Presentation to the Minister of Energy on the Ontario Fair Hydro Plan Act

Purpose

- Purpose is to walkthrough the main elements of the legislation.

- The Act consists of two components:
  - Part 1: Legislation to provide for the fair allocation of costs of electricity over time
  - Part 2: Legislative amendments for social programs

Part 1:
Overview of Legislation to provide for the fair allocation of costs of electricity over time

1. Ontario Fair Hydro Plan Act – Fundamental Principles
2. Brief Overview of the Legislation
3. Stakeholder Consultation and the Process to Prepare the Legislation
4. Building Blocks of the Legislation
   - What costs are part of the program?
   - How are the costs allocated fairly amount ratepayers now and in the future?
   - What consumers does the program apply to?
   - How is the program financed?
4. How the Legislation Works
   - Clean Energy Initiative
   - Clean Energy Costs and Benefits
   - Clean Energy Adjustments
   - Fair Adjustment
   - Fair Allocation Amount
   - Regulatory Asset and the Investment Asset
   - Issuance and Payment of Debt
   - Financing Plan
5. Who Does What
   - Minister of Energy
   - Role of OPG
   - Role of IESO
   - Role of OEB

Ontario Fair Hydro Plan Act – Fundamental Principles

- The actions taken by the Government of Ontario to achieve a clean, modern, and reliable electricity system have resulted in significant costs. The burden of financing the electricity system improvements and funding key programs has unfairly fallen on the shoulders of today's consumers.
- The Ontario Fair Hydro Plan Act is founded on the principle that costs related to the development of a clean, modern and reliable electricity system (with a diverse supply mix) ought to be charged to those consumers, today and in the future, who will be the beneficiaries of those costs.
- The Government of Ontario is committed to ensuring that the costs of financing these investments are allocated fairly among present and future generations of consumers.
- The challenge inherent in the development of the legislation was the need to balance several key factors: the fundamental principles of the program, the program's desired accounting treatment, ratepayer interests, expectations of the financial markets, financeability, and legal considerations.

Stakeholder Consultation and the Process to Prepare the Legislation

- The development of the Ontario Fair Hydro Plan Act was preceded by extensive consultation, on an ongoing basis, with representatives from the Ontario Energy Board, the IESO, Ontario Power Generation, the Provincial Controller's office, the Ministry of Energy, the Ministry of Finance, dealers, investment advisors and Canadian (and in some cases U.S.) counsel for each of the involved parties.
- As appropriate, other Ministries were circulated with drafts of the legislation and consulted on particular issues.
- Several drafts of the legislation were circulated among stakeholders and several mark -ups of draft legislation were received in response.
- Lengthy face to face meetings also took place with stakeholders and their counsel both as a group and individually.
- Legislative counsel were involved on a daily basis and produced multiple versions of the legislation.
- A steering committee chaired by the Deputy Minister met and were briefed weekly on the status of the legislation (the "Rate Mitigation Implementation Group" consisting of senior executives of the Ministry of Energy, Ministry of Finance, OPG, OEB, IESO, Treasury Board Secretariat, and office of the Minister of Energy).

Brief Overview of the Legislation

- Legislation is based on the principle that the costs incurred to move to a clean, modern and reliable electricity system creates benefits that will be experienced by multiple generations of Ontario ratepayers and, therefore, in the interest of fairness, those costs should be shared by those multiple generations.
- The legislation identifies:
  - what costs ought to be more fairly allocated ("clean energy costs");
  - mechanisms to allocate costs fairly among generations of consumers ('fair adjustment" and "fair allocation");
  - the consumers to whom the program applies ("specified consumers");
  - how the program is funded (borrowing on the strength of the revenue stream from consumers); and
  - the roles of various provincial entities in the program (Minister of Energy, Ontario Energy Board, IESO and OPG)
- In order to ensure the financeability of the program, considerable portions of the legislation are devoted to dealing with the "nuts and bolts" of what is required for successful financing including,
  - the quantification of the value of the regulatory asset;
  - the transfer of the regulatory asset to the (OPG) financing entity (which creates the "investment asset");
  - the establishment of an OPG financing plan to ensure, among other things, an appropriate program of financing the shortfalls that are created by the deferred collection of revenues; and
  - provisions setting out the way in which the financings are backed by amounts payable by specified consumers.

Building Blocks of the Legislation – What Costs are Part of the Program?

