Divestment of Ontario Northland Transportation Commission
Special Report
December 2013
To the Honourable Speaker
of the Legislative Assembly

I am pleased to transmit my Special Report on the Divestment of Ontario Northland Transportation Commission, as requested by the Standing Committee on Public Accounts under Section 17 of the Audit General Act.

Bonnie Lysyk
Auditor General

December 2013
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1.0 Reflections

There are several key lessons to be learned from the Ontario Northland Transportation Commission (ONTC) divestment process. They are:

- Any undertaking as complex as the sale of a government agency, especially one with the scope and reach of the ONTC that involves hundreds of millions of dollars, nearly 1,000 jobs, and key services to dozens of smaller communities in northeastern Ontario, requires a thorough business-case analysis that provides objective, complete and defensible information for decision-making. After announcing on March 23, 2012, its plan to divest the ONTC by March 31, 2013, the government stated in an addendum to the 2012 Ontario Budget (see Appendix 1) that this measure would save $265.9 million over the next three years. However, this did not clearly or fairly communicate the potential financial impact of the proposed divestiture. Also, the risk was high that these savings would not be achieved because they were dependent on the optimistic assumption that divestment would occur within one year of the announcement. It was only well after the divestment announcement of $265.9 million in savings that the government obtained the information that would normally be needed for a comprehensive business-case analysis. This information, along with information we obtained during our work, indicates that there are both known and not-yet-known costs associated with divesting the ONTC. The known costs may be as high as $820 million, and recouping this amount by the government no longer paying the ONTC the normal annual operating and capital subsidies it has been providing could well take a decade or longer. The Ministry advised us that costs will be managed to avoid the worst-case scenario and that the payback will depend on how divestment transactions and other initiatives are finalized. It also indicated to us that detailed due diligence is planned to be performed on any future ONTC business-line divestment proposals provided to the government for specific approval.

- Constructive ministry/agency relationships and effective governance are critically important. The Ministry of Northern Development and Mines (Ministry) and the ONTC did not have a trusting or open relationship, so transparent and open communication did not consistently occur. As well, with complicated initiatives such as divestments, for which there is no pre-established blueprint for government to follow, it is important that there be clarity around roles and responsibilities. Our sense in this case was that there could have been more clarity. As a result of keeping
the ONTC out of initial divestment discus-
sions, the Ministry’s ability to provide the
government with complete information, and
therefore a complete initial financial analysis,
was impacted. With the establishment of the
Minister’s Advisory Committee, the role of the
ONTC’s Transition Board became less clear.
There is a need to clarify the governance of
the ONTC to ensure that ongoing operations
are not negatively impacted during this period
of change.

- Stakeholder involvement in major initiatives is
  important. The government made the ONTC
divestiture announcement without consulting
key stakeholders such as customers, unions,
and the ONTC Board of Directors and senior
management. This in turn created uncertainty
in the marketplace about the ONTC’s operations
and its ability to obtain new business opportu-
nities. There is a lack of information around what
the ONTC will look like in the future or whether
there will even be an ONTC. The government
has since said that going forward, it will consult
northerners to seek possible alternatives to an
outright sale of ONTC assets.

- Planning for, and funding, long-term capital
  requirements is important in order to provide
services using infrastructure that is safe and
reliable. In the case of the ONTC, ongoing
annual capital spending has not been suffi-
cient to plan for and complete improvements
to properly maintain the infrastructure for
which the ONTC is responsible in northeast-
ernor Ontario. Instead, the ONTC has had to
rely on annual capital plans with periodic
special requests to the province when such
funding was deemed absolutely essential to
ensure that services could continue and safety
risks were managed.

There is little doubt that without change, the
operation of the ONTC in its current structure
will require taxpayers to subsidize its operations
on an annual basis. While we believe that the
government initially underestimated the costs and
efforts associated with divesting the ONTC, we
acknowledge that, on a long-term basis, divesting
the ONTC would reduce the taxpayer burden. On
the other hand, without change, there may well be
socio-economic benefits to justify subsidizing the
ONTC. However, this is a policy decision for the
government of the day to make, and it is not up to
the Auditor to comment on whether the proposed
divestment is a good or a bad idea.

This report provides context around the
March 23, 2012, public announcement on potential
savings from the ONTC divestment and highlights
the importance of full and clear communication
when a significant initiative like this is undertaken.

2.0 Background

The Ontario Northland Transportation Commission
(ONTC) was established as a Crown agency in 1902
under the Ontario Northland Transportation Com-
misson Act. Headquartered in North Bay, the ONTC
reports to the Ministry of Northern Development
and Mines (Ministry).

Until March 2012, the ONTC was mandated
under its Memorandum of Understanding with
the Ministry to provide efficient transportation
and telecommunication services in northeastern
Ontario as directed by the government of Ontario
through the Minister from time to time, including
the following:

- support and promote, through the services
delivered by the ONTC, northeastern Ontario
economic development, job creation and com-
munity sustainability;

- through its services, support, promote and
enhance linkages and clustering between
communities within the region and between
northeastern Ontario and other regions;

- deliver price-competitive transportation and
telecommunication services that are safe, reli-
able and responsive to customers, residents
and businesses in northeastern Ontario; and
• deliver services in a financially efficient and effective manner with an objective of improved cost recovery and self-sustainability. In fulfilling its mandate in the sparsely populated Northeast, the ONTC has operated at a loss each year. For instance, in the 2012/13 fiscal year, it had operating revenues of $97 million, but required operating and capital subsidies from the province totalling $78 million. Over the past decade, it has required total operating and capital subsidies of almost $500 million. It has more than 940 employees and services 53 northeastern communities through four primary business lines:

• **Rail Freight Services** provides passenger and freight service from the James Bay Lowlands to Toronto over 1,100 kilometres of track and infrastructure. The Northlander passenger service between Toronto and Cochrane was cancelled in September 2012, but the Polar Bear Express between Cochrane and Moosonee still operates. The ONTC owns and operates more than 400 locomotives and rail cars, 90 bridges and over 2,200 culverts, and is responsible for maintaining them. It handles almost all its maintenance at its heavy-equipment maintenance and repair shops in North Bay, Cochrane and Englehart.

• **Motor Coach Services** owns and operates 25 buses carrying passengers and parcels over 3.5 million kilometres annually into some of the smallest communities in the Highway 11 corridor in northeastern Ontario. It also connects with rail and other bus lines to provide service to Toronto. Coaches are serviced in-house at a combined administrative and operations facility in North Bay.

• **Telecommunications, called Ontera**, owns and operates over 2,000 kilometres of carrier-grade fibre-optic network in the Northeast, managing private networks for provincial organizations like eHealth Ontario and the Ontario Public Sector Network Access Service. It also provides connectivity to the Ontario Provincial Police, the courts, hospitals, school boards, First Nations communities, homes and businesses in the region.

• **Refurbishment Services** shares space with Rail Services at the ONTC’s mechanical shops in North Bay. In 2004, ONTC obtained an $81-million contract to refurbish 121 GO Transit commuter rail cars over a six-year period. However, in 2011, based on a public tender, Metrolinx awarded a $120-million GO Transit refurbishment contract to a Quebec-based firm. The ONTC’s business lines have been segregated as either commercial (rail freight, refurbishment, telecommunications and motor coach services) or non-commercial (Northlander and Polar Bear Express train services). Its infrastructure has aged over the years, and the ONTC’s 2009 Long-Term Sustainability Plan estimated that over the following 15 years it would need more than $735 million to cover capital costs to repair its aged infrastructure. Figure 1 illustrates how the ONTC’s historic capital spending has been below the industry benchmark of 17% of commercial rail revenue.

On March 23, 2012, the government announced in a news release that it planned to wind down the ONTC and called for the cancellation of the non-commercial Northlander train between Toronto and Cochrane. With the signing of a new Memorandum of Understanding between the Ministry and the ONTC on March 23, 2012, the ONTC Board of Directors was dissolved and replaced by a Transition Board appointed to work with the ONTC’s Chairman, and its President and Chief Operating Officer, to begin the divestment process. The revised ONTC mandate in this new Memorandum was to:

• divest the assets of the ONTC and implement alternative models of service delivery to provide transportation services in northern Ontario;

• wind up and liquidate any assets and obligations that could not be divested; and

• continue to provide efficient, safe and reliable services in northern Ontario as directed by the province until the completion of the divestiture process.
The government committed to protect services to rural and remote communities by providing an annual subsidy of $25 million to continue the Polar Bear Express train and up to a $2-million-a-year subsidy for motor-coach service to communities currently served only by the ONTC.

On March 27, 2012, the 2012 Ontario Budget announced that the divestment of the ONTC would result in savings of $265.9 million by the end of the 2014/15 fiscal year. A separate section of the Budget included $325 million as part of a government Transition Fund to cover some divestment costs. These costs were not separately identifiable as relating to the ONTC.

