not the shareholder, and Hydro's Chief Executive Officer (CEO) be appointed immediately as CEO of Holdco as well, until such time as it is deemed appropriate by the LGIC to nominate a separate CEO for each company.

l. Both former employees of Hydro, and new employees of Holdco as appropriate, be included in the Public Service Pension Plan; and

m. Other legislative provisions flowing from Hydro's ongoing review of the *Corporations Act.*

2. It is further recommended that the following items be adopted as Cabinet policy:

a. A Committee of the Holdco Board of Directors be responsible for the nomination of potential directors for Holdco and its wholly-owned subsidiaries (including Hydro), and Holdco's representatives on the Boards of subsidiaries that have third-party shareholders for consideration by the Shareholder. The Committee would give consideration to the skills, experience and other factors necessary on the Board in preparing the list of potential candidates. While the Committee of the Board would recommend candidates, the final decision on Board appointments would remain rest with Government through the Lieutenant-Governor in Council, and would not be limited to those individuals recommended by the Committee.

b. Criteria for independence, consistent with practices in publicly-traded companies, be introduced for directors of Holdco and its wholly-owned subsidiaries (including Hydro), and that a majority of the members of the Board of Directors (including the Board Chair) should satisfy the following criteria:

i. Is not employed by the Corporation or any of its subsidiaries or affiliates (now or in the past two years).
ii. Does not have a family member employed in a senior management position at the Corporation or its subsidiaries.
iii. Did not benefit from a business relationship with the Corporation in the past year that could impair the independent judgment of the director.
iv. Did not receive remuneration from Holdco or any of its subsidiaries, except for directors' fees or post-retirement benefits during the past year.
v. Was not a partner or employee of the current external auditor during the previous two years.

c. For future director appointments, the appointing OC shall specify that the director will continue to serve after the expiration of his/her term until a replacement is appointed. This will ensure continuity on the Board while director replacements are being identified and appointed.

The Committee recommends approval of the Minister's Submission.

May 8, 2007

[redacted]

2007/05/10

[redacted]

NR/DM
B. Parrott
Deputy Clerk
File

[redacted]

A Presentation on Hydro Corporation Structure and the Submission of the Minister of Natural Resources respecting Creation of a New Crown Corporation were deferred.

Deputy Clerk of the Executive Council

[redacted]

2007/05/14

[redacted]

NR/DM
FIN/DM
JUS/DM
B. Parrott
C. Lake
E. Martin
L. Galway
AG
Deputy Clerk
File

[redacted]

A Presentation on Hydro Corporate Structure was received from the Deputy Minister of the Department of Natural Resources, the Acting Assistant Deputy Minister (Energy Policy) in the Department of Natural Resources and Mr. Derrick Sturge, Chief Financial Officer and Vice President Finance of Hydro. The Submission of the Minister of Natural Resources respecting Creation of a New Crown Corporation was considered.

The following direction was provided:

1) Approval was given for the Office of Legislative Counsel, in consultation with the Departments of Natural Resources, Finance and Justice, and Hydro, to draft legislation, for the approval of Cabinet prior to its introduction into the House of Assembly, to create a new crown corporation (yet to be named so referenced in this Directive as Holdco). Holdco will implement Government's intended activities in the energy sector, and hold the shares of Newfoundland and Labrador Hydroelectric Corporation (Hydro), which will continue to provide regulated electricity services to provincial customers, and Hydro's existing subsidiaries (Churchill Falls Labrador Corporation, Gull Island Power Corporation and Lower Churchill Development Corporation). Specifically:

a) Holdco have substantially the same powers and objects as those currently stated for Hydro and be subject to legislative provisions similar to all of the provisions of Hydro with the exception of those proposed in Annex 1 of the Submission;

b) The Hydro Corporation Act be amended with the changes proposed in Annex II attached to the Submission;

c) Hydro's objects be amended to limit its activities to those of a regulated electrical utility, primarily the production and delivery of power for use by customers in the Province;

[redacted]

2007/05/14

d) Notwithstanding the Corporations Act, provision be made that Government be able to issue specific direction to the Board of Directors of Hydro, despite not being the legal shareholder, provided that the Board of Directors of Holdco is appropriately informed, and that such direction would relieve the boards of both companies from relevant fiduciary duty;
e) The legislation incorporating Holdco specify that its activities will not be subject to the Public Utilities Act. This will ensure that Holdco has the flexibility to pursue its objectives on the basis of commercial and economic development considerations. The Electrical Power Control Act will apply to Holdco;
f) Hydro be authorized to transfer all assets and liabilities pertaining to activities not subject to the purview of the Public Utilities Board to Holdco at a value equal to their net book value at the time of transfer;
g) Holdco's total borrowing be limited to $600 million. This amount is additional to Hydro's current incremental borrowing limit of $600 million as outlined in Section 38 of the Hydro Corporation Act;
h) Holdco's short-term borrowing be limited by the Lieutenant Governor in Council, and initially set at $300 million. This amount is additional to the $300 million short –term borrowing limit currently imposed on Hydro by the Lieutenant Governor in Council under section 33(2) of the Hydro Act. These short-term borrowings comprise part of the $600 million limits referenced in (g) above;
i) For Holdco and each of its subsidiaries, the maximum number of directors be 14 (the Board of Directors of Hydro is currently limited to no more than 10);
j) The Hydro Board of Directors be appointed as directors of Holdco as well until such time as it is deemed appropriate by the Lieutenant Governor in Council to appoint separate

[redacted]

