Ontario

Treasury Board / Management Board of Cabinet Request Assessment Note	
Ministry:	Energy & Finance
Meeting Date:	September 25, 2017
Agenda Class:	Discussion (In-Camera)
Last reviewed by: ENERGY TB/MBC May 9, 2017	**Tracking to:** Fast Track Cabinet (September 27, 2017)

Submission Title:	Provincial Protection Agreement (Supports Ontario's Fair Hydro Plan implementation)

I. Decision Before the Board

Approve the Ministries plan for implementing provisions within the *Fair Hydro Plan Act, 2017* (FHPA) to provide protection and assurance arrangements in respect of debts, obligations, securities or undertakings associated with investment interests acquired by entities established by Ontario Power Generation Inc.

II. Recommendations

Approve the plan for implementing provisions of the *Fair Hydro Plan Act, 2017* (FHPA) to provide protection and assurance arrangements in respect of debts, obligations, securities or undertakings associated with investment interests acquired by entities established by Ontario Power Generation Inc. (OPG).	*Approve*
Approve that the Minister of Finance and Minister of Energy provide a protection agreement, to be authorized by Order in Council under the *Fair Hydro Plan Act, 2017(FHPA).* – In respect of the debts, obligations, securities and undertakings of one or more OPG Financing Entities substantially reflecting the terms set out in the Provincial Protection and Assurances Indicative Term Sheet and subject to such revisions that the two Ministers acting together may determine	*Authorize*
Recommend that Cabinet approve an Order in Council (OIC), in accordance with section 5 of the *Fair Hydro Plan Act, 2017 (FHPA)* that authorizes the Minister of Finance and the Minister of Energy, acting together on behalf of the Province, – To agree to guarantee or indemnify any debts, obligations, securities or undertakings associated with an investment interest; and – To determine terms and conditions of the guarantee or indemnity and the maximum liability for the guarantee or indemnity.	*Recommend*

III. Financial Summary

$ Millions	**2017-18**	**2018-19**	**2019-20**
Initiative cost requested	0.0	0.0	0.0
Initiative cost recommended	0.0	0.0	0.0
Recommended program base	0.0	0.0	0.0
Offset Recommended	0.0	0.0	0.0

Total Fiscal Impact	0.0	0.0	0.0

IV. KEY COMMENTS AND CONSIDERATIONS

Under the *Fair Hydro Plan Act, 2017*, (FHPA), which enables Global Adjustments (GA) Refinancing, the Independent Electricity System Operator (IESO) will have a funding gap resulting from the reduction in amounts collected from consumers.

- IESO will incur a cash shortfall, as the amounts collected from the consumers of electricity (collected by local distribution companies) will be reduced, but the amounts paid to the generators of electricity will remain at the market and/or contractual rates.

The legislation enables IESO to record the under-collection of GA in a variance account, and deems this under-collected amount to be a “Regulatory Asset”.

The OFHPA provides for IESO to sell all or a portion of the Regulatory Asset (i.e., to sell the right to recover those deferred amounts from specified consumers in the future). Under the FHPA, a Financing Entity (i.e., an entity established or caused to be established by OPG as the Financial Services Manager under the FHPA) will he the right, but not the obligation to purchase the regulatory asset, effectively financing the shortfall generated by the reduction in amounts collected from eligible ratepayers.

To purchase the regulatory asset from IESO, the Financing Entity will borrow a portion of the funds (planned to be 51%, with other financing to come from OPG and, indirectly the Province) from the capital markets.

OPG’s financial advisors have indicated that without adequate protection against legislative and judicial risk, the debt would not be financeable. OPG, therefore, has advised that the Government of Ontario provide a protection agreement to the Financing Entity and prospective debt holders such that, under certain circumstances, the Province would pay the funding obligations of the Financing Entity.

- Providing this through Provincial assurance and guarantee provisions was recommended in a May 2017 TB/MBC item reviewing proposed FHPA.

What would trigger the protection agreement?