The decision to divest was part of the government’s 2012 Budget reductions and one of its policy responses to the 2012 report of the Commission on the Reform of Ontario’s Public Services, *Public Services for Ontarians: A Path to Sustainability and Excellence* (the Drummond Report). Released on February 15, 2012, the Drummond Report was intended to advise the government of Ontario on measures to balance the budget. Ministry documentation indicates that the government could not justify the existing level of subsidy to the ONTC in the fiscal environment at the time and could no longer subsidize unsustainable and/or non-essential services that compete with or can be delivered more efficiently by the private sector. Various operational initiatives had been undertaken between 2003 and 2011 to bring about sustainable cost reductions. Those efforts and initiatives are summarized in Appendix 2. The divestment of the ONTC was
Divestment of Ontario Northland Transportation Commission

placed on a tight timeline and was targeted to be completed within one year.

Because the Ministry required expertise to handle a divestment of this nature, Infrastructure Ontario (a provincial Crown agency) was engaged to assist with the divestment process. The Ministry, with assistance from Infrastructure Ontario, has been handling most of the divestment process (including presentations to Treasury Board).

Since the 2012 Budget announcement, the Northlander train (a non-commercial business) ceased operations on September 28, 2012, and Ontera (a commercial business line) has been put up for sale, with proposals from prospective buyers currently under evaluation. However, there has been no firm decisions made for the other business lines as of October 2013. ONTC senior management and staff view that they have been operating in a “holding pattern” under financial supervision by the Ministry, and with limited ability to make operational changes or initiate new business arrangements. On the other hand, in the Ministry’s view, with future public–private partnerships now delegated to Infrastructure Ontario, the ONTC can pursue new business opportunities that could generate positive cash flow.

The nature of the ONTC divestment process continues to evolve and is subject to considerable uncertainty. In March 2013, the newly appointed Minister of Northern Development and Mines announced the creation of a Minister’s Advisory Committee of northern representatives to provide input into a new transformation process, including advice on the timing of and approach to solutions for the ONTC. This Committee has also been asked to examine such alternatives to divestment as restructuring, alternative service delivery and new partnerships.

3.0 Summary

The 2012 Budget reference to $265.9 million ($325 million in 2012, $131.2 million in 2013/14 and $134.7 million in 2014/15) as “savings associated with the ONTC [Ontario Northland Transportation Commission] resulting from a combination of no longer subsidizing the ONTC and its expenses no longer being consolidated with the Ministry’s expenses,” did not include a number of other significant revenues and expenses that would need to be considered in determining any net savings resulting from the divestment of the ONTC. The $265.9-million figure represented only the reduction to the Ministry of Northern Development and Mines (Ministry) budget of the ONTC’s estimated gross operating expenses for 2013/14 and 2014/15, and optimistically assumed that the ONTC’s operations would be fully divested within one year of the budget announcement.

We acknowledge that another section of the 2012 Budget earmarked $325 million to cover some of the divestment costs, as illustrated in the first cost column of Figure 2. However, these costs were not separately identifiable as relating to the ONTC; rather, they were included in a $500-million government-wide Transition Fund announced in the Budget. The purpose of this government-wide Transition Fund was to cover the costs associated with a number of transformational initiatives being considered by the government in addition to the ONTC divestiture.

Subsequent to the Budget announcement, the Ministry began to obtain a fuller understanding of the total financial impact of the divestment, as indicated by the following:

- In July 2012, information (the first form of a divestment business case prepared with assistance from third parties) was submitted to Treasury Board by the Ministry, four months after the 2012 Budget was tabled. It estimated that potential ONTC divestment costs would be about $690 million, more than double the $325 million included in the 2012 Budget, as illustrated in Figure 2. It indicated that the ONTC divestment would be recovered over four to five years (that is, the cash-flow payback period) based on savings of $100 million
annually arising from the Ministry no longer paying operating and capital subsidies to the ONTC.

In March 2013, the Ministry informed Treasury Board that the high-range estimate of divestment costs, liabilities and asset impairment that will need to be managed as part of the divestment process had risen to about $820 million, as illustrated in Figure 2. Based on our estimation, these increased costs, combined with a reduction in the projected savings from $100 million to $73 million annually due to the government’s commitment to continue subsidizing the Polar Bear Express and certain bus routes, potentially extends the cash-flow payback period to seven to eight years. However, as with the July 2012 estimate, the March 2013 estimate did not include such as-yet-unknown costs as environmental cleanup of ONTC land, costs associated with the government meeting its duty to consult with Aboriginal peoples and subsidies that may need to be paid to potential buyers, which could extend the recouping of total costs through the elimination of the ONTC’s annual operating and capital subsidies to a decade or longer. The Ministry has indicated that it is intending to pursue strategies that will minimize the risks of the high-range estimate of costs being realized.

The estimated cash flows in these business cases are subject to a high degree of uncertainty. As well, until serious negotiations are undertaken with potential buyers of ONTC business lines and assets, the actual costs and any potential savings are difficult to estimate with a high degree of reliability.

The most recent analysis, completed in June 2013, shows that the costs of divestment are similar to those in the March 2013 column of Figure 2 and that the divestment option continues to present

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**Figure 2: Estimated ONTC Divestment Costs and Liabilities to be Managed — March 2012, July 2012 and March 2013 ($ million)**

*Source of data: Ministry of Northern Development and Mines*

<table>
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<tr>
<td>Labour/severance</td>
<td>25</td>
<td>293</td>
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<tr>
<td>Post-retirement benefits</td>
<td>70</td>
<td>70&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Pension</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Transaction costs</td>
<td>30&lt;sup&gt;a&lt;/sup&gt;</td>
<td>27</td>
</tr>
<tr>
<td>Annual subsidy to support Polar Bear Express and certain motor coach routes</td>
<td>27</td>
<td>27&lt;sup&gt;b&lt;/sup&gt;</td>
</tr>
<tr>
<td>Subsidy to close</td>
<td>To be determined*</td>
<td>To be determined&lt;sup&gt;**&lt;/sup&gt;</td>
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<td>Costs associated with the duty to consult Aboriginal peoples</td>
<td>To be determined&lt;sup&gt;a&lt;/sup&gt;</td>
<td>To be determined&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>Environmental clean-up costs</td>
<td>To be determined&lt;sup&gt;b&lt;/sup&gt;</td>
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Total Undiscounted Cash Outflows: 125<sup>2</sup> 490<sup>2</sup> 632<sup>2</sup>

Asset impairment (accounting writedown): 200<sup>c</sup> 200<sup>c</sup> 188<sup>c</sup>

Total Estimated Costs to Province: 325<sup>d</sup> 690<sup>d</sup> 820<sup>d</sup>

<sup>a</sup> While the government anticipates a subsidy to close will be required and has estimated an amount, the amount has not been disclosed because of commercial sensitivity while subject to negotiation with prospective buyers.

<sup>b</sup> Costs or liabilities triggered by divestment.

<sup>c</sup> Costs or liabilities that exist under status quo or divestment.

<sup>d</sup> Accounting issue triggered by divestment.

<sup>**</sup> Costs also referenced in June 2013 financial update to the Minister’s Advisory Committee.
significant positive financial impacts to the province when compared with a status-quo situation of the ONTC continuing to operate as it has in the past. Again, this will be dependent upon future negotiations.

The lack of clarity in the 2012 Budget reference to $265.9 million in savings has, in our view, resulted in differing interpretations of the estimated financial impacts associated with the ONTC divestment. Accordingly, we have presented four interpretations that came to our attention in reviewing documents associated with the proposed divestment. We believe the fourth one provides the most realistic assessment of the resulting costs and possible long-term savings of the ONTC divestment.

The financial challenges facing the ONTC can essentially be approached in one of three ways: through an internal restructuring and operational improvements; by selling part or all of its operations to the private sector (a divestment); or through a hybrid of the two. It appears that the province’s major incremental costs related to pension, severance and wage continuation would likely be similar in each scenario, because a private-sector purchaser would be unlikely to agree to assume all of these obligations without some compensation. As a result, these costs become largely unavoidable, and the province will likely continue to bear the responsibility for many of them regardless of the option chosen. Restructuring or divestment options could likely require substantive changes in staffing arrangements. There are complexities around labour agreements and the size of the organization that need to be considered.

We also noted the following with respect to the government’s 2012 Budget announcement regarding the divestment and projected savings:

- Full due diligence of the ONTC’s collective agreements was not completed prior to the Budget announcement. As a result, the government did not take into account the relatively high salary continuation and severance provisions in the collective agreements covering almost 800 employees accounting for 90% of the ONTC workforce, as well as a number of other factors, including the extent to which government subsidies may be needed. While the government has committed the operating and capital funding needed for the ONTC’s remaining public (non-commercial) services (Northlander ceased operations in September 2012), any proposed capital subsidy for a commercial business would be subject to a government policy decision.

- Under the original Memorandum of Understanding with the Ministry, the ONTC was expected to support job creation and maintenance as it provides public infrastructure to a small population over a vast geographical area (with complex environmental realities such as difficult weather conditions and muskeg rail bed concerns). At the same time, it must operate in a financially efficient and effective manner with a goal to improve cost-recovery and self-sustainability. These requirements can put socio-economic objectives in conflict with the government’s desire to achieve cost savings in light of the province’s current deficit.

