MEMO

To: SNGR Chief & Council

From: SNGRDC Board of Directors

Date: July 5, 2022

Re: **ITC/ Lake Erie Connector project**

Background

The Lake Erie Connector ("LEC") is a bi-directional 1,000 MW high voltage direct current underwater transmission line that will provide a direct connection between the Ontario power grid (via the IESO) and PJM which is a regional transmission organization in Pennsylvania, USA. There are several benefits associated with the LEC project, the most significant being an improvement to system reliability, reduction in greenhouse gas emissions, and significant ratepayer savings.

Over the past several years the project went largely silent due to shifting political priorities. However, this recently changed with the current Ontario government's focus on reducing hydro cost for Ontario ratepayers. The Canada Infrastructure Bank also recently announced its intent of financing up to $695 million in the LEC project – this has triggered a re-emergence of the project as a potential addition to the Ontario power system.

In June 2014, LEC was acquired by ITC Holdings Corp (ITC), ITC is a subsidiary of Fortis Inc. which is a public company originally founded in 1885 and is currently traded under ticker symbol FTS on the NYSE and TSE stock exchanges. Fortis owns diverse energy assets in Canada, United States, and Caribbean, with a total asset value of $57B, and annual revenues >$9B. Fortis Inc. operates in 17 regulated jurisdictions and hold several assets in Ontario, including a partnership position in Wataynikaneyap Power a project owned alongside 24 First Nations in Northern Ontario.

SNGRDC management believes this project fits within the economic development function of SNGRDC and as such has sought a renewed mandate from SNGR to pursue a potential equity position in the LEC project. On October 25, 2021, the President/CEO attended a Political Liaison meeting with Lonny Bomberry, SNGR Director of Lands & Resources, where the Director recommended that SNGR appoint SNGRDC as the lead on the LEC project moving forward. SNGR passed resolution **PL#107-25/10/2021** approving SNGRDC as the lead on the project.

SNGRDC is very familiar with these types of transactions and possesses the requisite experience and corporate structure to accomplish the following:

- Create a new special purpose entity/ LP to hold an ownership interest in LEC;
- The capacity to conduct investment due diligence;
- The capability to contract with ITC to secure equity financing;

- The ability to coordinate community outreach to educate the community on the project;
- The capacity to actively manage and monitor investment returns; and
- The structure to provide corporate income tax mitigation through SNGRDC's tax strategy.

As a best practice, SNGRDC and ITC entered into a Mutual Confidentiality Agreement (MCA) to discuss the terms for the potential direct or indirect economic participation of Six Nations. The MCA binds SNGRDC from disclosure of the project for a period of five years, without the consent of ITC.

In addition, ITC has committed to fund SNGRDC's due diligence costs in an amount up to $250,000. A Capacity Funding Agreement (CFA) was executed to capture this commitment. These funds will be used to complete SNGRDC's due diligence on the project while assessing the business viability (legal, environmental review, financial analysis, community outreach, etc.).

Term Sheet

A term sheet was entered into on February 8, 2022 between SNGR, SNGRDC and ITC. The term sheet provided the following participation options:

1. Option 1 Equity Ownership
   The LEC project includes an opportunity for Six Nations to secure a 7.5% equity (ownership) position in the transmission asset at an estimated cost of ~$26 million. LEC project is being developed using an Ontario Energy Board regulated rate base revenue and financing (60/40 debt to equity) model.

   In exchange for the investment, Six Nations would hold a 7.5% ownership in the LEC project for the entire life of the asset which conceivably can be 55+ years with proper maintenance and upkeep. Although the rate of return is regulated, the ownership of transmission assets is one of most coveted investments available on the market because the rate of return is underwritten by a contract with the Independent Electricity System Operator (IESO).

   Based on preliminary financial analysis prepared by our financial advisor, First Canadian Property Investments Ltd., the equity option had the potential of generating ~$44M in ownership distributions over the next 40 years with the possibility of generating up to ~$90M if the contract is extended to 55 years. These figures do not include any terminal value estimate.

2. Option 2 Participation Payments
   An alternative option to equity ownership is the option of receiving an annual "participation payments", without securing an ownership position in the LEC asset. Participation payments are significantly less and are expected to yield up between $30M - $40M over 40 and up to ~$58M over 55 years. The participation payment option does not provide any ownership interest in the asset, now or in the future.

3. Option 3 No Participation
   SNGR has the option not to participate – in this case there will be no participation payments royalty or equity ownership distributions.