In order to achieve its purpose, the legislation establishes the following “building blocks”:

- Clean Energy Initiative – This is the term used to describe the Government of Ontario’s policies to foster growth and investment in and remove barriers and promote opportunities for clean and renewable energy sources and technologies and promoting conservation and demand management. The “clean energy costs” under the legislation arise from the “clean energy initiative”.
- Clean Energy Costs – These are costs (attributable to the “clean energy initiative”) that are to be more fairly distributed among generations of consumers.
- Clean Energy Benefits – These are the value of the benefits derived by the “specified consumers” (including the clean energy costs).
- Clean Energy Adjustments – This is adjustment to a consumer invoice on a monthly basis to repay principal, interest and other financing.

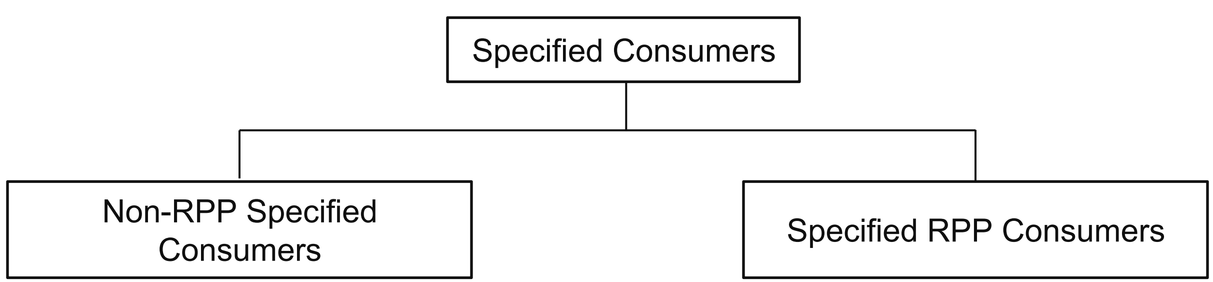
Building Blocks of the Legislation – How are the Costs to be Allocated?

- Fair Adjustment – This is the adjustment that gives the "relief" to certain specified consumers during the period from July 1, 2017 to June 30, 2022 (including this program's portion of the 25 per cent reduction).

- Fair Allocation Amount – This is the concept/mechanism by which the fair distribution of "clean energy costs" (including, for example, financing costs, the cost of the power contracts, and the costs of the fair adjustment) is calculated and implemented.

Building Blocks of the Legislation – What Groups of Consumers Does the Program Apply To?

- Specified Consumers – This is the defined group of consumers to whom the legislative program applies. These consumers are persons who have an account with an electricity vendor for the supply of electricity in Ontario and,
  - have a demand for electricity of 50 kilowatts or less (or as otherwise prescribed);
  - annually use not more than 250,000 kilowatt hours of electricity (or as otherwise prescribed);
  - carry on a farming business (basically pursuant to the *Farm Registration and Farm Organizations Funding Act*);
  - have an account with an electricity vendor that is for a “dwelling”, condominium property, residential complex or co-operative housing; or
  - are otherwise prescribed.



Building Blocks of the Legislation – How is the Program Financed?

- The ability to engage in the fair distribution of clean energy costs among the specified consumers requires financing during periods where the collection of the clean energy costs is, as part of the fair allocation, deferred to later years (thereby creating a revenue shortfall). A series of complex provisions are required to (i) enable the financing, and (ii) meet requirements known to be important to rating agencies and investors.
- Regulatory Asset – This is fundamentally IESO's right to recover the revenues that it has deferred collecting because the clean electricity costs are being allocated across generations of ratepayers.
- Investment Asset – This is the asset that results when the regulatory asset is transferred to the (OPG) financing entities.
- The (OPG) financing entities will fund the acquisition (transfer) of the investment asset in the capital markets.

How the Legislation Works – Clean Energy Initiative

- The "clean energy initiative" concept is set out by definition. Its purpose is to establish the fundamental basis for the legislation.

- The definition is self-explanatory and is as follows:

"clean energy initiative" means the policies of the Government of Ontario related to,

a) *eliminating coal generation and fostering the growth of and investment in clean, modern and reliable energy sources and technologies,,*
b) *removing barriers to and promoting opportunities for clean and renewable energy sources and technologies,*
c) *promoting conservation, demand management and energy efficiency; and*
d) *investing in energy infrastructure to ensure a clean, modern and reliable system;*

How the Legislation Works – Clean Energy Costs and Benefits

- "Clean energy costs" are those costs that arise from the "clean energy initiative" and are allocated to the specified consumers for past, present and expected costs.
- The costs included in the "clean energy costs" include estimated amounts to be paid by the IESO in adjustments made under section 25.33 of the *Electricity Act* (basically, the Global Adjustment provisions) which relate to contracts for,
  - renewable energy generation or capacity
  - conservation and demand management, including shortage
  - energy efficiency
  - natural gas generation and capacity (excluding certain contracts under section 78.2 of the *Ontario Energy Board Act* or as prescribed)
  - payments made under section 78.5 of the *Ontario Energy Board Act*
- Other such costs to be included in "clean energy costs" may be prescribed
- These are the costs to be distributed fairly among the specified consumers through the "fair allocation amount".