- The divestment process has been, and continues to be, driven by the Ministry and the province, with assistance from Infrastructure Ontario. Based on representations made to us, there has been little input from ONTC senior management. While the ONTC’s Transition Board of Directors met a number of times between March and December 2012, its involvement decreased significantly with the subsequent establishment of a redefined ONTC transformation process in early 2013. Improved lines of communication and decision-making responsibilities between the Ministry and ONTC management during the divestment process could have improved the quality of the information available to assist decision-makers.

- At this point, it is unclear what will be done with those ONTC assets that cannot be divested.
The ONTC is currently operating in an environment where there is uncertainty among staff regarding their future employment and doubts on the part of potential and existing customers as to whether they should do business with the ONTC. The Ministry is currently controlling the ONTC's financial operations and, in the ONTC's view, has limited the agency's ability to consider new business opportunities. Additionally, the ONTC's capital infrastructure continues to deteriorate, which will also require additional investment to maintain the integrity of the assets. On July 29, 2013, the ONTC was asked to present a report on divestment options, which it prepared in September 2013. It was recently requested to present the report to the Minister’s Advisory Committee in early December 2013.

MINISTRY RESPONSE

Northern Ontario depends on quality services and vital infrastructure to grow its economy. While the Ontario Northland Transportation Commission (ONTC) has played an important role over the years in supporting regional economic growth for northeastern Ontario, there is strong consensus among community leaders that the current state of the organization is not sustainable in the long term. There is continued opportunity to address this and deliver services in a more efficient and effective manner. The status quo is not serving the best interest of Ontarians, and change is needed.

In the 2012 Budget, the Government announced its decision to divest the ONTC while maintaining funding for a vital rail link between Cochrane and Moosonee, and bus service to communities served only by the ONTC. Based on years of study and attempts to improve the business, the government determined that the ONTC was unsustainable and its services could be delivered more effectively and efficiently by the private sector. This was in keeping with the 2012 Report of the Commission on the Reform of Ontario’s Public Services (the Drummond Report).

The Addendum to the 2012 Budget identified $269.5 million in savings that the Ministry of Northern Development and Mines would achieve against its budget over the three-year period to fiscal 2014/15. However, the 2012 Budget also included a provision of $325 million for associated divestment costs under a three-year, $1-billion Transition Fund, which was set up to support transformation initiatives such as the ONTC.

This process involves the Ministry of Northern Development and Mines, Infrastructure Ontario, the ONTC and external advisers undertaking detailed due diligence analysis.

In early March 2013, the government signalled a change in approach and began consultation with key stakeholders on options for a more sustainable future for the agency. The Minister continues to work with his Advisory Committee to consider these options and ensure stakeholder voices are heard. The goal remains to ensure northern communities and industries benefit from viable, efficient and sustainable transportation and communications systems.

We are pleased that the Auditor General acknowledges the significant challenges and complexity of transforming the ONTC, and that a thorough business case is directly informed by the response from the market and the sales process. This analysis also helps with the assessment of other options and approaches.

The Ministry and the ONTC continue to work together to ensure safe, ongoing operations during this period, governed by a Memorandum of Understanding that sets out clear roles and responsibilities. Going forward, continued efforts will be made to ensure good governance and regular communication with the ONTC and senior management. The amended 2013 Memorandum of Understanding now reflects the Minister’s new direction of transformation, which may include restructuring, alternative service delivery and divestment.
The prosperity of northeastern communities remains of vital importance. The government has been clear that transformation of the ONTC requires a balanced approach that considers proceeds, sustained employment and investment in northern Ontario. This generates informed dialogue around the socio-economic benefits of delivering services through the public or private sector.

Any proposed transaction by government must be held to a high standard, with a fair, competitive and transparent commercial process. This has been led by Infrastructure Ontario and overseen by a Fairness Commissioner to avoid any real or perceived conflict of interest by the Ministry of Northern Development and Mines or the ONTC.

The Auditor General notes that complex public policy decisions will inform the future of the ONTC and that many of its current costs and liabilities exist under either restructuring or divestment. The Ministry continues to work with the Minister’s Advisory Committee to explore options to improve the sustainability of ONTC services while ensuring funding of vital public priorities. The government will take the time to meet the aims of sustainable employment, continued economic growth and a strong transportation and telecommunications network in northern Ontario.

**ONTC RESPONSE**

This report captures the complexity of, and financial demands on, an organization that tries to deliver services in a vast and unique geography and challenged economy. The historic realities are accurately summarized, and the challenges of the organization are reflected with clarity.

The report accurately reflects the numerous studies already conducted into the organization, along with their recommendations. Much was already known about the organization, which helped with the task of divestment, along with calculation of its costs.

The report is correct in citing that constructive and effective relationships and governance are critical for success. This is the most important observation in the report and must be addressed going forward in order to achieve a transformation that the region and government can say is successful.

The financial costs for the divestment process far exceed current financial plans. However, it is important to focus on the future and bring success to a region that so badly needs it in order to permit sustainability and a future for the people. This can really only be achieved through public policy.

## 4.0 Review Objective and Scope

On March 6, 2013, the Standing Committee on Public Accounts (Committee) passed the following motion:

> That the Standing Committee on Public Accounts direct the Auditor General of Ontario to undertake a special assignment, as per Section 17 of the Auditor General Act, R.S.O. 1990, to investigate the government’s divestment of, and the operations of, the Ontario Northland Transportation Commission, and the validity of the government’s claim in its 2012 Budget that the divestment will save $265.9 million by 2014/15.

In discussions with the Committee, we established that the intent of the motion was for us to consider those aspects of ONTC operations that could affect the publicly communicated savings and costs of divestment, rather than conduct a full value-for-money audit of the ONTC. An excerpt...
from an addendum to the 2012 Budget, reproduced in Appendix 1 of this report, was the focus of the Committee’s motion requesting us to examine the divestment.

We initiated this assignment with letters to the Minister and Deputy Minister of Northern Development and Mines, and to the President and CEO of the ONTC, in March 2013.

As part of our work, we examined documents and relevant financial information related to the proposed divestment and to the savings identified in the 2012 Budget. We also examined documents from the Ministry of Northern Development and Mines and ONTC documents related to its operational initiatives dating back to 2000. As well, we interviewed key current personnel from the ONTC, the Ministry of Northern Development and Mines, the General Chairpersons Association (representing the ONTC's unionized employees), Infrastructure Ontario, the ONTC Transition Board, the Minister’s Advisory Committee, and the Ministry of Finance.

We visited the ONTC’s head office and operations facilities in North Bay in November 2013.

It should be noted that a significant portion of the estimated future costs have yet to be incurred, and that the projected savings from divestiture are estimated to be realized in the future. Making assumptions about future events and their effects involves considerable uncertainty. Accordingly, readers should be cautioned that the estimates discussed in this report will also likely differ from future actual costs and savings.

5.0 Detailed Observations

5.1 FINANCIAL OVERVIEW OF ONTC OPERATIONS

A series of operational initiatives over the past decade, outlined in Appendix 2, concluded that the ONTC’s financial outlook was deteriorating, while the need for government investment and operating subsidies was increasing. The ONTC's financial results by business line for the 10-year period 2003 to 2013 are shown in Figure 3. In each of the 10 years since 2003, all of the ONTC’s key business segments have experienced operating losses.

The ONTC co-ordinated the preparation of a Long-Term Sustainability Plan (LTSP), completed in 2009. Some of the factors noted in the LTSP that contributed to the ONTC’s deteriorating financial outlook are cited in Appendix 2. These factors included insufficient capital funding of rail and telecommunications infrastructure; reduced freight revenues following a decline in forestry and mining shipments, combined with extreme variations in the cost of diesel fuel; and ONTC staff levels in rail services that were twice the industry norm. The LTSP concluded that in addition to its own revenues, the ONTC would need more than $660 million in government operating and capital subsidies over the 15 years from 2009 to 2024 to effectively deliver its mandate, with cash requirements being greater in the first few years because of the need to repair capital infrastructure such as rail beds and track structures to ensure continued safe and reliable operations. These cash requirements would address capital-spending backlogs that had accumulated over 20 years. The LTSP also identified initiatives that the ONTC was proposing to undertake, including business process improvements, establishing relationships with the Ministry of Transportation and the Ministry of Energy and Infrastructure, a new labour partnership, involvement in the proposed growth plan for northern Ontario, and First Nation Partnering. The LTSP also highlighted the impact of the ONTC's contribution to northeastern Ontario’s gross domestic product. It was estimated that every dollar of direct revenue produced by the ONTC was worth $2.61 to the province as a business output multiplier.

As noted in government news releases and backgrounders accompanying the 2012 Budget, the decision to divest the ONTC was based primarily on financial factors that included historical and projected funding levels required to sustain its operations. The government referred to the fact
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that the ONTC was on an unsustainable financial path, and that it would look to targeted private-sector involvement as a way to more effectively and efficiently deliver ONTC services.

