BRIEFING NOTE – IMPACT OF ONTARIO'S FAIR HYDRO PLAN ON NON-UTILITY GENERATORS (NUGS) WITH ONTARIO ELECTRICITY FINANCIAL CORPORATION CONTRACTS

ISSUE:

- The Ontario Electricity Financial Corporation (OEFC) / Ontario Financing Authority (OFA) are seeking advice from ENERGY on a proposed approach regarding the potential implications of Ontario's Fair Hydro Plan (OFHP) on certain OEFC NUG Power Purchase Agreement (PPA) rates.

KEY INFORMATION:

- Under the *Ontario Fair Hydro Plan Act,* 2017 (OFHPA), a portion of the Global Adjustment (GA) is being refinanced. From July 1 to the mid-2020's, all residential electricity consumers – and as many as half a million farms and businesses – will pay less GA than they otherwise would have had to pay absent the OFHPA.

- OEFC/OFA has advised ENERGY on the potential impact of the OFHP on certain OEFC NUG PPA rates.

  - Rates under some OEFC NUG PPAs escalate on the basis of Total Market Cost (TMC) indices, which reflect amounts charged to electricity consumers, including GA costs.

  - TMC from 2011 onwards is calculated to include the amount of GA payable by all energy consumers, allocated on a pro rata energy use basis, as required under the judgment of Justice Wilton-Siegel dated March 12, 2015 in *Iroquois Falls Power Corporation v. Ontario Electricity Financial Corporation*.

- The OFA (on behalf of OEFC) may include the impact of GA Refinancing in the calculation of TMC. OFA is seeking ENERGY's views on this matter. Implications of this approach include:

  - This would mean that TMC escalation – and therefor NUG PPA rates – would be lower in the years during which GA payments by consumers are reduced via the OFHPA reductions (i.e., from July 1, 2017 to the mid-2020s).

  - PPA payments to the ten impacted NUGs would be reduced by $68 million over their full contract terms. However, if reductions under the OFHPA are not included in the calculation of TMC, the $68 million would need to be recovered via GA.

- The OFA advise that it would like to notify the impacted NUGs by mid-October with a proposed approach. The OFA would calculate NUG rates by the end of the year.

BACKGROUND:

Total Market Cost (TMC) / Proposed Options on How to Proceed

- Rates under some of the NUG PPAs escalate on the basis of Total Market Cost (TMC) indices, which reflect amounts charged to electricity consumers, including the GA costs. TMC from 2011 onwards is calculated to include the amount of GA payable by all energy consumers, allocated on a pro rata energy use basis, as required under the judgment of Justice Wilton-Siegel dated March 12, 2015 in *Iroquois Falls Power Corporation v. Ontario Electricity Financial Corporation*.

- GA Refinancing under the OFHPA could affect the calculation of TMC indices depending on how GA costs are reflected in TMC.

- Outlined below are options how to proceed on this matter:

Options	Description	Considerations
1. Include the impact of GA Refinancing in the calculation of Total Market Costs (TMC)	Under this option the rate of escalation under NUG PPAs would be impacted by a reduced GA component (i.e., the GA cost component would be reduced by the OFHPA reductions).	• GA costs are currently a component of TMC. Given that under OFHPA, a portion of GA is being refinanced, OFA advise that the GA costs component may also be reduced to be consistent with the 2015 Court's decision. • TMC has been interpreted by the Court – in the 2015 decision (upheld on appeals) – to comprise all energy-related costs that are intended to be recovered from electricity customers, including but not limited to all of the costs associated with the generation and supply of electricity. • Based on preliminary OFA estimates, overall payments to NUGs would be approximately $68 million lower on a present value basis under this option. • The NUGs may commence a court challenge to obtain a judicial interpretation of the issue. The NUGs may argue that the "contract calculations" should not be affected as a result of a policy change by the government.