Community Benefit Payments

In the event option 1 or 2 are selected, Lake Erie LP will enter into a Community Benefit Agreement (CBA) directly with SNGR, which in exchange for securing project support, will provide the following financial benefits paid directly to SNGR:

a. *Initial Payment*: An initial payment of $100,000 CAD to be paid within 10 business days of signing of the Community Benefit Agreement;

b. *Annual Payment prior to COD*: A payment of $225,000 CAD to be paid on the Financial Close Date of the Project and annually for three subsequent years (totaling $900,000 CAD); and

c. *Annual Payment commencing at COD*: A payment of approximately $118,000 CAD per year. This payment is an annual Project cost which would continue until the Project is abandoned or decommissioned.

The total value of the CBA payments is approximately $5.7M over the 40 year term.

<u>Current Situation</u>

Upon execution of the term sheet, SNGRDC initiated a community investment review process and commenced due diligence which included retaining legal advisors, environmental engineers, financial advisors, and a community engagement firm - all costs of which are funded by the CFA. All due diligence materials, reports, and supporting documentation will be retained indefinitely and accessible to the public on the snfuture.com website.

Due Diligence activities & outcomes

1. <u>Legal Review:</u> Legal counsel for SNGRDC, Fogler Rubinoff LLP, have completed a legal review of the definitive agreements associated with the Six Nations potential participation in the project, the agreements are:

    - Limited Partnership Agreement (if Option 1 is selected)
    - Project Participation Agreement (if Option 2 is selected)
    - Community Benefit Agreement – attached (comfort letter from Blakes LLP is attached)
    - Limited Recourse Guarantee
    - Securities Pledge
    - Subscription Agreement

    The law firm is satisfied that the definitive agreements are in a substantial final form to accurately capture the transaction and protect our interests. Depending upon the option selected, additional legal work is required to ensure the definitive agreements fully conform to the level of participation selected. A comfort letter from Fogler Rubinoff LLP is attached.

2. <u>Financial Review:</u> First Canadian Properties Ltd. has completed their independent financial assessment. This financial review included analyzing and assessing the following components:

    - June 30, 2022 updated financial model
    - Lenders technical advisory report
    - LEC transmission procurement agreement

    There were noteworthy changes in the project economics – these are summarized in Notable Changes below.

    The conclusion of the independent financial states, *“From virtually all perspectives, our analysis* *indicates the equity option should be considered seriously for investment" and further "We are therefore satisfied that this is an attractive investment opportunity for Six Nations of the Grand River and SNGRDC. While in our view, the royalty and equity options are both attractive at the same level of risk, the latter promises greater returns to long-term equity owners"* (ref report pg. 16-17). The final report is attached.

3. Environmental Peer Review: Neegan Burnside Ltd, an Indigenous Engineering and Environmental consulting firm, have completed a review of technical documents associated with the project (approval process, cumulative effects, fish and fish habitat, water quality, environmental management, air and noise impacts, terrestrial habitat enhancement, cultural impacts and archaeological). The report was submitted to SNGR on June 27, 2022.

   There were no major risks identified in the report; all low and medium risks have a mitigation plan and are fully documented in the final report (ref report, Table 6, pgs. 42-51)

4. Community Engagement: Dillon Consulting Ltd. facilitated the community investment review from March 1 to April 30 and the final report was submitted to SNGR on June 27, 2022. The investment review process spanned 60 days and consisted of 9 virtual and 1 in-person sessions, was broadcasted using Facebook live and the campaign had the capability to accept online and written submissions. Based on the final report there were 49 direct participants and a total audience of 1,860 using social media metrics.

   Dillon's report concluded the investment review was inconclusive on which option was most supported by the participants.

   ITC has reported to SNGRDC and publicly that they have been engaged with the HCCC via the HDI since 2014, we are not a party to those discussions and are unaware of current status.

Notable changes since Term Sheet Execution:

1. Option 1 (equity ownership) increased to 10%

Rising interest rates and to a lesser extent commodity pricing have had a negative impact on project economics. These factors have negatively impacted the equity returns previously expected at 7.5% ownership. In response, SNGRDC negotiated an increased ownership option of 10%.

If selected, this option will increase our investment to ~$33M (formerly $26M at 7.5% equity ownership) and the total net cash flow (after debt servicing) to Six Nations during the first 40 years is expected to be $43M. It is important to note that this level of cashflow is not evenly distributed over 40 years, rather the cash flows hover below $1M per year until year 40 when there is a sizable one-time payment which may occur in the event a contract extension is not secured. It's best to view the $43M as a worst-case scenario.