To support its concerns regarding the unsustainable public-funding levels for the ONTC, the government disclosed the following ONTC financial and operating information in the March 23, 2012, press release:

- In the 10 years up to 2012, Ontario invested over $430 million in ONTC operations, with 50% related to the maintenance of capital assets.
- Based on current trends, current and future funding requirements from the government for the ONTC would be about $100 million a year, compared to just $27.6 million a year in 2002. (According to the ONTC, about 50% of the $100 million would be needed just to maintain the safety and integrity of its capital assets.)
- With the exception of a few peak periods, both motor coach and Northlander passenger services were operating well below 50% of capacity.
- The subsidy for the Northlander was four times more than the train earned from passenger fares. With the exception of a few peak periods, both motor coach and Northlander passenger services were operating well below 50% of capacity. The subsidy for the Northlander was four times more than the train earned from passenger fares.
- The ONTC management had not taken cost containment seriously. The review acknowledged that the ONTC had implemented part of a cost-containment plan prior to the divestment announcement, but implementation of the remaining measures in the plan was delayed by the divestment announcement.
- Unless a service is discontinued, some of the costs that are directly tied to the service, particularly the fixed costs, are necessary in order to deliver the service.

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Rail services</td>
<td>(18,451)</td>
<td>(20,251)</td>
<td>(23,196)</td>
<td>(15,938)</td>
<td>(25,084)</td>
<td>(28,637)</td>
<td>(34,908)</td>
<td>(36,362)</td>
<td>(40,267)</td>
<td>(31,058)</td>
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<td>Telecommunications</td>
<td>(5,957)</td>
<td>(6,918)</td>
<td>(8,490)</td>
<td>(3,391)</td>
<td>(1,225)</td>
<td>(134)</td>
<td>(3,170)</td>
<td>(2,151)</td>
<td>(3,877)</td>
<td>(1,238)</td>
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<tr>
<td>Motor coach services</td>
<td>364</td>
<td>599</td>
<td>53</td>
<td>960</td>
<td>(950)</td>
<td>(401)</td>
<td>(1,716)</td>
<td>(905)</td>
<td>(1,449)</td>
<td>(1,849)</td>
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<tr>
<td>Refurbishment</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>(3,575)</td>
<td>(2,959)</td>
<td>(2,366)</td>
<td>(7,242)</td>
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<td>Marine services (Moosonee)</td>
<td>(213)</td>
<td>(73)</td>
<td>(67)</td>
<td>(124)</td>
<td>(79)</td>
<td>(76)</td>
<td>(26)</td>
<td>(94)</td>
<td>(217)</td>
<td>(323)</td>
</tr>
<tr>
<td>Rental properties/development</td>
<td>496</td>
<td>165</td>
<td>229</td>
<td>204</td>
<td>206</td>
<td>290</td>
<td>139</td>
<td>209</td>
<td>197</td>
<td>154</td>
</tr>
<tr>
<td>Administration</td>
<td>(7,793)</td>
<td>(7,202)</td>
<td>(7,827)</td>
<td>(7,413)</td>
<td>(7,705)</td>
<td>(7,321)</td>
<td>(9,250)</td>
<td>(9,611)</td>
<td>(9,842)</td>
<td>(9,312)</td>
</tr>
<tr>
<td>Total</td>
<td>(31,554)</td>
<td>(33,680)</td>
<td>(39,928)</td>
<td>(29,277)</td>
<td>(37,796)</td>
<td>(38,645)</td>
<td>(56,173)</td>
<td>(50,246)</td>
<td>(58,444)</td>
<td>(47,846)</td>
</tr>
</tbody>
</table>

Note: Figures exclude certain immaterial items that could not be allocated to a specific business line.

a. ONTC originally had a December 31 year end as is reported for 2003 and 2004. For 2005/06, ONTC changed its year end to March 31. Therefore, the results for March 31, 2006 are for a 15-month period (January 1, 2005–March 31, 2006).
For instance, the passenger rail service will continue to incur staff costs, fuel, maintenance, etc. These costs are non-discretionary if the service is to continue. For such non-discretionary costs, there isn’t much scope for curtailment. The significant amount of cost reduction, not containment, will result from reductions in operations.

5.1.1 Chronology of Key Events Up to October 2013

A detailed chronology of events up to and following the 2012 Budget announcement of the ONTC divestment is provided in Appendix 3. Although the 2012 Budget announcement was a surprise to many, the Ministry had since 2000 commissioned a succession of consultants’ reports, summarized in Appendix 2, to obtain advice about the ONTC. However, in the ONTC’s view and with the exception of support for the initiatives coming from the Service Improvement Plan of 2000–2003, the Ministry did not provide approval or support for the ONTC to implement any significant action plans during the same time frame. Key observations in these reports included the need for significant increases in capital spending to make up for years of chronic under-spending; the existence of higher staff levels than in comparable private-sector operations; and declining profitability due to a drop in shipments from the mining and forestry sectors.

The 2009 Long-Term Sustainability Plan (LTSP) further observed that the ONTC needed to strategically plan and be able to manage and control the changes required to guarantee its sustainability in the future. The LTSP said this work could not be designed or implemented without a consensus of all stakeholders, and it warned that without renewal, the ONTC’s infrastructure would continue to decline and result in a resource-rich region of the province being disconnected from its market.

5.2 CHALLENGES OF ONTC’S MANDATE AND GOVERNANCE STRUCTURE

In preparing this report, we thought it important to comment on the challenges the ONTC faced in delivering on its dual mandate (outlined in the pre-March 23, 2012, Memorandum of Understanding), and its accountability relationship to the Ministry of Northern Development and Mines (Ministry). We believe these two factors have also contributed to the ONTC’s long-term financial and operational challenges, and have influenced the government’s efforts to address the future of the ONTC and the proposed divestment announced in March 2012.

The ONTC’s original mandate required it to provide public infrastructure to a small population over a vast geographical area in a financially efficient and effective manner with a goal to improve cost recovery and self-sustainability. This was further complicated by its socio-economic mandate to support job maintenance and creation, making for a somewhat contradictory and challenging mandate. As one 2006 Operational Review observed, the ONTC “provides services where there is limited viability for a commercial business case, but there is a compelling social need.”

Those opposed to divestment have observed that most public-transit systems require some form of government help. They stress the importance of comparing subsidies to the ONTC with similar provincial funding for Metrolinx or the proposed city of Toronto transit improvements.

The ONTC’s management and several consultants have also pointed out that historically, operating issues and opportunities relating to the ONTC have been politically sensitive (see Appendix 2). This has traditionally led to a reluctance by government to make significant operational changes; instead, the tendency has been to accept the status quo and continue to provide subsidies. The 2006 Operational Review noted that when cost-cutting measures had been identified in the past, the ONTC had been asked not to pursue these measures for various reasons associated with its mandate in the North.
Had more strategic and timely action been taken, it is possible that the operating and capital financial pressures facing the ONTC on March 31, 2012, might not have been as significant.

The 2006 Operational Review of the ONTC also recommended the establishment of guidelines to clearly delineate those decision-making responsibilities that ONTC management could assume on its own, and those requiring Ministry approval. To fully appreciate this point, it is important to understand how governance and accountability relationships of an agency in the public sector differ from private-sector corporations. Prior to March 23, 2012, the ONTC, like most public-sector agencies, was accountable to a Board of Directors whose members were drawn from the community and appointed by the Lieutenant Governor in Council. While a private-sector Board is ultimately responsible for making all decisions of a strategic nature, in the public sector, the Minister and the Ministry can also have significant influence and control over an agency like the ONTC.

The Agency Establishment and Accountability Directive (Directive) establishes the roles and responsibilities of an agency’s Board and its minister. The Directive provides the minister with significant authority over an agency’s direction, mandate, funding and management, including recommending for approval by Treasury Board the establishment, merger, or elimination of an agency. The Directive also provides that an agency Board is accountable for oversight and governance of the agency, through the Chair, to the Minister. This responsibility includes establishing the goals, objectives and strategic direction of an agency consistent with the agency’s mandate and government policies, including the minister’s direction, where appropriate. Roles and responsibilities are further refined in a Memorandum of Understanding (MOU) that spells out in greater detail the relationship between the relevant ministry and an agency.

In conducting our review, it became apparent that the relationship between the ONTC and the Ministry was strained. The ONTC was of the view that the Ministry had constrained its ability to implement restructuring and operational changes before the announced divestiture, did not understand its mandate and businesses, and was not communicating openly and transparently with senior management. The Ministry, on the other hand, did not trust the ONTC’s financial management because the agency had difficulty achieving its budgets, and took a more interventionist role. The ONTC’s view is that it was being consistently underfunded, resulting in it having to exceed its budget in order to provide its mandated services. Having said this, the government provided funding to the ONTC when the agency made requests to address operational risks as they arose. The challenge of negative cash flows generated by the ONTC put additional strain on the Ministry/agency accountability relationship.

The ONTC believes it would benefit from a reporting relationship with the Ministry of Transportation, which has more industry-specific expertise, rather than the current relationship with the Ministry of Northern Development and Mines, which focuses primarily on economic development. Until recently, the ONTC has not been actively involved in discussions regarding the Growth Plan for Northern Ontario, announced March 4, 2011, which included plans to develop a northern multimodal transportation study.

The divestment decision and much of the divestment process was undertaken under the direction of the government through the Ministry (with assistance from Infrastructure Ontario), with inconsistent involvement of the ONTC Board and management, as illustrated by the following:

- Both the ONTC’s President and CEO and the Chair of its Board of Directors first learned of the government’s divestment plans only within a week of the divestment being publicly announced on March 23, 2012.
- When the government announced the ONTC divestment on March 23, 2012, it replaced the existing nine-member ONTC Board of Directors (except the Chair) with a new Transition Board. The majority of directors on the former
Board were non-government employees, while the new Transition Board is comprised of four senior government officials and the Chair of the former Board.