Ontario Financing Authority (OFA), the Ministry of Finance and external advisors recommend limiting activation of the protection agreement to the following circumstances (Appendix C provides the non-binding term sheet):

- Actions of the Legislative Assembly that undermine the financing arrangement, i.e., repeal or amendment of the FHPA/related regulations or new legislation that materially and adversely affects the ability of an OPG Financing Entity to receive amounts relating to its investments interest so that it can pay its funding obligations
- A court decision that declares the ability of an OPG Financing Entity to receive amounts on its investment interest so it can pay its funding obligations to be invalid; and
- A change in the organization or structure of the IESO or Ontario’s electricity market undertaken at the initiative of the Province or an entity controlled by the Province that materially and adversely affects the ability of an OPG Financing Entity to receive amounts relating to its investment interest so that it can pay its funding obligations.

Financial:

If the protection agreement is provided, the Province takes on a contingent liability. The amount of the contingent liability would increase over the duration of Ontario’s Fair Hydro Plan (OFHP) and peak at approximately $20B of debt (final cost forecasts TBC), including principal and accumulated interest.

- In the event the protection agreement is triggered, the Province’s net debt would be expected to increase by an amount equal to the contingent liability for the debt outstanding at that point in time.

- The Province's interest payments will also increase by the debt interest servicing of the debt payment obligations it will be required to make under the protection agreement. In addition there may be additional payments related to derivatives agreements and for service providers that the Province will be required to make. The fiscal impact of the increased interest payments will depend on the circumstances of the change (e.g. will the amounts continue to be recovered from the ratepayers through the clean energy adjustment as provided for under the FHPA).

Financial (Risk) – In the event the protection agreement is triggered:

The Province would be required to pay principal and interest on debt issued by the Financing Entity and other obligations of the Financing Entity as they come due (without acceleration). The Province may also be required to pay other obligations which may include payments under derivatives agreements (e.g. the Financing Entity might enter into interest rate swap agreements to hedge the interest rate payable on its issued debt) and to service providers.

- The Minister of Finance and Minister of Energy will negotiate terms and conditions as part of the proposed protection agreement that would provide a process for determining which future obligations, securities/derivatives would have the benefit of the protection agreement. The process and framework is currently under development but may include approving standard terms and conditions of debt issuances in advance, setting a maximum amount of debt that may be issued within a period.

This would likely have implications for the Province's fiscal plan and appropriation requirements.

- The Province's net debt would be expected to increase by an amount equal to the contingent liability for the debt outstanding at that point in time, and the Province may incur an expense equal to the amount of the debt.
- The Province's interest payments will also increase by the debt interest servicing of the debt payment obligations it will be required to make under the protection agreement. The worst case scenario would be the Province assuming the debt at its peak at which point interest on debt (IOD) expense could increase between $0.8B and $1.3B per annum (final cost forecasts TBC), depending on the interest rate at which the Financing Entity will be able to borrow at.
- In addition there may be additional payments on derivatives agreements and for service providers that the Province will be required to make.

The protection agreement would continue until all guaranteed obligations of the Financing Entity are fully discharged. In addition, the Province would have the option to directly replace the OPG Financing Entity with respect to its outstanding rights obligations and liabilities, but if the Province decided to do so additional authority would be required and may require a change in legislation.

The Ministries indicate that if the protection agreement is triggered, and the Province becomes responsible for the obligation to service and pay down the debt, that the magnitude of the fiscal impact (IOD expense) will depend on whether or not some portions of the OFHPA continue in some form, or not.

- For example, if the payment streams from ratepayers via the collection of the Clean Energy Adjustment (CEA) continue, this would offset the debt and interest payments, albeit not necessarily in the same fiscal period; however, if the CEA is ended (e.g., if the OFHPA is repealed or is determined by a court not to be constitutional) and not replaced by another authorized charge, the incremental IOD expense as well as any continued impact of reduced electricity rates would impact the Government's fiscal plan and likely takes away fiscal resources that can be otherwise used.

- Debt incurred to benefit the ratepayer could become the responsibility of the taxpayer.

TBS staff note the protection agreement, assuming the Board proceeds with the request, would be approved prior to the commercial agreements being finalized. Also from an accounting perspective, previously provided opinions/memos from KPMG re: IESO and EY re: OPG have yet to be updated.

Implementation
The Minister of Finance will be asked to approve for the purpose of FAA s. 28 the two Ministers seeking the OIC in the form attached to the final TB/MBC Submission.