2007/05/14

boards for each company;

k) The appointment of the Chief Executive Officer of both Holdco and Hydro be done by the Lieutenant Governor in Council and not the shareholder, and Hydro's Chief Executive Officer be appointed immediately as Chief Executive Officer of Holdco as well, until such time as it is deemed appropriate by the Lieutenant Governor in Council to nominate a separate Chief Executive Officer for each company;

l) Both former employees of Hydro, and new employees of Holdco as appropriate, be included in the Public Service Pension Plan; and

m) Other legislative provisions flowing from Hydro's ongoing review of the Corporations Act;

2) The following is approved as Cabinet policy:

a) A Committee of the Holdco Board of Directors will be responsible for the nomination of potential directors for Holdco and its wholly-owned subsidiaries (including Hydro), and Holdco's representatives on the Boards of subsidiaries that have third-party shareholders for consideration by the Shareholder. The Committee would give consideration to the skills, experience and other factors necessary on the Board in preparing the list of potential candidates. While the Committee of the Board would recommend candidates, the final decision on Board appointments would remain with Government through the Lieutenant-Governor in Council, and would not be limited to those individuals recommended by the Committee;

b) Criteria for independence, consistent with practices in publicly-traded companies, are to be introduced for directors of Holdco and its wholly-owned subsidiaries (including Hydro), and that a majority of the members of the Board of Directors (including the Board Chair)

[redacted]

2007/05/14

should satisfy the following criteria:

i) Is not employed by the Corporation or any of its subsidiaries or affiliates (now or in the past two years);

ii) Does not have a family member employed in a senior management position at the Corporation or its subsidiaries;

iii) Did not benefit from a business relationship with the Corporation in the past year that could impair the independent judgment of the director;

iv) Did not receive remuneration from Holdco or any of its subsidiaries, except for directors' fees or post-retirement benefits during the past year;

v) Was not a partner or employee of the current external auditor during the previous two years;

c) For future director appointments, the appointing Order in Council shall specify that the director will continue to serve after the expiration of his/her term until a replacement is appointed. This will ensure continuity on the Board while director replacements are being identified and appointed.

Deputy Clerk of the Executive Council

Email Message

From:	Griffin, Gerard [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=GERARDGRIFFIN]
To:	O'Reilly, Ed [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Edoreilly]
Cc:	
Sent:	5/4/2007 at 10:30 AM
Received:	5/4/2007 at 10:30 AM
Subject:	[redacted]

Hi Ed,

I have reviewed this submission dealing with the Hydro Corporation Act and proposed new legislation. The following are my comments:

The proposed legislation re a crown corporation is of great interest to our office in the long term as there will likely be significant implications in terms of new regulatory requirements being created. As a result, we will be informing the department today that once the new legislation is drafted and presented for Cabinet's approval, a comprehensive Regulatory Impact Analysis (RIA) will be required at that time.

With respect to the proposed amendments to the Hydro Corporation Act as outlined in Annex II, these are largely administrative in nature dealing with a reduction in Hydro's mandate. For this reason, we do not require a RIA to justify the amendments.

The larger issue for our office is the new legislation for the crown corporation and the impacts that will have - i.e. the regulatory requirements created by the legislation itself and any new regulations or policies which will naturally result from the creation of the new corporation. Once the new legislation is drafted and comes back to Cabinet, it should include a RIA as noted above. Following that, we will maintain contact with NR and the new corporation to ensure new regulatory requirements are monitored and reported to our office.

Regards,

Gerard

[redacted] [redacted]

Attach To: NR2007-[redacted]
EPC2007[redacted]

[redacted]

Title: **Creation of New Crown Corporation**

Branch Comment:

The Communications Branch has discussed the incorporated communications plan with the Communications Director for Natural Resources who will be submitting a revised plan that will be made available as soon as it is ready. The revised plan will take into consideration:

- Holding a technical briefing and news conference, perhaps in collaboration with Hydro, on the day the bill gets second reading in the House to ensure that accurate information is conveyed to news media and that they have a good understanding of the purpose and implications of the legislation.
- Internal communications – determine if Hydro has an internal communications plan in place to address any issues and concerns employees may raise.
- Determining whether other briefings are appropriate; or otherwise determining how this will be communicated to other key stakeholders (examples - aboriginal community, Hydro Quebec if need be, local industry organizations)
- Developing communications collateral material, including Q and As, in consultation and collaboration with Hydro; providing an opportunity for the Premier's Office and the Communications Branch to review the materials before they are finalized.
- Revising the key messages to more accurately reflect the proposed new corporate structure.

The Branch notes that while the name of the department's communications director is on the communications plan, she is not the author.

Date: May 3, 2007

Prepared by: J. Cheeseman

Email Message

From:	Myrden, Paul [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=PMYRDEN]
To:	O'Reilly, Ed [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Edoreilly]
Cc:	
Sent:	5/7/2007 at 2:41 PM
Received:	5/7/2007 at 2:41 PM
Subject:	Re: Fwd: Cabinet Paper on Restructuring

Ed:

I've reviewed the responses from Hydro but bear in mind that, even though Earl and I discussed the paper, the comments are his and my review of the replies may not fully take into account Earl's mindset when he prepared them. Having said that, here are my comments (numbered to correspond to Earl's questions):

1. On the pro-forma balance sheet, it's a little curious as to how Holdco, a new company, emerges with $615 in retained earnings. More to the point, the Dec/05 balance sheet for Hydro shows net assets (assets less liabilities) of $500 million. Post-reorg, this number has been reduced to $215 million, which includes the $65 million note. Does this mean that Holdco has acquired $300 in net assets with no consideration paid to Hydro. I realize the #'s have been simplified but I feel like I'm missing something.