As originally contemplated, ITC is committed to sourcing our equity investment requirement ($33M) through incremental senior debt secured by the project assets. This provides a few key advantages to Six Nations:

a. Lower cost of capital and interest rate certainty

b. Amortization period extends to 55 years

c. Debt is non-recourse to Six Nations

2. IESO purchase option

Due to an inability to predict energy demand and cost structures 40 years into the future, the IESO has negotiated a purchase option at year 40. In this scenario, the IESO has the ability to acquire the Lake Erie LP project for its net book value, less outstanding debt, for a net amount estimated to be $227M. Should this occur, Six Nations would receive approximately $11M in exchange for its 10% interest.

Rather than proceed with the sale, the preferred scenario is for the parties, Lake Erie LP and IESO, to agree on an extended contract for an additional 15 years. In this case Six Nations would earn a 10% share of the profits which are estimated to be as high as $38M. In this best-case scenario, Six Nations could generate as much as $70M over the full 55 years.

At this point there is no way to predict which option may be selected. In either case there is a sizable economic benefit to the community 40 years into the future.

3. Sub-contracting & Employment opportunities

Additional language has been added to the LEC Engineering, Procurement and Construction (EPC) and the Community Benefits agreements to ensure subcontracting and employment opportunities will be made available to Six Nations. A6N is engaged to assess sub-contracting opportunities and the EPC contractor is in active talks with Grand River Employment & Training.

4. Deferred Equity Participation Option

ITC introduced an alternative option which is best characterized as a 'deferred equity participation option'. In this scenario, Six Nations would secure Class B exchangeable shares at financial close which would have the right, but not the obligation, to convert into Class A shares 2 year's post commercial operation date. The challenge which this option is that there would be no financial benefits flowing to the community for the first 2 years and Six Nations would need to bring its own funding to acquire an ownership interest. This is not an attractive option to Six Nations.

Informed Decision

While the project economics are attractive, it is important to highlight other value streams associated with the project. These items should be viewed as key factors to help inform the final decision:

1. **GHG reduction**: The LEC project is expected to remove between 80 – 150 million tons of green house gas over the next 40 to 50 years.
2. **Optimization of Six Nations renewable assets**: The community has invested heavily in wind and solar projects, they are contributing to GHG reduction and generating revenue for the community. Unfortunately, the energy system in Ontario isn't perfect and is constrained by design flaws; as a result our renewable energy production gets curtailed if power doesn't get utilized when generated. This means all ratepayers are paying for power in some cases when it is not needed – this creates social and political frustration around renewable energy. The LEC project will help unlock some of grid inefficiency by introducing a tool to export power when its not needed – this will improve the economic performance of our

current assets and lead towards future renewable energy procurement which is good for the environment.

3. **Maximize use of existing energy assets**: The existing Nanticoke transmission corridor significant unutilized capacity, the LEC will make use of this capacity which will help mitigate the need to build new transmission corridors and avoid further environmental impacts.
4. **Energy security**: As society continues to grow and evolve, we all need energy reliability for our homes, schools, and hospitals. The LEC enhances the Ontario energy grid by providing a new tool to help manage system requirements.
5. **Rate payer savings**: The LEC project is expected to trigger $4 billion in rate per savings over the next 40 years ($100 million/ year). This will benefit all hydro consumers, Six Nations included - it doesn't mean free hydro but it is designed to help.

Based on the feedback from our comprehensive due diligence and the findings of the investment review process, SNGRDC is recommending the following:

Recommendations

1. That the Six Nations Elected Council accept and approve the Lake Erie Connector Community Investment Review Report prepared by Dillon Consulting
2. That the Six Nations Elected Council accept and approve SNGRDC's Board of Directors recommendation to complete a 10% equity ownership option in the Lake Erie Connector Project to be held by SNGRDC
3. That the Six Nations Elected Council approve Chief Mark Hill to execute any and all required definitive agreements to complete the 10% equity ownership by SNGRDC in the Lake Erie Connector Project, **subject to any additional changes vetted by legal counsel.**
4. That the Six Nations Elected Council approve the Community Benefits Agreement for the Lake Erie Connector Project **subject to any additional changes vetted by legal counsel**, and further authorize Chief Mark Hill to execute.
5. That the Six Nations Elected Council waive second reading on all the above.

Attachments:

- Community Benefits Agreement
- First Canadian Property Investment Ltd Final Report
- Blakes, Cassels & Graydon LLP letter
- Fogler Rubinoff LLP letter

Attachments previously submitted:

- Dillon Consulting Community Investment Review Report
- Neegan Burnside Due Diligence Review Report