- Between the time the newly appointed Transition Board was established (March 23, 2012) and December 2012, the Transition Board held over 30 meetings to discuss operational and divestment matters relating to the ONTC. However, after the new Premier took office in January 2013 and the subsequent March 2013 establishment of the Minister’s Advisory Committee, the Transition Board’s activity decreased substantially and its role effectively changed. With options other than divestment now on the table, the Board, once focused on winding down the ONTC through divestment, now focused more on day-to-day operations.

- ONTC management indicated they have had limited involvement in the divestment process.

- The four unions representing ONTC employees expressed dissatisfaction about not having been consulted or asked for their input into the divestment process. The unions had proposed a plan that envisaged turning the ONTC over to a federally regulated port authority.

- In March 2013, the newly appointed Minister of Northern Development and Mines announced the creation of an Advisory Committee (Committee) of northerners to provide input into a redefined ONTC transformation process. The Committee’s mandate is to provide advice to the Minister of Northern Development and Mines on the timing of and approach to solutions for the ONTC. The establishment of the Committee signaled a change in government direction for the ONTC by having the Committee examine multiple options beyond divestment, such as restructuring, alternative service delivery and new partnerships. In announcing the Committee’s establishment, the Minister of Northern and Development and Mines said he wanted to ensure the voices of northerners and all those impacted by the divestment of the ONTC are heard.

In our view, improved lines of communication and greater clarity of decision-making responsibilities between the Ministry and ONTC management at certain stages of the divestment process could have improved the quality of the information available to assist decision-makers.

5.3 ONTC SAVINGS COMMUNICATED IN THE 2012 ONTARIO BUDGET

The reference in the 2012 Budget to combined savings of $265.9 million for the 2013/14 and 2014/15 fiscal years was accompanied by the following wording: “Savings associated with the ONTC will result from a combination of no longer subsidizing the ONTC and its expenses no longer being consolidated with the Ministry’s expenses.”

In conducting our review, it became apparent that the term “savings” and the related financial impact of the ONTC divestiture in this budget reference have been interpreted by stakeholders in a variety of ways. Depending on the interpretation, the nature of the financial information associated with the ONTC divestment varies significantly. The four interpretations are as follows:

1. the internal savings to the Ministry of no longer having to include the ONTC’s gross operating expenses in its estimates and budgets under the assumption that all of ONTC’s operations would be sold off;
2. the estimated ONTC divestment costs and liabilities to be managed, including severance, employment-security provisions, pension-solvency deficits, government subsidies and asset writedowns;
3. the elimination of operating and capital subsidies to the ONTC on a go-forward basis; and
4. the **full financial impact of the divestment of ONTC based on a multi-year business-case analysis** that examined all costs and benefits associated with the divestment.

### 5.3.1 Interpretation 1—Internal Savings to the Ministry of Northern Development and Mines

The Ministry advised us that this was the scenario under which the 2012 Budget estimates were prepared. The $265.9 million in savings identified in the 2012 Budget addendum was intended to represent forecasted gross expenditure savings to the Ministry, as opposed to the consolidated impact of the ONTC’s net operating results on the province’s financial statements, under the assumption that the ONTC’s operations would be fully divested within one year of the Budget announcement. The $265.9 million represented the ONTC’s forecasted gross operating expenses (as they would have been reflected in its financial statements) for the 2013/2014 and 2014/2015 fiscal years.

The Ministry had indicated to the Ministry of Finance that, although the 2012 Budget wording regarding savings associated with the ONTC was technically correct, there would be more costs associated with the divestment.

In our opinion, the budget wording of “savings associated with the ONTC will result from a combination of no longer subsidizing the ONTC and its expenses no longer being consolidated with the Ministry’s expenses” was confusing because it could be interpreted as meaning that the $265.9 million reflected the total financial impact to the province of the divestment of ONTC. This was not the case as it did not include estimates for any of the following:

- the ONTC’s operating revenues for 2013/14 and 2014/15 had it continued operation as a going concern (historically, the ONTC had operating revenues of about $100 million a year);
- divestiture costs and liabilities to be managed, including potential asset writedowns, severance and pension costs (some estimated divestment costs were provided for in another section of the 2012 Budget and are discussed in Section 5.3.2 of this Report);
- the continuing annual subsidy to support the Polar Bear Express train service and certain motor coach routes;
- costs for environmental remediation of land, and those associated with the government meeting its duty to consult with Aboriginal peoples; and
- any sale proceeds, government subsidies and related transaction costs associated with the sale of ONTC assets/business lines (government subsidies would likely have to be paid to prospective buyers of ONTC service lines to address the ONTC’s aged capital assets).

However, the 2012 Budget also announced the establishment of a Transition Fund to support government-wide transformation initiatives (discussed further in section 5.3.2). The $500 million in funding committed in the Budget for the 2012/13 fiscal year for the Fund included a provision of $325 million relating to the ONTC, but this provision was not apparent or identifiable.

### 5.3.2 Interpretation 2—Estimated ONTC Divestment Costs and Liabilities to be Managed

This interpretation considers the high range of the estimated total costs and liabilities to be managed for a divestiture, as illustrated in Figure 2.

The 2012 Budget contained a general fund for transformational initiatives that was outlined in another section of the Budget and that did not highlight that it contained an estimate for costs related to the divestment of the ONTC. Page 168 of the 2012 Budget noted the creation of a government-wide Transition Fund as follows:

Implementing transformational initiatives to achieve the savings necessary to manage growth in program spending...
may require some upfront costs, such as transition costs, expenses associated with organizational changes and severance costs. To support these initiatives while protecting essential front-line core services, a transition fund of $1 billion over three years, including $500 million in 2012–13, is included in the fiscal plan to assist ministries in managing the cost of transformational activities.

The 2012 Budget did not identify the specific details of the Transition Fund, but the Fund was identified as part of the Ministry of Finance’s 2013 Estimates (as opposed to the Estimates of the Ministry of Northern Development and Mines). Information provided by the Ministry indicated that $325 million of the Fund had been earmarked to cover certain costs of the ONTC divestment as follows:

- severance—$25 million;
- unfunded pension liability (solvency valuation)—$100 million; and
- writedown of business-line assets—$200 million.

We noted that in July 2012, four months after the 2012 Budget was tabled, Treasury Board was informed by the Ministry that the estimated potential ONTC divestment costs and liabilities would be about $690 million, more than double the $325 million included in the 2012 Budget.

In March 2013, Treasury Board was further informed by the Ministry that the high-range estimate of these costs had risen further, to about $820 million. This estimate assumes the worst-case scenario for severance cost estimates and that no employees would be retained after divestment. It is the Ministry’s position that this is unlikely to occur as ONTC labour strategies include negotiating the employment of employees with the new owners of ONTC business lines, supporting the transition of employees into other business lines of the ONTC, negotiating pension bridging for senior employees, negotiating severance settlements for employees and reducing the workforce through attrition. It should be emphasized that the $820-million figure does not include the as-yet-unknown costs to clean up environmental contamination on ONTC land or costs associated with the government meeting its duty to consult with Aboriginal peoples; nor does it include an anticipated government capital subsidy to close a potential sale (an amount that would be subject to negotiation with prospective buyers).

While the 2013 Budget increased the government-wide Transition Fund by an additional $150 million, to $650 million, none of this increase was earmarked to cover ONTC divestment costs.

The Minister of Finance’s 2013 Economic Outlook and Fiscal Review, presented on November 7, 2013, noted a funding allocation of $75 million from the Transition Fund to the ONTC to support ongoing operations in 2013/14 while stakeholder consultations and transformation continued.

However, we noted that the original intent of the Transition Fund with respect to the ONTC was not to fund ongoing operations but rather to cover certain specific costs associated with divestment, relating to pension liabilities, severance and asset writedowns. The Ministry’s view was that because these unforeseen and unplanned operating costs have resulted from delays in the timelines of the divestment process, it was appropriate to finance them through the Transition Fund.

We would have expected that the financial impact of the provisions in the ONTC collective agreement would have been assessed during preparation of the 2012 Budget, and considered in making the initial decisions and estimates regarding divestment. Ministry staff indicated that they were not aware of the financial impact of the significant wage-continuation and severance provisions in the collective agreements covering 90% of the ONTC workforce because they had not consulted fully with the ONTC during preparation of the 2012 Budget. A lack of communication by the Ministry with senior ONTC management contributed to these costs being underestimated in the early stages of the divestment process.
An overview of the employment security (wage continuation) and severance benefits entitlements of the unionized workforce of over 800 employees under 11 collective agreements is provided in Figure 4. To summarize, 347 employees hired prior to 1996 may be entitled to full wage continuation that provides up to 100% of their salary for up to 14 years or their normal retirement date under the ONTC pension plan, whichever comes first. The remaining employees are entitled to a more modest severance benefit package. According to estimates provided by ONTC management, an employee qualifying for the maximum wage-continuation benefit would be entitled to total compensation averaging more than $800,000 on termination of employment.