2. One of the later replies mentions that the supportive dividend policy is totally discretionary. The Province's supportive policy has allowed Hydro to retain $ that otherwise would have been stripped out and this has obviously been viewed positively by the rating agencies. It would appear that a future supportive dividend policy would see dividends being paid by Hydro but retained by Holdco. This may be supportive of Holdco's activities but would not be seen in the same light from the Hydro perspective and may represent a change in policy with negative implications for the rating agencies, particulary in conjunction withn the removal of income producing assets from Hydro.

4. The reply here confirms our view indicates that an increase in the total debt guaranteed by the Province is a certainty, as Holdco moves forward with its new mandate. On this basis, to even suggest that Holdco borrowing is largely a substitute for previous Hydro borrowing activity is misleading.

The remaining points all involve rating agency considerations and conclude that the impacts have been discussed with appropriate third parties and that these impacts will be generally benign. While this very well may be the case, much of the impact will depend on the future operation of Holdco. Howver, it can be expected that much of Holdco's investment, and related borrowing, will be long term in nature and that payback (or even debt self-supportability) may take many years to achieve particularly in Phases II and III. In that scenario, we might expect to see some leakage in terms of Holdco's impact on Provincial ratings and this should be recognized.

Earl may have some additional thoughts.

Paul

Paul Myrden, CA
Manager of Capital Markets and

Financial Assistance Programs
Debt Management Division
Department of Finance
Government of Newfoundland & Labrador

Phone: (709) 729-6846
Fax: (709) 729-2095

>>> Ed O'Reilly 5/7/2007 12:48 PM >>>
Paul:

Earl suggested I send this to you for review. We are planning to get this analysis out to Ministers in the next hour or so.

Thank you
Ed

>>> Charles Bown 2007/05/07 10:52 AM >>>
As requested

>>> <MBradbury@nlh.nl.ca> 07-May-07 10:37 am >>>

Charles:

As per our discussion this morning, attached is the document incorporating your comments. I have also provided note of the section in the Corporation Act that we referenced when making the comment regarding enforceability of contracts.

I have attached both the marked up and clean versions.

Mark Bradbury
Corporate Treasurer
Newfoundland and Labrador Hydro
Ph: 709-737-1294
Fx: 709-737-1901
Email: mbradbur@nlh.nf.ca

Email Message

From:	Curtis, Ken [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=KCURTIS]
To:	O'Reilly, Ed [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Edoreilly]
Cc:	
Sent:	5/4/2007 at 11:16 AM
Received:	5/4/2007 at 11:16 AM
Subject:	Re:[redacted]Hydro

Hi Ed,

There is another item with respect to this submission. In Annex I, it is indicated that Section 19 (4) of the Hydro Act would not be required by Holdco. The PSS advises that it would be better to keep this provision in place. There is an MOU between Government and NAPE which indicates that if this provision is ever rescinded, removed, deleted, etc. affected employees would be entitled to receive the related wage increases retroactively. The PSS feels removal of this provision for Holdco could potentially mean affected employees would be entitled to the retroactive wage increases and it could be precedent setting for other groups.

Thanks,
Ken

>>> Ed O'Reilly 5/2/2007 11:12 AM >>>
Hi:

Friday noon will be fine for any comments you may have.

Thank you

Ed

Email Message

From:	Curtis, Ken [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=KCURTIS]
To:	O'Reilly, Ed [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Edoreilly]
Cc:	Saunders, Earl [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Esaunders], Paddon, Terry [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Tpaddon], Brewer, Donna [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Dbrewer], Morris, Joan E. [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Jmorris]
Sent:	5/7/2007 at 4:43 PM
Received:	5/7/2007 at 4:43 PM
Subject:	[redacted] - Creation of New Crown Corporation

Ed,

As discussed, here are some additional comments on this submission.

The submission indicates that the proposed restructuring will not have a significant impact on the Province's credit rating because the extra debt will be self-supporting. It also indicates that there will not be a significant financial impact to the Province because no significant equity infusions are required in the initial two to three year period. While both of these points are valid in the short term, there could be potential impacts on the Province's credit rating in the medium to long term. The consolidated Hydro/Holdco will be taking on a significant increase in debt and there may not be a significant increase in revenues in the medium to long term to help service this extra debt. Some of the activities envisaged for Holdco may take some time to generate revenue but there will be significant up-front costs. This could have an impact from the rating agencies perspective but will depend on the type, magnitude and timing of the activity being contemplated. As well, given the extra debt, there could be a significant requirement for direct equity infusions into the consolidated entity in the medium to long term in order to maintain debt to capital and debt servicing ratios prior to Holdco/Hydro generating increased self supporting revenues. A down grade in the credit rating for Hydro/Holdco, a significant increase in its debt and significant equity infusions could have a significant direct and/or indirect financial impact on the Province. The potential impact on credit ratings can only be assessed in the context of any future potential activity which Hydro/Holdco engage in. Ministers should be aware of these considerations as they assess this submission.

If you require anything further, please let me know.