Options	Description	Considerations
2. Do not include the impact of GA Refinancing in the calculation of TMC	Under this option the rate of escalation of NUG PPAs would not be impacted by a reduced GA component (i.e., the GA cost component would continue to be calculated as if there had been no OFHPA reductions).	• The OFA advise that this option is <u>not</u> consistent with the 2015 Court decision regarding the calculation of NUG PPAs. • This option is also not consistent with the treatment of other Ontario Fair Hydro Plan (OFHP) amounts by OEFC: The charges for the Rural or Remote Rate Protection Program (RRRP) and the Ontario Electricity Support Program (OESP) are included in TMC calculations under Wholesale Market Service Charges. Since RRRP and OESP charges will no longer be recovered entirely from electricity customers, the portion of these costs shifted to the tax-base would not be included in the calculation of TMC. The exclusion of these amounts will result in a small downward pressure on TMC of about 1.6 per cent on an annualized basis • This option is favourable to the NUGs with PPAs calculated using TMC escalation (i.e., their rates would remain unaffected by the government's decision to refinance a portion of GA). • Not including the impact of OFHPA on GA in the calculation of TMC would result in increased cost to ratepayers.

<u>OFA's Preliminary Analysis / Considerations</u>

- Based on preliminary OFA estimates, overall payments to NUGs would be approximately $68 million lower on a present value basis if GA refinancing under the OFHPA is reflected in the TMC calculation.

    - Note: Aggregate nominal payments to most of the NUGs over the life of their PPAs will increase. However, there is one large NUG that will experience a large reduction in payments amounting to $56.4 million, as its PPA will expire before the OFHPA cost recovery phase commences in the mid-2020s.

- In addition, even those NUGs that receive an overall higher nominal payments over time (i.e., over the lifetime of the NUG PPAs) are likely worse off on a present value basis, if the cost of capital for the NUGs exceeds the GA refinancing interest rate. For example, at a 7 per cent discount rate, it is estimated that seven of the 10 affected NUGs will see a net decline in payments over the remaining life of their respective PPAs.

Table 1 – NUG PPAs potentially impacted by OFHPA

Owner	NUG	Location	PPA Expiry	Capacity (MW)
Atlantic Power	Nipigon	Orient Bay	31-Dec-22	40
Northland Power	Iroquois Falls	Iroquois Falls	01-Jan-22	126
Capstone Infrastructure	Dryden	Dryden	01-Nov-20	3.88
Capstone Infrastructure	Wawatay	Thunder Bay	03-Jul-42	13.5
Algonquin Power	Long Sault Rapids	Cochrane	01-Apr-48	15
Brookfield	Nagagami	Near Hearst	01-Feb-46	15
Brookfield	Carmichael Falls	Fauquier	01-Apr-42	18.7
Brookfield	Cameron Falls	Massey	07-Mar-41	4
Brookfield	Serpent River	Spanish	07-Dec-39	7.2
Northland Power	Kirkland Lake	Kirkland Lake	23-Aug-31	103

<u>Court Decision – Justice Wilton-Siegel dated March 12, 2015 *in Iroquois Falls Power Corporation v. Ontario Electricity Financial Corporation*</u>

- NUG PPAs were originally entered into by Ontario Hydro with the NUGs whose PPAs were affected by the above court decision (NUG Applicants).
  - The PPAs included a price adjustment based on changes in Ontario Hydro's rate schedule for direct industrial customers (essentially those whose average monthly demand was 5 MWs (or greater), assuming a 100 per cent load factor (i.e., same hourly consumption all year) and that they were taking "firm" power.
  - The rate schedule reflected the total cost to Ontario Hydro of generating and delivering electricity to direct industrial customers.
- As a result of the restructuring of the electricity sector in 1998, the OEFC assumed the PPAs from Ontario Hydro. There was no longer a single rate that reflected the total cost of generating and delivering electricity to direct industrial customers. Between 2002 and 2008, the OEFC and the NUG Applicants entered into Term Sheets setting out certain amendments to the PPAs, including a new price adjustment.
- Effective January 1, 2011, certain amendments (GA Reg Amendments) were made to the calculation of the GA under Ontario Regulation 429/04 (O. Reg 429/04) made under the *Electricity Act, 1998*:

- As a result of the GA Reg Amendments, OEFC made a corresponding change to the calculation of the GA component of TMC under the PPAs.

- OEFC's rationale was that TMC was intended to reflect the price of electricity to direct industrial consumers, who were now the newly established Class A consumers.

- Since the effect of the GA Reg Amendments was to reduce the GA paid by Class A consumers, the GA component of the TMC was correspondingly reduced. This significantly reduced the amounts payable to the NUG Applicants under the PPAs.

