April 17, 2017

Overview of the proposed
Intergenerational Fairness in Hydro Rates Act, 2017

Objective

- Process has attempted to solve for accounting treatment and legal risk, while balancing the interests of the Province, OPG, IESO, OEB, LDCs, ratepayers and investment dealers to create a saleable financial product

Considerations

- Significance of credit rating – "AAA" objective
    - "Sovereign ceiling"
- Discretion of and benefits to OPG as Financial Services Manager and, through its special purpose vehicle (trust), as an "investment asset owner"
- Implications for IESO as both borrower and "Servicer"
- Implications for LDCs in collecting the "Clean Energy Adjustment"
- Relationship to ratepayers

Overview of the Legislation

Preamble & Purpose

- Links the investments made to develop a clean, modernize and reliable electricity system with allocating the costs of these investments among generations as well as long-term benefits for future generations of Ontarians
- Important from a constitutional law perspective (to be reviewed by MAG)

Crown Undertaking

- The Crown would undertake not do anything to adversely affect an investment asset or funding obligation, including hinder, impair, prejudice the charging, collection or remittance of the clean energy adjustment
- The Minister would be authorized enter into agreements, including guarantees (see Appendix)

The Fair Adjustment

- Legislation would show an immediate reduction in rates in recognition of the investment clean energy initiatives made by rate payers since 2005
- Rates would be increased by CPI in years 2 to 5 in accordance with regulations
- OEB would calculate appropriate adjustments for specified consumers

Fair Allocation Plan

- Established by the Minister and subject to LGIC approval, the Fair Allocation Plan would provide the policy foundation for measuring and allocating the costs and benefits of the clean energy initiative to provide inter-generational fairness to rate payers
- Principles established in the bill would require proper match over time between the costs of providing facilities for clean electricity generation and conservation and the consumers who benefit from these investments in the system

Financing Plan

- Prepared by OPG as Financial Services Manager to implement the Fair Allocation Plan
- Provided to the Minister. Minister may remove Financial Services Manager if Financing Plan is not consistent with the Fair Allocation Plan after Financial Services Manager has been given opportunity to address Minister's concerns
- May be amended from time to time as determined by the Financial Services Manager
- In practical terms, the Financing Plan is intended to show how debt (with varying incurrence dates, maturities, interest rates) will be used over time
- The OEB would review the administrative costs of the Financial Services Manager

Regulatory Asset & Investment Asset

- Created as IESO incurs a funding shortfall equal to the difference between the rates it receives after implementation of the Fair Adjustment and amounts owed under generation and conservation contracts
- Subject to the OEB approval, IESO would record the funding shortfall as a regulatory asset. IESO would also have collection rights to recover the funding shortfall, which may be sold.
- The Financing Plan would contemplate a (trust or a special purpose vehicle created by OPG) to buy the regulatory asset and the associated rights in exchange for a payment to IESO. The IESO would use the payment to offset its funding shortfall.
- This purchase and sale turns the regulatory asset into an investment asset
- IESO has rights to eventually collect its funding shortfall from ratepayers (after year 5) in the event that a portion of the regulatory asset is not bought and sold
- The rights associated with the investment asset require IESO and LDCs to collect money from rate payers as agent of the investment asset owner (OPG SPV)

Clean Energy Adjustment

- The amount that will be recovered from consumers in the future to pay principle, interest, transaction costs and administrative costs associated with the investment asset
- Subject to a true-up process that will reconcile actual amounts collected with expected amounts
- To be invoiced to consumers and collected as part of electricity bills through existing IESO and Local Distribution Company processes

Appendix - Provincial Guarantees – Dealers' position

The dealers have indicated that they are looking for two types of guarantees from the Province.

1. A springing guarantee would require the Province to step in and assume responsibility for paying all amounts that are or become due in respect of:

   (i) any of the outstanding funding obligations;

   (ii) the operation and maintenance of the financing entity [OPG SPV]; and

   (iii) any other amounts due in relation to the program that have not yet been paid (collectively, the "Fair Hydro Program Costs").

The springing guarantee would apply should any of the following happen:

(1) any change in the legislation or regulations that is, or could be, adverse to finance entity noteholders or

(2) the legislation is determined to be beyond the authority of the Province (ultra vires).

In these two situations, the springing guarantee would require the immediate repayment of all Fair Hydro Program Costs (including any makewhole prepayment obligations).

(3) there is a market disruption (i.e. there is a period of time when capital markets term funding is not available to take out the warehouse facilities).

In this third situation, either (i) rate payers would become immediately responsible for payment of the clean energy adjustment; or (ii) the Province must be responsible for the immediate repayment of those warehouse facilities.

The dealers say that to the extent that the springing guarantee does not require the Province to make whole the loss, but simply requires the Province to repay the debt in accordance with its original repayment terms, the credit rating of the program may be impacted.

2. A performance guarantee – would require the Province to stand behind certain obligations of the IESO [and possibly LDCs], including taking responsibility remedying any breaches the covenants, representations, warranties made by the IESO and standing behind any indemnities that may be owing by IESO.

The performance guarantee would also require the Province to ensure that the Servicer [IESO] performs its servicing activities as set out in the securitization documents and if it does not, put in place an alternative servicer who would perform those servicing activities.

This performance guarantee would be included as part of the securitization documents for the program.