Thanks,
Ken

Ken Curtis
Budget Analyst
Budgeting Division
Department of Finance
729-1579 (phone)
729-2156 (fax)

Email Message

[redacted]

Email Message

[redacted]

[redacted]

[redacted]

HYDRO CORPORATE RESTRUCTURING
Phased Approach
May '07

Phase 1 -2007	Phase II – 2008/2009+	Phase III
Creation of Holdco, separate regulated and non- regulated	**New entities to facilitate financing and ownership requirements**	**Other potential subsidiaries**
New company formed (Holdco) – Parent of Hydro	Possible new entities include the Lower Churchill Project, large Labrador Wind Project or an oil and gas investment.	As Hydro continues its pursuit of its expanded mandate, new financing structures and legal entities may be required.
Purpose of Holdco is to oversee both the non-regulated and regulated activities of the Hydro Group and to facilitate pursuit of Hydro's new mandate. .	Given the "project" nature of these development opportunities, it is considered likely and advisable that they be funded via a project finance approach and under separate legal entities. Our goal would be to obtain debt that is investment grade and non-recourse to the Province.	Examples include: • new HVDC link to the Island • Transmission sub (to accommodate OATT requirements) • Maritime underwater cable (if third party equity investor required) • Energy marketing sub (to facilitate LHP access to markets) • Financing sub (should group borrowing requirements dictate). • Subsidiary to hold Holdco's potential oil & gas equity investments. These are examples of potential subsidiaries. The need and timing of these may change as business and financing plans mature.
Regulated and non-regulated activities of the Hydro Group are separated via corporate lines, with all non-regulated assets and activities of the current Hydro being transferred to Holdco	Holdco would fund development activities up to the time that these projects are deemed to have reached a stage in their maturity that supports the issuance of project specific debt instruments in the capital and possibly private debt markets. Development assets incurred by Holdco to that point would be transferred to the new entity and related Holdco debt extinguished via refinancing by the new entity.	The proposed restructuring plan provides the necessary flexibility to move forward with these development opportunities while achieving the original objectives.

HYDRO CORPORATE RESTRUCTURING
Phased Approach
May '07

Phase 1 -2007	Phase II – 2008/2009+	Phase III
Creation of Holdco, separate regulated and non- regulated	**New entities to facilitate financing and ownership requirements**	**Other potential subsidiaries**
Objectives include: • Develop structure in which regulated and non-regulated activities can co-exist. • Flexibility to enter into joint ventures, partnerships, and obtain third party equity. • Protect business units from financing and other risks incurred by other business units. • Facilitate project financing and other financing alternatives. • Transparency, accountability and governance.	A decision to form these new entities will be driven by the business case and significant development activities would require shareholder support from an equity investment perspective. All new long-term borrowings would require LCiC approval.	Prior to the formation of any new entity, full discussion with stakeholders would be required to ensure a valid business case.
Hydro will continue to issue guaranteed debt as at present to fund its regulated operations. Holdco will also issue guaranteed debt under its name to pay for assets transferred from Hydro and to fund business development activities.	Some third party equity investment may be contemplated as a means of financing these new infrastructure projects. Hydro's proposed restructuring plan is designed to accommodate this possibility without adversely impacting the other Group activities.	Each new entity will require individual consideration as to its funding needs which may be addressed by a combination of debt, equity from the Province, or third party investment for example. The financial position of not only the Hydro Group, but also the Province are of primary concern.
Non-regulated entities currently owned by Hydro will be transferred to Holdco (CF(L)Co, LCDC and GIPCO.	A decision as to the continuing need for the existing LCDC and GIPCo entities will be made as part of the Phase II process.	Our primary goal would be to minimize the amount of guaranteed debt required and instead focus on meeting financial parameters for each new entity that support an investment grade credit rating and the issuance of non-recourse debt.
Hydro will continue as a regulated entity in the Province with a focus solely on regulated activities.		

HYDRO CORPORATE RESTRUCTURING
Phased Approach
May '07

Phase 1 -2007	Phase II – 2008/2009+	Phase III
Creation of Holdco, separate regulated and non- regulated	**New entities to facilitate financing and ownership requirements**	**Other potential subsidiaries**
Organizational analysis is still underway, but it is expected that while most staff will remain with Hydro, there will be some transfer of staff to Holdco, relating largely to the delivery of corporate services and non-regulated activities.		
Dividend policy in both companies will be driven by the need to preserve a characterization of debt by credit rating agencies as self-supporting.		

Email Message

From:	<MBradbury@nlh.nl.ca> [SMTP:MBradbury@nlh.nl.ca]
To:	O'Reilly, Ed [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Edoreilly]
Cc:	Bown, Charles W. [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Cbown], DSturge@nlh.nl.ca [SMTP:DSturge@nlh.nl.ca]
Sent:	4/16/2007 at 8:10 AM
Received:	4/16/2007 at 8:10 AM
Subject:	Slight change to section on financial advisors

Ed:

I was updating the syndicate leads late last week on the status of the restructuring and in reviewing the wording relating to the consultation with them, Scotia had suggested removing the reference to practice in the US. While they felt that the statement was correct, they did not feel they had done the necessary due diligence work to be able to support it conclusively (RBC was OK with it). So the reword would simply remove the US reference as follows:

Details of the restructuring plan were reviewed with Hydros lead managers. They were supportive of the concept and agree that it will facilitate Hydros pursuit of its new mandate. They also confirmed that the structure whereby the regulated operations are separated corporately from other non-regulated activities is the preferred model in Canada.