- The NUG Applicants brought a court application (NUG GA Lawsuit) challenging the change in calculating GA under the affected PPAs. Their rationale was that TMC was intended to reflect the costs of generating and supplying electricity to direct industrial customers, not the price of electricity paid by those customers.

- The Trial Court found in favour of the NUG Applicants, and directed OEFC to:

  - Re-calculate the GA component of TMC (retroactive to January 1, 2011) in the same manner as it had been calculated before the GA Reg Amendments came into force;

  - Pay the NUG Applicants the difference between the original (post-December 31, 2010) payments under the PPAs and the re-calculated (post-December 31, 2010) payments, plus interest in accordance with the Courts of Justice Act; and

  - Continue to calculate the GA component of TMC on a going-forward basis in the same manner as it had been calculated before the GA Reg Amendments came into force.

- The Ontario Court of Appeal upheld the Trial Court calculation, and an application by OEFC seeking leave to appeal to the Supreme Court of Canada was dismissed.

- The following twelve NUG PPAs were part of the NUG GA Lawsuit:

Owner	NUG	Location	PPA Expiry	Capacity (MW)
Northland Power	Kirkland Lake	Kirkland Lake	23-Aug-31	103
	Iroquois Falls	Iroquois Falls	1-Jan-22	126
	Cochrane Power	Cochrane	12-Jan-15	38
Brookfield	Serpent River	Spanish	7-Dec-39	7.2
	Cameron Falls	Massey	7-Mar-41	4
	Carmichael Falls	Fauquier	1-Apr-42	18.7
	Lake Superior Power	Sault Ste.Marie	1-May-14	110
	Nagagami	Near Hearst	1-Feb-46	15
Capstone Infrastructure	Dryden	Dryden	1-Nov-20	3.88
	Wawatay	Thunder Bay	3-Jul-42	13.5

Owner	NUG	Location	PPA Expiry	Capacity (MW)
	Cardinal Power	Cardinal	31-Dec-14	165
Algonquin Power	Long Sault Rapids	Cochrane	1-Apr-48	15

- "Standstill" agreements were entered into for the following seven NUG PPAs, whose PPAs would be interpreted in the manner determined by the courts in the NUG GA Lawsuit:

Owner	NUG	Location	PPA Expiry	Capacity (MW)
TransAlta	Ottawa Cogeneration	Ottawa	31-Aug-13	68
	Windsor Cogen	Windsor	1-Dec-16	74
	Mississauga Cogen	Mississauga	31-Dec-18	110
Atlantic Power	North Bay	North Bay	31-Dec-17	40
	Kapuskasing	Kapuskasing	31-Dec-17	40
	Tunis	Tunis	31-Dec-14	48
GDF Suez	West Windsor	Windsor	31-May-16	116

APPENDIX:

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September 15, 2017

MEMORANDUM TO: Serge Imbrogno
Deputy Minister of Energy

FROM: Gadi Mayman
Vice-Chair and Chief Executive Officer, Ontario Electricity Financial Corporation

SUBJECT: **Fair Hydro Plan Implications for Non-Utility Generators**

I am writing concerning the potential impact of Ontario's Fair Hydro Plan ("FHP") on the price escalation provisions contained in certain legacy Ontario Hydro Power Purchase Agreements ("PPAs") with non-utility generators ("NUGs") managed by the Ontario Electricity Financial Corporation ("OEFC"). OEFC is seeking advice from the Minister of Energy as to the Ministry of Energy's view of the intention of the Province with respect to the impact of the FHP on NUGs.

The rate escalation provisions for certain PPAs are based on changes in a price index called the Total Market Cost ("TMC") index. TMC is comprised of various cost components paid for delivered electricity by consumers, including the Global Adjustment ("GA"). The main impact of the FHP is through the timing of the payment of GA costs by FHP eligible consumers, deferring the payment of a portion of total GA costs in the early years of the FHP and recovering the deferred amounts from electricity consumers in the later years.

Under the current administration of the definition of TMC in the PPAs, consistent with the language of the March 2015 Global Adjustment lawsuit decision, the deferral of GA costs in the early years and recovery in the later years would result in the amount of the calculated TMC index being lower in the early, GA deferral years and greater in the GA recovery years than would have been the case in the absence of the FHP. This would result in lower rates under the affected PPAs in the deferral years and higher rates in the recovery years. The overall, aggregate result would be a net reduction in payments under the PPAs.

