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, 2017 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*.

- OFA has sought ENERGY's views on whether to include the impact of GA Refinancing in the calculation of TMC. Implications of including the impact of GA Refinancing include:

    - 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. Note that specific NUGs will be better or worse off depending on how their contract terms align with OFHP borrowing/payback timelines.

- ENERGY staff, in consultation with OFA, have drafted a letter of policy support from the Minister of Energy to the Minister of Finance outlining that the Minister of Energy supports the administration of NUG contracts in a manner that allows NUGs to be unaffected by GA refinancing, if that is what is desired by affected NUGs.

- In terms of next steps, the OFA would like to notify the impacted NUGs as soon as possible with a proposed approach. The OFA would calculate NUG rates by the end of the year.

BACKGROUND:

GA Refinancing Impact on Total Market Cost (TMC)

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

- 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*.

- 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

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

- 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

Owner	NUG	Location	PPA Expiry	Capacity (MW)
	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
	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

Energy Supply Policy Division
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Appendix – Options Considered

- 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.
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

Options	Description	Considerations
		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.