Perhaps you could add this change. thanks

Mark Bradbury
Corporate Controller and Treasurer
Newfoundland and Labrador Hydro
Ph: 709-737-1294
Fx: 709-737-1901
Email: mbradbur@nlh.nf.ca

Email Message

From:	Bown, Charles W. [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=CBOWN]
To:	Bazeley, Dave [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Dbazeley], O'Reilly, Ed [EX:/O=PSNL/OU=FIRST ADMINISTRATIVE GROUP/CN=RECIPIENTS/CN=Edoreilly]
Cc:	
Sent:	4/10/2007 at 4:24 PM
Received:	4/10/2007 at 4:24 PM
Subject:	Fwd: Re: Impact on Electricity Rates

>>> <GMitchell@nlh.nl.ca> 10-Apr-07 4:22:25 pm >>>

Hi Charles;

We have indicated to the PUB that we will be seeking a higher return and internally we are planning on filing for a market-based rate of return at our next General Rate Application. A market return would basically mean a doubling of the present return on equity of 4.5% and, based on current financial circumstances, mean an additional $8 million. This would result in forecast rate increases in the range of 1.5% to 2 % all else being equal.

Regards

Glenn

Glenn H. Mitchell
Manager, Rates and Financial Planning
Newfoundland and Labrador Hydro
Ph. : (709) 737-1473
Fax : (709 737-1902
email : glenn.mitchell@nlh.nf.ca

"Charles Bown"
<CBown@gov.nl.ca>
To
04/10/2007 04:04 <GMitchell@nlh.nl.ca>
PM cc

Subject
Impact on Electricity Rates

Glenn;

In the context of the restructuring Cabinet Paper, should Hydro proceed to petition PUB for a market rate of return, what would be the resulting impact on ratepyers ?

Charles

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

EARL SAUNDERS QUESTIONS

1. Paper states that non-regulated assets and liabilities will be transferred from Hydro to Holdco.

a) Can these assets and liabilities be quantified?
b) Relate the amounts to the requested borrowing limits for Holdco.
c) Provide pro forma balance sheets for both Holdco and "regulated" Hydro, after the restructuring.

Answer: 1.a & c

Our current expectation is that the transfer would take place January 1, 2008. The opening balance sheet of Holdco is expected to look as follows:

	Millions $
Value of equity investment in Hydro	215
Value of investment in CF(L)Co	350
Value of investment in the Lower Churchill Development Corporation	3
Muskrat Falls assets	2
Work In Progress Lower Churchill	150
Total Assets	**720**
Note payable to Hydro	65
Share capital	23
Contributed capital	17
Retained earnings	615
Total Liabilities and equity	**720**

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

Hydro's expected opening balance sheet on January 1, 2008 would look as follows:[1]

	Millions $
Assets	1549
Liabilities & Debt	1334
Share capital	215
Total Liabilities and Equity	1549

The debt to capital calculation for Hydro would exclude certain liabilities such as accounts payable, accrued interest and employee future benefits. As such, the total anticipated debt to capital ratio as at January 1, 2008 for Hydro is estimated at 83%.

Answer to 1.b.

The requested borrowing limits relate to the repayment of the $65 million note payable to Hydro, but also to the planned expenditures of Holdco going forward. It is recognized that there are many potential investment opportunities currently under discussion. The decision to proceed under any of these could have both structural and financial implications associated with them. It was not intended that the requested borrowing limit for Holdco would fund all of the projects currently under discussion, but rather would provide Holdco with the financial depth necessary in the shorter term to provide bridge financing to these opportunities, pending final decision to proceed.

2. Under Alternative 1, it is stated that the recommended option will "provide Holdco with access, in the first instance, to Hydro's available dividends..."

a) Again, no $$$ provided. Paper also doesn't mention that in both 2006/07 and 2007/08 the Province suspended dividend payments to provide cash flow to facilitate growth initiatives. This "supportive dividend policy" has left more than $100 million in Hydro.

b) What is meant by the words "in the first instance"?

[1] Based on 2007 budgeted balance sheet as submitted to the Minister of Natural Resources with the non-regulated assets and liabilities/equity for Holdco removed.

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

Answer 2.a.

In the "Financing Platform" section of the paper, Hydro states:

> "The need for incremental equity investment by the Province in Holdco will depend upon the desired financial parameters such as debt to capital and debt service coverage ratios that the financial markets set for the company in order that Hydro's guaranteed debt would be viewed as self-supporting. It is important that Hydro's debt be viewed in this manner because it impacts on the rating agency view of the Province's overall debt load. Guaranteed debt that is self-supporting is viewed as having its own source of funding and thus not simply considered as an add-on to the total provincial debt."

So the governing factor as to Holdco's dividend policy will be Holdco's financial position and whether or not its debt is viewed as self-supporting by the rating agencies. This categorization of Holdco's debt is seen as critical in order to avoid any detrimental impact on the Province's credit rating.

While dividend payout at some point is anticipated, it is really dependant upon the shareholder objective to maximize the value of its investment in Holdco to the benefit of the Province, without detrimental impact to Hydro's rate payers. Maximization of value may entail a further suspension of dividends in order to pursue favorable investment opportunities.

Answer to 2.b.

"In the first instance" is a reference to the above discussion pertaining to Holdco dividend policy. Dividends will "in the first instance", be paid by Hydro to its new shareholder Holdco. Whether or not these dividends are thereafter flowed through to the Province will be dependent upon the factors as mentioned in 2.a above.

3. **Is this corporate restructuring something that will require PUB approval, pursuant to the *Electrical Power Control Act*?**

Answer:

No; the regulated part of Hydro will not be affected so PUB approval is not required.

4. **Financial Considerations**

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

In the opening paragraph of this section, it is stated that "Any Holdco borrowing not offset by debt retirement by Hydro will increase the overall indebtedness of the Province". Assuming new borrowings by Holdco, and the refinancing of Hydro debt as it matures, an increase in the Province's total debt is essentially assured.