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OEFC is seeking advice from the Minister of Energy on the intent of the Province as to the impact of FHP on NUGs. In particular, is it the intent of the Province that deferral of a portion of the GA costs under the FHP not affect rates payable under the PPAs , or is it the intention of the Province that the NUGs with relevant PPA price escalation clauses be affected through the continued administration of the PPAs in accordance with their terms.

Absent any policy advice to the contrary from the Minister of Energy, and direction from the Minister of Finance, OEFC would contact the affected NUGs in the fall, and advise them that, under the terms of the PPAs, the annual calculation of TMC would include the GA costs as they are passed through for recovery from consumers, such that the deferred portion of GA costs would not be included in the calculation of TMC during the deferral period, and that the Clean Energy Adjustment charged to ratepayers in later years of the FHP would be included in the calculation of TMC.

Based on preliminary estimates, the impact of the FHP on the calculation of TMC would result in power supply contracts costs recovered from ratepayers being reduced, over the remaining lives of the PPAs, by approximately $65 million on a present value basis. This estimate includes both decreases in power supply contract costs in the deferral years of approximately $95 million and increases of $30 million in the recovery years, on a present value basis. These estimates are preliminary and based on a GA deferral and financing forecast provided by Ministry of Energy staff that corresponds with estimates used in early March. The impact on individual NUG PPAs would vary, depending on their escalation clauses and lengths of their PPAs, for example.

OEFC has not yet communicated to NUGs about this impact. One NUG owner has written to OEFC, enquiring about the impact of the FHP, reminding OEFC of its position that any adjustments to TMC would require OEFC to undertake industry consultations and final agreement of the NUG counterparties.

OEFC's position is that there is no change in the definition or formula for TMC; however, a change in the value of the input components would affect the value of the TMC, which is normal PPA administration of the existing TMC and not a change.

NUGs that contest the inclusion of GA costs as they are charged to ratepayers may attempt to argue that the contract calculations should not be affected as a result of a policy change by the government. Should OEFC eventually take the position that the deferred GA costs not be included in TMC, NUGs may commence a court challenge to obtain a judicial interpretation on the issue.

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OEFC's legal advice is that the definition of TMC, as confirmed in the March 2015 reasons for decision in the Global Adjustment lawsuit, requires OEFC to include GA costs in calculations of TMC as they are charged to consumers. A unilateral decision by OEFC to include deferred GA costs in TMC as those costs are accrued, would not enable OEFC to avoid the offsetting exclusion of the deferred costs from TMC when they are recovered from ratepayers. Explicit agreement from the NUGs would be required in order to allow deferred GA costs and interest to be omitted from TMC when these costs are recovered from ratepayers through the Clean Energy Adjustment.

If the Minister of Energy provides a letter of advice to the Minister of Finance confirming that the intention of the Province is that the NUGs not be affected by FHP deferral of GA costs, OEFC would be able to, with direction from the Minister of Finance, undertake broader consultations with NUGs on how the definition of TMC could be amended in the context of FHP to eliminate the impact of the deferral of GA on the calculation of the index.

Policy direction from the government is required if it is intended for OEFC to consider an option that allows NUGs to be unaffected by the GA deferral provisions of the FHP. A decision to consider such an option is a policy decision, and would require policy advice from the Minister of Energy to support the issuance of a direction by the Minister of Finance to OEFC to engage in such broader consultations with affected NUGs on the impact of FHP plan on NUG PPAs.

If such direction were received, an alternative TMC calculation would need to be discussed with and offered to NUGs, outlining what would and would not be included in the calculation over the expected period of the FHP. Discussions could include as an objective unanimous agreement amongst the NUGs and OEFC on how to calculate TMC in the context of the FHP, such that the TMC would include deferred GA costs in TMC as those costs are accrued, and exclude from the TMC calculation the deferred GA costs and interest when they are later recovered from eligible ratepayers.

Should you have any questions, I and staff are available to meet with you, at your request. Thank you for your attention to this matter.

Sincerely,

Gadi Mayman
Vice-Chair and Chief Executive Officer

c. Ronald Kwan, Vice President

Energy Supply Policy Division
Prepared: October 2017