How the Legislation Works – Fair Adjustment

- The fair adjustment provisions are set out in Part II of the legislation.
- Part II establishes that the rate that will be payable by "specified RPP consumers" from May 1, 2017 to April 30, 2018 for the first fair adjustment is the rate that would be required from this program to contribute to that consumer to receiving a total a monthly invoice amount that is 25 per cent lower than the monthly invoice amount for that consumer under the "comparison rate". The comparison rate is a rate to be determined by the OEB using the method prescribed by regulation under s 79.16(1)(b) of the OEB Act.
- Part II includes a transition provision in circumstances where for technical or operational reasons invoices cannot be adapted in time for the issuance of the first invoices under the program (i.e. adaptation of invoices must be implemented by August 1, 2017 followed by a subsequent lump sum credit to the consumer once the invoice is adapted).
- The Lieutenant General in Council is given the authority after April 30, 2018 to make regulations prescribing the rate for electricity (and therefore prescribing the "fair adjustment" until June 30, 2021). After June 30, 2021, regulations will have regard to the fair allocation amount and clean energy adjustments.

How the Legislation Works – Fair Allocation Amount

- The Minister sets the fair allocation amount.
- The establishment of the "fair allocation amount" is required to,
  - fairly measure and allocate the estimated clean energy costs (and the clean energy benefits) among the "specified consumers" for applicable "reference periods"; and
  - take into account (in the fair allocation) funding obligations (financing) that have been incurred (largely arising from the redistribution of cost across generations of consumers)
- The "fair allocation amount" is to have regard to:
  - clean energy costs and allocating the appropriate proportionate amount of the clean energy benefits to the "specified consumers" (in the applicable "reference periods");
  - reasonable assumptions regarding the time value of money, the number of consumers in the "reference period"; and
  - expected electricity consumption for the reference period.

How the Legislation Works – Regulatory Asset and Investment Asset

- The IESO will have a funding gap resulting from the reduction in amounts collected from specified consumers during the first 5 years because of the fair adjustment. The IESO's funding gap will be financed indirectly through the debt capital markets.
- The Act enables the financing of this IESO funding gap, on an ongoing basis, by establishing the funding gap as a "regulatory asset". In simple terms, the regulatory asset is IESO's right to recover the revenues that it has deferred collecting (which deferral creates IESO's funding gaps).
- IESO will then legally transfer portions of this right to recover revenues to the (OPG) financing entities.
- The (OPG) financing entity that receives the transfer of the right to recover revenues acquires a right to impose, invoice and collect those regulatory charges (called the "clean energy adjustments"). This is generally described in the legislation as the "investment asset".
- The (OPG) financing entity will need to finance its acquisition (from IESO) of the investment asset, and it will do so in the capital markets.

How the Legislation Works – Issuance and Payment of Debt

- Debt securities and related funding obligations will be incurred by one or more (OPG) financing entities. These entities will be managed by OPG, as the financial services manager.

- The financings will be backed primarily by the “clean energy adjustments” payable by specified consumers. The “clean energy adjustments” will track the actual payment obligations incurred by the financing entities when they become due and payable. To ensure intergenerational fairness, these amounts will be managed by OPG to align with the “fair allocation amounts” ascribed to each of the next 60 six month periods ending in 2047 (or such later period as prescribed).

- IESO and each electricity distributor will act as agent for the financing entities to impose, invoice and collect the clean energy adjustments, which will be channeled through to pay each financing entity’s related funding obligations.

- To support the program, the Government of Ontario will be expected to provide certain performance guarantees, indemnities and bond-purchase covenants. The terms of these obligations will be worked out over time in connection with the marketing of financings through OPG. The goal will be achieve highest rated securities, although that will largely depend on issues such as the strength of the Government of Ontario’s undertakings not to adversely affect the program through subsequent legislation.