Answer:

We had requested that this section be reworded as follows:

> "Long-term debt issues would require LGiC approval and total borrowings would be limited by the legislation to $600 million with the short-term borrowing component being not more than $300 million as set initially by LGiC. Any Holdco borrowing not offset by debt retirement by Hydro will increase the overall debt that is guaranteed by the Province. However, both Hydro and Holdco would be governed by a supportive dividend policy that is reflective of targeted debt to capital ratios."

This suggested rewording did not get incorporated into the final document. It's purpose was to make the distinction between provincial indebtedness and debt that is guaranteed by the Province. Having said this, you are correct in suggesting that as Hydro's activities ramp up, overall debt that is guaranteed by the Province can be expected to increase.

5. **Upon the transfer of its net investment in CF(L)Co. to Holdco, non-consolidated Hydro's debt to capital will increase from XXX to??? Percentages not provided.**

Answer:

Please see answer to question # 1 above; i.e. 83%.

6. **It's expected that this ratio won't get back to 80% until 2009/10, with a supportive dividend policy. What is the basis for the claim that this is "not expected to have an appreciable impact on the credit rating agency view of Hydro's debt as being self-supporting" especially when coupled with the fact that Hydro's net income will drop from $70 million to about $10 million?**

Answer:

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

As a preliminary comment we note that this point was made in consultation with the rating agencies and these financial impacts clearly outlined to them. Their response was that generally Phase 1 does not result in any appreciable impact on the ability of the Hydro operations to service its debt obligations and hence there was no alteration in their view of the debt servicing capability. As support for this conclusion, we point to the fact that Hydro did not have access to recall revenues prior to 1998 and yet its debt was viewed as self-supporting at that time. In addition, even when Hydro had access to recall and experienced a significant increase in its net income as a result, all resultant cash flows were nevertheless paid out as dividends. Hence there was virtually no positive cash impact on Hydro's debt servicing capability as a result of the recall agreement.

7. **In its 2005 rating report on Newfoundland and Labrador Hydro, DBRS cited a "two-thirds ownership in Churchill Falls (Labrador) Corporation Limited" as a rating "Strength". Under restructuring, CF (L) Co. will now be owned by Holdco. How does this relate to the statement in the financial section that the rating agencies "have expressed comfort" with the restructuring?**

Answer:

The "rating strength" afforded Hydro by virtue of its investment in CF(L)Co largely pertains to the positive impact of that investment on the capital stature of Hydro. While the impact is significant, it should be remembered that debt to capital is really only an indicator of debt servicing capability and that further analysis is required in order to determine whether in substance, the investment actually enhances debt service capability from a cash flow perspective. In the case of Hydro's investment in CF (L) Co, the positive cash to Hydro is virtually negligible in that all dividends from CF (L) Co were passed through to the Province. So in actual fact, there was little or no enhancement of Hydro's debt servicing ability by virtue of its investment in CF (L) Co.

Having said this, it is recognized that dividend payouts are essentially discretionary, and hence there is a level of flexibility provided Hydro by virtue of having access to earnings from its investment in CF (L) Co in the first instance. With this in mind, it is Hydro's intention to conduct ongoing consultation with the rating agencies as we proceed to implement this strategy, to ensure that the self-supporting characterization of Hydro's debt is preserved.

8. **Consultations**

We assume the discussions with "lead managers of Hydro's borrowing syndicate" is a reference to the Canadian underwriting

group since Hydro does not borrow outside of Canada. Did the Canadian managers really comment on the preferred model in the US?

The presentation to the credit rating agencies (Annex VI) outlines the rationale for the restructuring, and explains the 3 phases, while focusing on the initial phase. It is a very "top of the trees" presentation and does not provide any financial information whatsoever, which is what the rating agencies would really expect to see before commenting on any potential rating impact.

Answer:

Yes, consultation was had specifically with RBC and Scotia Capital.

With respect to the reference to the U.S., we had requested that this be removed from the document but unfortunately this does not appear to have been done. While Scotia Capital was prepared to stand by the reference to the U.S., RBC was not and for that reason, we had asked that it be removed.

Quantitative data was supplied to the rating agencies in terms of the anticipated impact on the balance sheet of Hydro. The following is an excerpt from speaking notes that we had prepared outlining areas to cover in our consultative sessions with them:

- "We need to focus on key impacts on financial profile of the current Hydro as well as a view to what the new Holdco will look like.

- We know that with regard to NLH, the debt to capital will move just north of 80% from its current level of 75%[2].

- DBRS currently discloses a target for regulated operations of 20%; so basically the point we want to make is that in the short term, we will move just north of our regulatory target, but with a supportive dividend policy, our plan is to achieve the 80/20 target by the 2009/10 period.

- Net income for Hydro will be impacted significantly by the removal of CF earnings and recall (from \$70 million back to about \$10 million). The point we want to make here is that this is then a purely regulated company with significant protections over the \$10 million including protections against the following risks:

[2] DBRS familiar with the 2004 and 2005 levels of 75% and 73% respectively. Have not yet seen 2006 numbers which are at 70%.

- Oil prices
- Hydrology
- Load

We also need to make note of the fact that in previous years, virtually all cash flows from recall and our investment in CF(L)Co were passed through to the Province as dividends.

- Our focus on Holdco should be on explaining to them that it will have a healthy debt to capital ratio supported by robust earnings from recall. Targeted debt to capital would be 80%. The intent is that it would have its own rating and that we would be issuing guaranteed debt to support our un-regulated activities with spin off to non-recourse as and when the maturity of a given project warrants.