Any solutions to address the financial challenges facing the ONTC will involve significant costs. Theoretically, these challenges can essentially be approached in one of three ways: through an internal restructuring and operational improvements, by selling part or all of the ONTC’s operations to the private sector (a divestment), or through a hybrid of

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**Figure 4: Overview of Labour Agreements**

Source of data: Ministry of Northern Development and Mines

<table>
<thead>
<tr>
<th>Collective Agreements</th>
<th>Paid Over Period of Time, Up Until Earliest Retirement Date</th>
<th>Severance</th>
<th>Date of Collective Agreement Expiration</th>
<th>Total Unionized Employees</th>
<th>Employees w/ Employment Security</th>
</tr>
</thead>
<tbody>
<tr>
<td>Office Clerks (CAW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2013</td>
<td>55</td>
<td>29</td>
</tr>
<tr>
<td>Customer Service/Sales (USW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2014</td>
<td>42</td>
<td>14</td>
</tr>
<tr>
<td>Ontera (USW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2014</td>
<td>94</td>
<td>51</td>
</tr>
<tr>
<td>Yard Office Clerical (CAW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2013</td>
<td>48</td>
<td>20</td>
</tr>
<tr>
<td>Train Servers (CAW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2014</td>
<td>21</td>
<td>2</td>
</tr>
<tr>
<td>Signals Dept. (IBEW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2014</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Maintenance of Way (Teamsters)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2014</td>
<td>174</td>
<td>85</td>
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<tr>
<td>Locomotive Engineers/Conductors (USW)</td>
<td>N/A</td>
<td>N/A</td>
<td>Dec. 31, 2014</td>
<td>81</td>
<td>46</td>
</tr>
<tr>
<td>Station Inn (CAW)</td>
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<td>N/A</td>
<td>Dec. 31, 2013</td>
<td>7</td>
<td>0</td>
</tr>
<tr>
<td>Motor Coach Operators (Teamsters)</td>
<td>N/A</td>
<td>N/A</td>
<td>Dec. 31, 2014</td>
<td>51</td>
<td>0</td>
</tr>
<tr>
<td>Mechanics (CAW)</td>
<td>10 weeks to 5 years</td>
<td>1 week per 10 years; max of 1.5 years’ salary</td>
<td>Dec. 31, 2013</td>
<td>225</td>
<td>98</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>802</strong></td>
<td><strong>347</strong></td>
</tr>
</tbody>
</table>

1. Table excludes approximately 150 employees not covered by collective agreements.
2. Full employment security pays 100% of salary for the earlier of 14 years or when an employee qualifies for normal retirement. Employees hired prior to 1996 who are terminated as a result of a technological, operational or organizational change receive 100% of salary; employees terminated for another reason receive 80% of salary.
3. Layoff and severance benefits available to those unionized employees not entitled to full employment security (i.e., hired after 1996).
4. Including benefits.
5. 2–20 years: 5 wks/year, 20–25: 3 years, 25–30: 4 years, 30–35: 5 years.
the two. It appears that the major incremental costs related to pension, severance and wage continuation would likely be similar in each scenario, because a private-sector purchaser would be unlikely to agree to assume all of these obligations. As a result, these costs become unavoidable and the province will likely continue to bear the responsibility for many of them regardless of the option chosen. Restructuring or divestment options could likely require substantive changes in staffing arrangements.

5.3.3 Interpretation 3—Elimination of Operating and Capital Subsidies to the ONTC on a Go-forward Basis

This interpretation represents the cash-flow savings to the province of no longer having to pay operating and capital subsidies to the ONTC. The accounting impact results from the elimination of the ONTC’s deficit from the province’s annual consolidated operating deficit. The cash flow and accounting impacts of the ONTC on the province for the years ending March 31, 2009, to March 31, 2013, are illustrated in Figure 5, along with the original and adjusted projected cash flow to the ONTC for the year ending March 31, 2014.

The Ministry’s original 2014 cash-flow projection was based on an optimistic assumption that most ONTC operations would be sold off before March 31, 2013, thereby significantly reducing the future cash-outflow impact to the province. However, due to the slower-than-anticipated progress of the divestment, this original cash-outflow projection was subsequently increased to cover the ONTC’s ongoing operational and capital requirements for 2013/14.

This interpretation essentially assumes that no proceeds are received for the assets divested, but on the other hand, a purchaser assumes all liabilities and costs related to pensions, severance and the environment, as well as any other liabilities, on a go-forward basis. Therefore, with no proceeds or costs associated with divestment of assets, the savings would essentially be the normal operating and capital subsidies that would no longer have to be paid each year. In essence, as indicated by the subsidy trend in Figure 5, this would result in savings of from $50 million to $100 million a year.

5.3.4 Interpretation 4—Full Financial Impact of the Divestment of ONTC Based on a Multi-year Business Case Analysis

A business case is a decision-making tool used to indicate how a major change in business or operational strategy alters cash flows over a period of time, how costs and revenues change, and it typically provides a payback period and an internal rate of return.

Treasury Board received a business case for sustaining the operations of the ONTC in 2009, which was the 2009 LTSP described in Appendix 2. Its focus was on initiatives to sustain ONTC overall operations and not on a divestiture. The Ministry presented the first business case for divestment to the Treasury Board on July 18, 2012, four months after the 2012 Budget announcement of divestment. As illustrated in the first column of Figure 6, this
simplified cash-flow divestiture business case estimated that on a net present-value basis there would be cash outflows of $420 million associated with funding the liabilities relating to the divestiture. This would be offset by cash flow savings of over $100 million annually from forgone operating and capital subsidies. On a cash-flow basis, it was estimated that an immediate divestment would result in a cash-payback/break-even period of between four and five years. The implied internal rate of return on the decision over a 10-year period was estimated at nearly 20%, and more if the model was extended beyond 10 years.

This divestiture business case did not contain the detailed support and analysis typical of traditional business cases. The Ministry indicated that it had used certain information from the 2009 LTSP as the foundation to support its decision to divest. ONTC management were not consulted or involved in the preparation of the Ministry’s divestiture business case.

The estimated net present value of cash outflows of $420 million included wage continuation and severance costs of $250 million, post-retirement benefits of $70 million, and pension costs of $100 million. The outflows also include an estimated subsidy that the government would have to pay a potential buyer to close a deal, representing the cost of one-time capital funding required to address previous under-investments in capital infrastructure. The cash flows were net of the estimated proceeds from the divestment. Because the business case was based on cash flows, the cash outflows excluded the accounting writedown of business assets of $200 million referred to in Interpretation 2.

We noted the following with respect to the figures and assumptions used to prepare the Ministry’s July 18, 2012, business case:

- The undiscounted wage continuation and severance costs were determined based on all eligible employees receiving full benefits totalling almost $300 million. The $300 million represents the maximum possible cost of wage continuation and severance, which the government is attempting to mitigate.
- The estimate of $100 million in pension costs used in the July 18, 2012, business case has subsequently risen to over $200 million, based on a more recent estimate.
- The cash outflows excluded consulting and legal costs and any unknown environmental

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**Figure 6: Multi-year Cash Flow Business Case Analysis, July 18, 2012 ($ million)**

Source of data: Ministry of Northern Development and Mines

<table>
<thead>
<tr>
<th>Estimated Cash Outflows at Closure</th>
<th>July 2012</th>
<th>OAG Update of July 2012 Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension (discounted)</td>
<td>100</td>
<td>200</td>
</tr>
<tr>
<td>Post-retirement benefits (discounted)</td>
<td>70</td>
<td>70</td>
</tr>
<tr>
<td>Labour (discounted)</td>
<td>250</td>
<td>250</td>
</tr>
<tr>
<td>Transaction costs</td>
<td>–</td>
<td>30</td>
</tr>
<tr>
<td>Subsidy to close</td>
<td>not disclosed*</td>
<td>not disclosed*</td>
</tr>
<tr>
<td>Proceeds</td>
<td>not disclosed*</td>
<td>not disclosed*</td>
</tr>
<tr>
<td><strong>Total Cash Outflows Costs</strong></td>
<td>420a</td>
<td>550</td>
</tr>
<tr>
<td>Annual Government Cash Flow savings representing forgone operational and capital subsidies</td>
<td>100b</td>
<td>73†</td>
</tr>
<tr>
<td>Cash flow payback period (a+b)</td>
<td>4 years</td>
<td>Beyond 7 years</td>
</tr>
</tbody>
</table>

* A number was determined for purposes of the business case analysis; however, it has not been included because of commercial sensitivity while subject to negotiation with prospective buyer.
† The $100 million reduced by the $27 million of annual funding the government has committed to provide for the Polar Bear Express and certain motor coach services.
clean-up costs or costs related to the government meeting its duty to consult with Aboriginal peoples.

- The estimated cash-flow savings of $100 million annually from forgone operational and capital subsidies was not reduced by the government’s commitment to continue to subsidize the operations of the Polar Bear Express train service and certain motor coach services, estimated at a combined total of $27 million annually. The uncertain nature of the estimated cash-flow savings of $100 million annually is illustrated by the fact that Treasury Board was informed in March 2012 that the forgone subsidies would be in the range of $40 million to $80 million. Four months later, the business case increased this figure to $100 million, as illustrated in Figure 7.