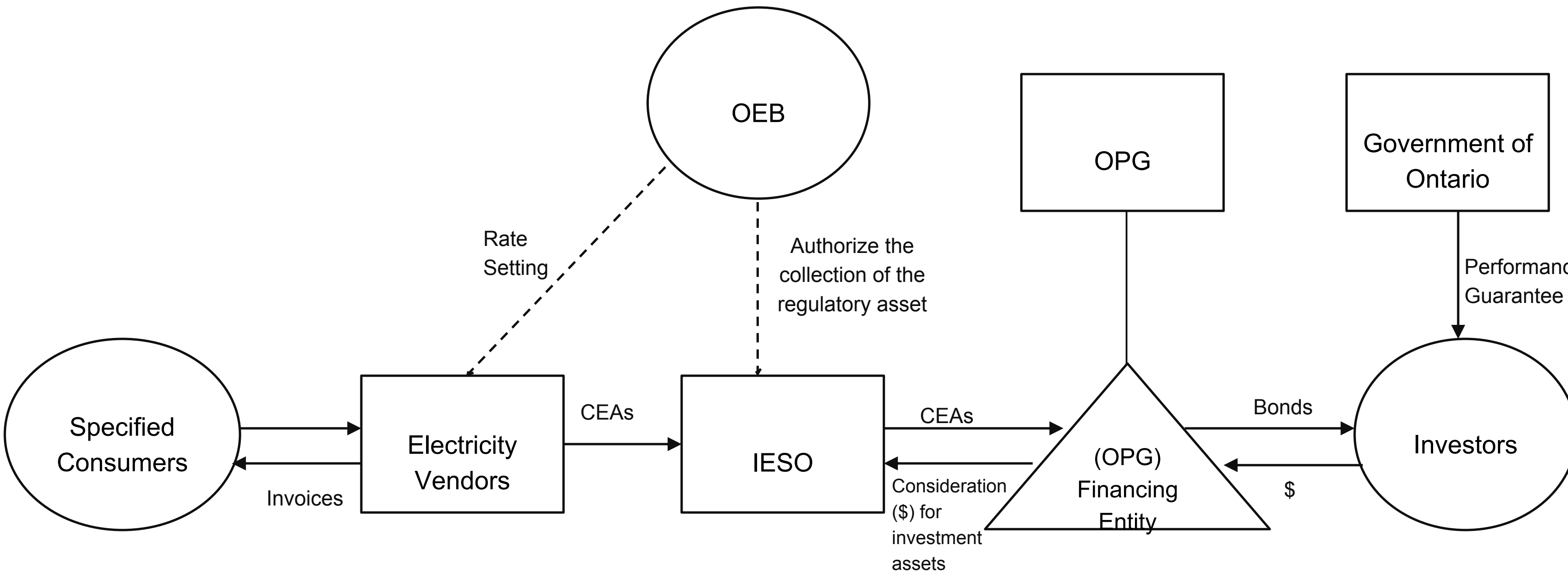
How the Legislation Works – Financing Plan

- The Financing Plan is prepared by the Financial Services Manager (OPG).
- The Financing Plan is the plan which is intended to set out when a “funding obligation” (financing) should be incurred so that the (OPG) financing entity can raise money to acquire the “investment interest” from IESO.
- There are rules that apply to the Financing Plan:
  - It must align with the “estimated finance amount” that will become due and payable during a “reference period”;
  - It must take into account the “fair allocation” and any “fair adjustment”;
  - It must plan to implement the financing in a reasonable and cost effective manner that reflects prevailing market terms and conditions; and
  - It must be based on certain reasonably assumptions set out in regulations (for example, related to anticipated IESO shortfalls, maturity of funding obligations, availability of refinancings, redemption opportunities and liquidity, and similar assumptions).

How the Legislation Works – Financing Plan (Continued)

- The (OPG) Financial Services Manager must incur funding obligations in conformity with the applicable Financing Plan.
- The Financing Plan will guide OPG's decisions regarding the repayment terms of the debt securities to be issued by financing entities. The Financing Plan will also deal with fundamental issues, such as the alignment (using derivatives) of any foreign currency obligations incurred by financing entities with the Canadian dollar cash flows arising through the clean energy adjustments.

How the Financing Structure Works



CEAs are “clean energy adjustments”

Who Does What–
Role of the Minister of Energy

- Determine the “fair allocation amount” applicable for each reference period. The fair allocation amounts will be set for all reference periods at the beginning of the program, based on reasonable expectations and forecasts at that time.