- Both companies governed by a supportive dividend policy.

The above points were raised with each of the agencies, so they were made well aware of what the financial impacts of the proposed move would be on the balance sheets and income statements of both companies.

9. **Principal Concern**

Currently, the rating agencies view Hydro's debt as self-supporting and do not include it in their financial analysis of the Province (i.e. in total debt, per capita debt, debt to GDP, etc.). Given the previous comments about "regulated" Hydro's increased debt to capital ratio, reduced net income and, to the extent that Hydro's return on equity (as established by the Public Utilities Board) continues to be below market, the rating agencies could determine that they can no longer consider all of Hydro's debt as self-supporting. Such an action may very well have an impact on the Province's ratings.

While the Paper states that regulated Hydro's net income is protected against certain risks (oil prices, hydrology, load) going forward it will be more important than ever that the PUB approve a rate of return comparable to investor-owned utilities. From this perspective, the Paper does not indicate whether this restructuring will have a positive/negative/ or neutral impact.

Answer:

Under "Financial Considerations" it states:

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

> "Hydro does not foresee any appreciable immediate impact on its consolidated financial profile or that of the Province as a result of these proposed changes. While there will be changes in the financial profile of Hydro on a non-consolidated basis as some assets are transferred to Holdco and liabilities reduced, on a consolidated basis Hydro's financial profile will effectively mirror the current consolidated profile of Hydro."

The feedback received from the rating agencies was that they regarded Phase 1 as being generally benign in terms of the financial position of the Hydro Group. They were actually more focused on Phase II & III and asked that we consult with them again prior to moving forward on these.

While the comments with respect to the impacts on Hydro's debt to capital ratios and its net income are well taken, it should be remembered that rating agency analysis is largely focused on cash flows. To this extent, little will change with respect to Hydro. In the case of both recall and its investment in CF (L) Co, all cash flows from these activities in the past were paid out as dividends. Hence, Hydro derived no positive cash impact and yet its debt was viewed as self-supporting. Under the new scenario, Hydro still receives no cash benefit from these activities, so little will have changed.

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

KEN CURTIS QUSTIONS

1. There is another item with respect to this submission. In Annex I, it Is indicated that Section 19 (4) of the Hydro Act would not be required By Holdco. The PSS advises that it would be better to keep this Provision in place. There is an MOU between Government and NAPE which Indicates that if this provision is ever rescinded, removed, deleted, Etc. affected employees would be entitled to receive the related wage Increases retroactively. The PSS feels removal of this provision for Holdco could potentially mean affected employees would be entitled to The retroactive wage increases and it could be precedent setting for Other groups.

Answer:

We have no problem with s. 19(4) being maintained in the Hydro Act and included in the Holdco Act.

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

ED O'REILLY QUESTIONS – May 4/07

1. Recommendation 1 I there is no discussion in the paper with respect to Changing the number of directors from 10 to 14. Can you provide some? Elaboration.

Answer:

This suggestion is based largely on an anticipated need for a broader skill set on the Board in order to deal with and to address that broadened mandate.

2. Recommendation 1 k - why is there is a reference with respect to the Appointment by LGIC and not the shareholder. Hydro Act specifies LGIC; Is there a nuance here that I am missing?

Answer:

This will keep the authority to appoint the CEO of Hydro with the Government as opposed to giving it to the shareholder of Hydro, which will be Holdco.

3. Recommendation 2 - A committee of the Board would make recommendations to LGIC; however, there would be additional restrictions that would limit board appointments by LGIC as there would be a requirement for independence (2a) of majority of the board members. I guess this has not been the case in the past? This would become policy as identified in the Appointments to Government Agencies, Boards and Commissions.

Answer:

Correct.

4. Recommendation 2c I think I understand why this recommendation is Written as policy versus inclusion of in section 5, but I will ask Anyway. Why would you not include this piece under section 5 of the Act.

Answer:

It was felt that by excluding it from the Act it would provide more flexibility if for some reason it was not desirable that a director continue on after his or her term has expired; presumably an OC could be passed to terminate the director in such a case. Also, it was seen as an unnecessary change to the legislation as it could be handled in another manner.

5. On page five it is stated "The pursuit of business opportunities in a Competitive environment will require timely decision-making within well Defined parameters. An independent Board of Directors is essential to This process, bearing in mind that certain decisions because of their Magnitude and potential impact on the shareholder will always require Cabinet approval. "Is this a function of having regulated and Unregulated companies separated? The reference to independent - is this A reference to the criteria? Was/is Hydro's board independent? Will Certain decisions requiring Cabinet approval are similar to what is Occurring with Hydro now? What type of decisions require Cabinet Approval?

Answer:

This would not be a function of separating the regulated and unregulated companies as Hydro presently has what we consider an independent Board (9 of 10 directors are independent as per the criteria). Certain decisions require cabinet approval ie. setting up a subsidiary of Hydro, long term borrowings, etc. It is not intended that such requirements for Cabinet approval be eliminated for either Hydro or Holdco.

6. Page 6 - Provincial Control With respect to government being required To provide a written directive which can relieve directors of their Fiduciary duty;

- **a. This would not be the case presently with Hydro?**
- **b. Are there potential impacts for government with this change?**
- **c. Would Government have to go through Holdco in order to issue directives to Hydro?**

Answer to 6.a.

No there is presently no provision applicable to Hydro which relieves directors of their fiduciary duty for adhering to a government directive.

Answer to 6.b.