- The estimated proceeds from divestment and the estimated government subsidies to close a deal are both subject to a high degree of uncertainty. The subsidies to close represent the potential financial subsidies or other support the government may need to provide to a prospective buyer to enable the buyer to upgrade the condition of the aged ONTC capital assets being acquired. We have not disclosed the estimated amounts due to commercial sensitivity, and their impact has been excluded from the analysis presented in this section. The actual amounts will not be known until negotiations between the government and prospective buyers have been completed. Based on this updated financial information (which is the most current information we reviewed and which is reflected in the second column of Figure 6), the payback period will almost undoubtedly exceed the four to five years estimated by the Ministry in its July 2012 cash-flow business case, and could well be in the eight- to 10-year range. The Ministry’s July 2012 business-case timeline provided for binding purchase agreements to be implemented for the various ONTC business lines prior to March 31, 2013. However, at the time of this writing, no such agreements had been finalized. There is also the question of what to do with those ONTC assets that could not be divested, a matter that still needs to be addressed. In addition, the financial analysis does not consider or attribute a value to the socio-economic importance of the ONTC to northeastern Ontario. As part of the 2009 LTSP, consultants were engaged to examine the socio-economic impact of the ONTC on its service area. They reported that every dollar of direct revenue produced by the ONTC generates $2.61 in additional revenues to other businesses in the province. The consultants noted the ONTC’s contribution to the local economy is even more pronounced at the community level, ranging from 1.4% of value added in Kirkland Lake to as much as 30.4% of value added in Englehart.

The ONTC’s Transition Board of Directors approved only the criteria and weighting used in the evaluation of the Ontera bids, and has had no further input into any of the negotiations with potential Ontera buyers. ONTC management has had no input into the Ontera negotiations. Infrastructure Ontario has taken the lead with the Ministry on this process, which is currently under way.

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**Figure 7: Estimated Annual ONTC Divestment Savings — March 2012, July 2012 and March 2013 ($ million)**

Source of data: Ministry of Northern Development and Mines

<table>
<thead>
<tr>
<th></th>
<th>High-range Estimate March 22, 2012</th>
<th>High-range Estimate July 2012</th>
<th>High-range Estimate March 2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cessation of Ontario government operating and capital subsidies to ONTC*</td>
<td>40–80*</td>
<td>100*</td>
<td>100*</td>
</tr>
</tbody>
</table>

* These amounts included the continuing subsidy for the Polar Bear Express and certain motor coach routes.
Since the Budget announcement, the Ministry and Infrastructure Ontario, with the assistance of external advisers, continue to update the potential financial impacts of the divestment. The most recent financial analysis, presented to the Minister’s Advisory Committee in June 2013, compared the cost of the status quo to the cost associated with a change to an alternative-service-delivery model. It assumed that the government would have had to pay subsidies to the ONTC in perpetuity. It estimated that, under that assumption and on a net present-value basis, divestment would have a positive financial impact for the government. This analysis excluded pension fund liabilities, employment severance payouts, environmental remediation and transaction costs. As well, it did not include the possible costs of government socio-economic policy decisions. These costs were excluded because the analysis assumed they exist regardless of whether or not there is a divestiture. The July 2012 business case, in contrast, did include these costs in its analysis.

### Appendix 1—Excerpts from the Addendum to the 2012 Ontario Budget—Report on Expense Management Measures

#### Introduction

This “Report on Expense Management Measures” provides a detailed list of expense management measures totalling $4.9 billion in savings planned over the next three years. As described in *Chapter I: Transforming Public Services*, of the 2012 Budget, these savings are planned through removing overlap and duplication, more efficient and effective delivery models, and focusing on core business ... 

#### Focusing on Core Business ...

**Ministry of Northern Development and Mines**

<table>
<thead>
<tr>
<th>($ Millions)</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15</th>
<th>3-Year Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ontario Northland Transportation Commission</td>
<td>–</td>
<td>(131.2)</td>
<td>(134.7)</td>
<td>(265.9)</td>
</tr>
</tbody>
</table>

The Ministry provides a subsidy to the Ontario Northland Transportation Commission (ONTC) to support its operating and capital expenses, which have risen by an unsustainable 274% since 2003.

With government subsidies to the agency rising to these unsustainable levels, some parts of the ONTC will be divested and an alternative business model will be developed for key transportation services in northern Ontario.

Savings associated with the ONTC will result from a combination of no longer subsidizing the ONTC and its expenses no longer being consolidated with the ministry’s expenses.
## Appendix 2—Recent Operational Initiatives

<table>
<thead>
<tr>
<th>Year</th>
<th>Initiative</th>
<th>Initiated By</th>
<th>Done By</th>
<th>Main Focus/Results</th>
</tr>
</thead>
</table>
| 2000–2003| Service Improvement Plan                               | Ministry of Northern Development and Mines | KPMG                        | • Reviewed operations and developed a comprehensive strategy to improve customer service.  
• Specific recommendations endorsed by the Minister included:  
  • pursue divestiture options for ONTC’s freight division;  
  • replace the Northlander with an express bus service; and  
  • foster telecommunications competition by exploring divestiture options for Ontera.  
• Divestiture of freight division abandoned when CN withdrew offer to purchase in 2003.  
• Government-approved restructuring initiatives included:  
  • rail restructuring, which resulted in more than 200 employees accepting early retirement offers at a total cost of $47 million; and  
  • ONTC partnering with Telus in 2003 to manage Ontera. |
  • maintenance programs;  
  • current and future infrastructure requirements; and  
  • potential long-term sustainable funding strategies.  
• Resulted in debt forgiveness of $20 million and re-establishment of lines of credit. |
| 2006     | Operational Review                                     | Ministry of Northern Development and Mines | PwC                         | • Reviewed management control duties and practices, and made recommendations to improve effectiveness of management.  
• Concluded that management is generally performing the required control duties and practices.  
• Noted that Board of Directors lacked the specialized knowledge required to deal with the complex issues facing ONTC.  
• Recommended establishment of guidelines to clearly delineate the decision-making responsibilities of ONTC management and Ministry of Northern Development and Mines (Ministry).  
• Called for a greater degree of accountability for performance of ONTC management and the Ministry. |
| 2006     | Ontera Business Plan Review to 2010                    | Ministry of Northern Development and Mines | Deloitte                    | • Conducted an independent review of the business plan, including underlying assumptions.  
• Concluded the status quo was not viable given the age and reliability of current infrastructure.  
• Ontera’s capitalization ratio had been significantly below that of other comparable companies since 2002.  
• Governance structure was unwieldy and may hamper Ontera’s ability to respond to the ever-changing telecommunications market. |
<table>
<thead>
<tr>
<th>Year</th>
<th>Initiative</th>
<th>Initiated By</th>
<th>Done By</th>
<th>Main Focus/Results</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008/09</td>
<td>Long-Term Sustainability Plan (LTSP)</td>
<td>Treasury Board</td>
<td>IBI, Argo, Oracle, Morcom</td>
<td>• Provided in-depth financial projections and funding requirements for the 15 years from 2009/10 to 2023/24.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>and co-ordinated by ONTC</td>
<td></td>
<td>• Observations of the LTSP included the following:</td>
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<tr>
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<td></td>
<td></td>
<td>• Total capital investment required for rail infrastructure, rolling stock, bridges and culverts projected to be almost $735 million over 15 years.</td>
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<td></td>
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<td></td>
<td>• Since the 1990s, the ONTC’s response to declining revenues, decreasing margins and a general cash shortage has been to reduce both operating expenses and capital spending. The years of sustained under-spending on capital has resulted in considerable “capital overhang,” defined as rail capital being replenished at a far lower rate than the benchmark 17% of commercial rail revenues suggested in various studies. As illustrated in Figure 1, only once in the period from 1991-2009 did capital spending exceed 17% of commercial rail revenues. ONTC has both an aging rail fleet and infrastructure, which includes 90 bridges (of which only 10 are less than 50 years old) and over 2,200 culverts running under the tracks, many of which are overdue for remediation.</td>
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<td></td>
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<td>• Contributing to the lack of funds for capital renewal is the fact that during the 1990s, the ONTC’s commercial operations were called upon to support the non-commercial (or mandated) operations of the organization.</td>
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<tr>
<td></td>
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<td>• For non-commercial rail services (Northlander and Polar Bear Express trains), roughly 30 cents of every operating dollar will need to be covered by government, and the total cumulative value for this cost was projected to be $328 million over the next 15 years.</td>
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<td></td>
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<td></td>
<td>• The Northlander was highlighted as a $16-million annual operation with $2.5 million derived from operating revenues, and government subsidies of $13.5 million needed to cover its annual operating deficit. Replacing the Northlander train with bus services was estimated to generate net present value savings of $105 million over a 15-year period.</td>
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<td></td>
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<td></td>
<td>• The ONTC operates a relatively high-cost railway with relatively low traffic density. The ONTC’s 11 different collective agreements with four different unions, covering almost 90% of the workforce, were identified as a major barrier to moving the rail operations towards self-sustainability.</td>
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<td></td>
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<td>• Benchmarking of the rail operations to similar private-sector rail operators indicated that on average, the ONTC had double the staff per route-mile than the industry norm.</td>
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<td></td>
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<td>• Declining freight profits resulted from a decline in forestry and mining shipments, combined with extreme variations in the cost of diesel fuel.</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>• Ontera underwent a major revenue loss in 2001 due to deregulation of the long-distance toll market. Total capital investment requirements for Ontera over the next 15 years was estimated at over $85 million.</td>
</tr>
</tbody>
</table>
Appendix 3—Chronology of Key Events in the ONTC Divestment

What follows is a detailed chronology of key events leading up to and following the government’s March 23, 2012, divestment announcement.