Who Does What–
Role of OPG

As financial services manager, OPG will be responsible for the following under the Act:

- Prepare and implement Financing Plan.
- Establish and administer the financing entities.
- Capitalize the financing entities by acquiring subordinated debt and equity, as required to achieve OPG's accounting and capital markets objectives.
- Estimate and "true up" periodic finance amounts, to be passed through as regulatory charges in the form of Clean Energy Adjustments.

Who Does What – Role of the IESO

- Calculate and record IESO funding shortfalls from time to time in a variance account, giving rise to a right of recovery from specified consumers to the extent not funded through the financings.
- Transfer the IESO's rights of recovery to (OPG) financing entities, in consideration for cash payments made by the financing entities from the proceeds of their financings.
- Coordinate the collection of "clean energy adjustments" from Electricity Distributors.
- Remit "clean energy adjustments" to (OPG) financing entity, for payment of financing entity funding obligations.
- Fund initial interest costs and expenses during the first 5 years.

Who Does What –
Role of the OEB

- Determine and set rates to account for fair adjustments, fair allocations and clean energy adjustments (monthly adjustments).
- Determine and set rates and process to allow the IESO to recover funding shortfalls (to the extent such amounts are not transferred to an (OPG) financing entity and financed in the capital markets).
- Review the administrative costs of OPG in connection with the administration of the program.

Part 2:
Overview of Legislative Amendments for Social Programs

- As part of the proposed Ontario Fair Hydro Plan, the Ministry of Energy is proposing amendments the *Ontario Energy Board Act, 1998* (OEBA) to enable the following measures:
  - Enhancing and providing tax-based funding for Rural or Remote Electricity Rate Protection (RRRP) through new enhanced rate protection for residential customers with high distribution rates;
  - Enhancing and providing tax-based funding for the Ontario Electricity Support Program (OESP); and
  - Creating a new First Nation On-Reserve Delivery Credit and providing for tax-based funding.

Overview of RRRP and Broadened Distribution Rate Protection

- Section 79 of the OEB Act would be amended to provide the Ministry the authority to prescribe, through regulation, classes of consumers whose cost would be transferred from the rate-base to the tax-base.
- If the proposed legislative amendments are approved, the government intends to propose regulatory amendments that would prescribe Hydro One's R2 customers as receiving RRRP from appropriated funds effective July 1, 2017. This would fulfill the government's intention to transfer the majority of the costs of administering the RRRP program to the tax-base.
- In addition, Energy is proposing legislative amendments that would broaden rate protection by creating a new distribution rate protection program to complement RRRP. This new program would be funded through tax payers.
- Distribution rate protection would be extended to eligible residential customers served by LDCs with the highest distribution costs.
  - Proposed legislative amendments would enable a maximum monthly base distribution charge to established through regulations.
- If the proposed legislative amendments are approved, the government intends to prescribe by regulation both program details and the residential customers eligible for broadened distribution rate protection served by the following LDCs:
  - Hydro One (R1 and R2 rate classes), Algoma Power, Atikokan Hydro, InnPower, Chapleau Public Utilities Commission, Sioux Lookout Hydro, Lakeland Power (Parry Sound service territory) and Northern Ontario Wires Inc.

Ontario Electricity Support Program

- Proposed legislation related to the Ontario Electricity Support Program (OESP) would shift program funding from the rate base to the tax base.
  - Tax-based funding would only kick in once the existing OESP variance account is depleted, which is expected to happen in the fall of 2017.

- To allow for the existing program structure to stay in place until tax-based funding kicks in, proposed new legislation would only come into force via a proclamation Order in Council, on a date to be determined.
  - This would ensure that existing OEB authorities remain in place while ratepayer funding is being used.

- In addition, a new authority to allow the OEB and the Ministry of Community and Social Services (MCSS) to share data on customers to support increased participation in the OESP program among Ontario Works and Ontario Disability and Support Program clients would be put in place.
  - Information Privacy Commissioner staff were consulted, and customer consent is reflected.
  - This information sharing component will come into force at Royal Assent, allowing OEB and MCSS to begin this process quickly, and support increasing OESP participation levels.

First Nations Delivery Credit

- Energy is proposing legislative amendments that would establish a first Nation Delivery Credit for On-Reserve Consumers. This new program would be funded through tax payers.

- The proposed First Nation Delivery Credit would provide:
  - All prescribed on-reserve consumers with a credit for the entirety of their delivery line or with a credit for the monthly service charge.
  - The costs that are covered by the delivery credit are also described in legislation.

- If the proposed legislative amendments are approved, the government intends to propose regulatory amendments that would:
  - establish the class of customers eligible;
  - determine what is considered on-reserve; and
  - determine the method of calculating the delivery credit.