An impact for the government if such a provision were applicable would be that on certain directives to the board, ie. ones that the board members had concern that they were not in the best interests of the corporation, they would have to be put in writing. If recommendation 1.d is accepted it would allow government to issue specific directions to the Hydro board.

It should be recognized that the presence of this clause may hamper Hydro's argument for a rate of return on its regulated equity consistent with that earned by other investor owned utilities. A principal argument of the regulator for the current relatively low level of return is the apparent degree of control exercised over the company by the shareholder in comparison to that of other investor owned companies. This clause could bolster that argument.

Answer to 6.c.

Yes if this recommendation was not included in the legislation.

7. Page 8 4th Para. What would happen if consent of parties to contracts Is not received to assign contracts to Holdco?

Answer:

The restructuring will continue in any case. The principle benefit of the restructuring relates to our ability going forward to anticipate and execute on business investment opportunities consistent with Hydro's new mandate. While it would be beneficial for all of Hydro's current non-regulated activities to be transferred to the new company, the fact that some of them might not, does not detract significantly from the expected benefits of this move.

8. There are still unanswered questions related to the application of Various governmental Statutes of general application. This may be an Issue esp. with Holdco. On page 4 key objective discuss Transparency And accountability initiative being maintained.

Answer:

It is anticipated that most if not all statutes of general application will apply to Holdco/Hydro. With respect to Transparency and Accountability, if this legislation were not to apply, Holdco/Hydro would be obligated through the provisions of their own legislation to abide by the spirit of that legislation, ie. annual reporting, approval of borrowing, etc., but the requirements relating to accountability and transparency would be tailored to the operations and needs of Holdco/Hydro. This issue will be addressed as part of Hydro's ongoing review and will be completed prior to drafting.

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

9. Supportive dividend policy I guess means Government does not take any dividends? In the past 2 years this was $100 million?

Answer:

No a supportive dividend policy does not mean no payment of dividends. A supportive dividend policy should be viewed in the context of what is necessary for Holdco's debt to be viewed as self-supporting. Hence, dividends can be paid as long as Holdco maintains a sound financial position whilst in the pursuit of the new mandate. A supportive dividend policy is one which recognizes these objectives and sets clear financial parameters for the company's financial position that must be adhered to, prior to dividends being paid.

ED O'REILLY QUESTIONS – May 5/07

1. What is the CF(L)Co Voting Trust Agreement with Computer share Trust Company of Canada?

Answer:

This agreement deals with a block of Hydro's shares in CF(L)Co which have been placed in trust. These shares are the shares which Hydro-Quebec will acquire if it makes payments on behalf of CF(L)Co under Articles V and VII of the Power Contract. Notwithstanding that they have been placed in trust, the shares are under the control and direction of Hydro.

2. What will be the debt to capital for Hydro unconsolidated?

Answer:

Presuming that we are talking about Hydro following the transfer of all non-regulated assets and liabilities to Holdco, then the answer is that we estimate 83% opening debt to capital for Hydro.

3. My understanding as per the submission is that it is still unknown as To how legislation will be drafted i.e. with corporations act with Exceptions (Would this mean having a Holdco Act and a Hydro Act?) Or Combining the 2 crown corps under 1 piece of legislation

Answer:

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

The applicability of the Corporations Act will not affect whether there are 2 separate Acts or one combination Act. We believe there should be two so that the incorporation of the holding company is done separately from the incorporating legislation of Hydro, which will be only one of the subsidiaries of the holding company. A suggestion was made that including the incorporation of Holdco under the Hydro Act may speed up the process, but this should be avoided as the incorporation of Holdco under the legislation incorporating a sub of Holdco does not seem appropriate. The combined legislation would have to be in two parts in any event to separate the provisions applying to each company, which would be similar to drafting two pieces of legislation. Also, Holdco could be the parent of several subs so it seems to be appropriate that it have its own stand alone incorporating legislation. This issue will be addressed with Legislative Council.

4. Need some justification for recommendations 2 a, b and c. What is Communications view of these recommendations - any communications Concerns?

Answer:

During 2006, the Hydro Board of Directors created a Corporate Governance Committee. The primary role of the Committee was to undertake a review of Hydro's corporate governance practices. The objective was to move the corporate governance practices to a level consistent with those found in publicly-traded companies. Improving the corporate governance practices was seen as enabling the Board to operate more effective, be more accountable to the Shareholder, and to support Hydro's eventual increased participation in the capital markets. The corporate governance recommendations included in the paper are those that the Board identified as requiring Shareholder support. These recommendations regarding Cabinet policy will not be part of the legislation and as such, will not be open to public debate.

5. How will the Corporations Act bring clarity to Hydro with respect to Shareholder control and enforceability of contractual documents?

Answer:

Shareholder control is addressed under Section 245 of the Corporation Act. The reference to enforceability of contracts relates to Section 32 of the act which addresses the use of the corporate seal.

HYDRO RESTRUCTURING
Responses to Questions Forwarded by C. Bown May 6/07

6. Why will Electrical Power Control Act apply to Holdco?

Answer:

It is necessary in order to protect the ability of the PUB to allocate and control electrical power produced in the Province in case of emergency. LGIC can exempt particular activities of Holdco from the authority of the EPCA.

7. Would you be able to put a little meat on the attached table?

Answer:

The "meat" is basically contained in the cabinet paper. The phases as outlined were indicative of Hydro's intended direction going forward. Beyond what we have outlined in the cabinet paper and in our responses to these questions, it is difficult to be any more definitive at this point. Further detail as to appropriate structural changes and/or financing strategies will evolve as business opportunities are assessed and approved for development.