<table>
<thead>
<tr>
<th>Date</th>
<th>Event Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008/09</td>
<td>A Long-Term Sustainability Plan provides in-depth financial projections and funding requirements for the 15 years from 2008/10 to 2023/24.</td>
</tr>
<tr>
<td>December 2010-January 2011</td>
<td>The Secretary of Cabinet introduces an expenditure management program and asks the Ministry of Northern Development and Mines (Ministry) to find cost savings within its base budget through transformational change. The Ministry identifies the ONTC as one program that could, under different governance and/or service offerings, relieve the government of significant fiscal pressure in the future.</td>
</tr>
<tr>
<td>February 25, 2011</td>
<td>The Ministry plans to undertake a thorough third-party review of ONTC operations, and develop alternatives for consideration by government in the next year’s results-based-planning (RBP) process.</td>
</tr>
<tr>
<td>July 13, 2011</td>
<td>The province/Metrolinx selects a Quebec-based company to refurbish GO transit coaches. This work had been previously done by ONTC.</td>
</tr>
<tr>
<td>August 26, 2011</td>
<td>The Ministry confirms to the Secretary of Cabinet that ONTC has been identified as a transformational opportunity. The Ministry notes that ONTC's financial outlook continues to deteriorate and the need for government investment and operating subsidies continues to grow. Preliminary annualized savings through some alternative-service-delivery models were identified as significant ($20 million to $40 million of annual operating and capital subsidies). It was also noted there would be one-time upfront costs to undertake a change in current operation and potential transfer of assets to another entity. However, these costs could be largely offset by proceeds from the sale of assets. The sale would likely also trigger book-value losses.</td>
</tr>
<tr>
<td>January 23, 2012</td>
<td>The Ministry’s 2012/13 Results-Based Plan Strategic Overview notes that the ONTC continues to face major operating and capital pressures, with current total subsidies of $42.8 million insufficient to meet annual operating cash-flow and capital needs. It notes the government cannot justify the current level of subsidy to the ONTC in the current fiscal environment, and can no longer provide substantial funding for unsustainable and/or non-essential services that compete with or can be delivered more efficiently by the private sector. The overview notes that transition costs would likely be significant, although no estimate was provided.</td>
</tr>
<tr>
<td>February 15, 2012</td>
<td>Treasury Board is asked to approve $20 million in emergency ONTC operational funding to address emerging financial pressures.</td>
</tr>
<tr>
<td>February 29, 2012</td>
<td>The Minister presents a divestment strategy to Cabinet.</td>
</tr>
<tr>
<td>March 22, 2012</td>
<td>Treasury Board is asked to approve implementation of the divestment strategy. Approvals are sought for a new mandate and a new Memorandum of Understanding (MOU) between the Ministry and the ONTC to reflect the new mandate; the dissolution of the current Board of Directors and the appointment of a new interim Board; and the development by the Ministry of alternative-service-delivery models, which may include provincial subsidies, to ensure that certain existing ONTC transportation services are maintained after divestment in areas where no other service exists. The new MOU contains the new ONTC mandate and requires the ONTC to divest its assets and business units, subject to the approval of the province; wind up and liquidate any assets and obligations which cannot be so divested; and until the completion of the divestiture process, continue to provide efficient, safe and reliable services in northern Ontario. The provincial subsidy for bus of up to $2 million per year, and the Polar Bear Express passenger and freight train from Cochrane to Moosonee, will be continued by a new operation with a government subsidy estimated at $25 million a year. A Treasury Board backgrounder assessing the risks and impacts of the ONTC divestiture highlights the fact that 966 jobs would potentially be affected. There would be only small initial savings but significant upfront costs from writedowns, severance and pension costs, and other potential liabilities. It was noted that the unions will press the province for job-security guarantees as part of the negotiated package and seek early-retirement offers, pension bridging or other provisions to mitigate job loss. The backgrounder contained information from the ONTC’s 2009 Long-Term Sustainability Plan. The Plan concluded the agency required considerable provincial investment over the next 15 years to effectively deliver its current mandate—specifically, ongoing non-commercial operating subsidies of $328 million; ongoing non-commercial capital funding of $196 million; and new capital spending of $559 million across all divisions.</td>
</tr>
<tr>
<td>Date</td>
<td>Event</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>March 22, 2012 (continued)</td>
<td>It was noted that the plan would require an upfront fiscal hit of between $100 million and $325 million, driven by one-time charges such as asset writedowns, severance costs and pension liabilities, to be determined upon final transaction details. The proposal would result in estimated ongoing cost avoidance of $40 million to $80 million annually. The proposal includes the continued annual subsidy for the Polar Bear Express ($25 million) and certain non-commercial motor coach lines ($2 million). The ONTC President and Chair of the Board are asked to sign the Memorandum of Understanding. The ONTC President had not been briefed prior to this meeting. The Chair of the ONTC had been briefed within a week before the meeting.</td>
</tr>
<tr>
<td>March 23, 2012</td>
<td>The government announces its plan to wind down the ONTC. A Transition Board is appointed to work with the current chair to begin the ONTC divestment. The Transition Board meets throughout 2012 and 2013.</td>
</tr>
<tr>
<td>March 27, 2012</td>
<td>The 2012 Ontario Budget announces the government will divest the commercially valuable ONTC assets and terminate the unsustainable Northlander Passenger Train Service. Once implemented, the measures will result in cumulative savings of $265.9 million by the 2014/15 fiscal year. The Budget also announced the creation of a three-year fund. Although not disclosed in the Budget document, $325 million from the fund was earmarked to support ONTC transformation initiatives.</td>
</tr>
<tr>
<td>July 18, 2012</td>
<td>Treasury Board is presented with an update of the ONTC divestment strategy and preliminary divestment decisions. This meeting was the first time a current business case had been formally presented, and was also the first mention of the specific employment security/severance provisions of the labour contracts. The updated cost analysis also estimated $70 million in post-retirement benefits, and $100 million in pension windup costs. This business case estimated the potential fiscal impact in the 2013/14 fiscal year would be close to $700 million, comprised of $250 million in security/severance provisions, net pension cost of $100 million, net writedown of assets of $200 million, and in-year operating and capital requirements to maintain operations and preserve the value of capital infrastructure during divestment. Other potential liabilities, such as environmental remediation costs and costs associated with the government meeting its duty to consult with Aboriginal peoples, were still to be determined. The large, geographically dispersed land holdings were noted to present a challenge with respect to both environmental and Aboriginal issues. Labour negotiations are identified as a key area where decisions will be needed.</td>
</tr>
<tr>
<td>September 28, 2012</td>
<td>The Northlander train service between Toronto and Cochrane ceases operation.</td>
</tr>
<tr>
<td>November 9, 2012</td>
<td>A federal arbitrator rules that the Northlander closing in September 2012 was a Technological Operational or Organizational change (TOO) as defined in the collective agreement, triggering significant compensation to Northlander employees affected by the closing. The arbitrator’s decision strongly suggests the rest of ONTC’s divestment will also be found to be a TOO change, which would have significant potential future financial consequences.</td>
</tr>
<tr>
<td>December 6, 2012</td>
<td>Estimated pension wind-up costs increased to $212 million. Proposed evaluation criteria for the Ontera RFP discussed. Maximum labour liabilities now estimated at between $170 million and $300 million.</td>
</tr>
<tr>
<td>December 17, 2012</td>
<td>Infrastructure Ontario releases a request for proposal inviting pre-qualified buyers to submit formal proposals to purchase, manage and operate Ontera.</td>
</tr>
<tr>
<td>March 26, 2013</td>
<td>A new business case for divestment shows the estimated positive financial impact to government between the status quo and divestment scenario expressed on a net present-value basis and assuming that capital and operating subsidies are paid in perpetuity. Costs and liabilities in the business-case analysis were estimated to be: labour—$293 million; transaction/due diligence—$15 million to $30 million; pension—$212 million; environmental—to be determined; other post-employment benefits—$60 million to $70 million; asset impairment accounting loss—$188 million.</td>
</tr>
<tr>
<td>June 24, 2013</td>
<td>The Ministry and Infrastructure Ontario present a financial update to the Minister’s Advisory Committee comparing the costs of the status quo to the cost of changing to alternative service delivery (ASD). The ASD model shows a positive impact to the government, assuming that capital and operating subsidies are paid in perpetuity.</td>
</tr>
<tr>
<td>September 2013</td>
<td>Divestment options are prepared by ONTC management. The options are to be presented to the Minister’s Advisory Committee.</td>
</tr>
</tbody>
</table>