The Minister of Finance will also be requested to approve under FAA s. 28 the final form of protection agreement to be entered into by the Minister of Energy and the Ministry of Finance as authorized by the OIC.

MOF Legal indicates the intention is that the protection agreement signed by the two Ministers would apply to all subsequent agreements entered into by the Financing Entity subject to compliance with the terms and conditions set out in the protection agreement. A section 28 approval of the protection agreement should cover these subsequent agreements. This may change as the protection agreement and the terms and conditions of the process have not been determined by the Ministers.

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Date:	September 21, 2017	**Log number:**	
Branch / Division:	GGPR / PEMD / Treasury Board Secretariat		

APPENDIX A: PROPOSED MINUTE

Approve the Ministries plan for implementing provisions of the *Fair Hydro Plan Act, 2017 (FHPA)* to provide protection and assurance arrangements in respect of debts, obligations, securities or undertakings associated with investment interests acquired by entities established by Ontario Power Generation Inc.

In this regard,

i) Approve that the Minister of Finance and Minister of Energy provide a protection agreement, to be authorized by Order in Council under the *Fair Hydro Plan Act, 2017* in respect of the debts, obligations, securities and undertakings of one or more OPG Financing Entities substantially reflecting the terms set out non-binding term sheet – Provincial Protection and Assurances Indicative Term Sheet included in the TB/MBC Submission, and subject to such revisions that the two ministers acting together may determine.

ii) Recommend that Cabinet approve an Order in Council, in accordance with section 5 of the FHPA, that authorizes the Minister of Finance and the Minister of Energy, acting together on behalf of the Province,

   a) To agree to guarantee or indemnify any debts, obligations, securities or undertakings associated with an investment interest; and
   b) To determine terms and conditions of the guarantee or indemnity and the maximum liability for the guarantee or indemnity.

iii) Direct the Ministry of Energy to report back to TB/MBC with final accounting/ legal/financial risk opinions.

APPENDIX B: FINANCIAL TABLES

FINANCIAL IMPACTS: CHANGES TO EXPENSE AND REVENUE				TABLE B1
		Fiscal Plan Basis		*Appropriations Basis*
$ Millions	**2017-18**	**2018-19**	**2019-20**	**2017-18**
Initiative cost recommended				
Expense changes:				
Oper				
Expense Offset:				
Oper				
Total Fiscal Impact	0.0000	0.0000	0.0000	**0.0000**

APPENDIX C: EXCERPT FROM *FAIR HYDRO PLAN ACT, 2017*

Protection and assurances

Prohibition

5 (1) No action or omission by the Board, the Minister or the Crown shall be effective to reduce, impair, postpone or terminate the obligations of specified consumers to pay amounts in respect of the clean energy adjustment or to impair or postpone the invoicing, collection or remittance of the clean energy adjustment.

Agreements

(2) The Minister and the Minister of Finance may together, with the approval of the Lieutenant Governor in Council, enter into agreements on behalf of the Province of Ontario with any person in respect of this Act, including agreements regarding the performance of the IESO or electricity vendors under this Act or related transactions.

Guarantee, indemnification

(3) The Lieutenant Governor in Council may by order,

> (a) authorize the Minister and the Minister of Finance, acting together on behalf of the Province,
>
> > (i) to agree to guarantee or indemnify any debts, obligations, securities or undertakings associated with an investment interest, and
> >
> > (ii) to determine terms and conditions of the guarantee or indemnity and the maximum liability for the guarantee or indemnity;
>
> (b) specify terms and conditions that must be included in any guarantee or indemnity given by the Minister and the Minister of Finance; and
>
> (c) specify a maximum liability for the guarantee or indemnity.

APPENDIX D: NON-BINDING TERM SHEET

Provincial Protections and Assurances

Indicative Term Sheet

Ontario Fair Hydro Plan Act, 2017

*This indicative term sheet (the "**Term Sheet**") relates to transactions contemplated to be undertaken under the Ontario Fair Hydro Plan Act, 2017 (the "**Act**") and the regulations made thereunder (the "**Regulation**"). This Term Sheet is to be held confidential. Unless otherwise specified, defined terms used herein have the meanings ascribed to them in the Act. The provincial protection and assurance arrangements contemplated in this Term Sheet will include such terms and conditions as the Minister of Energy and the Minister of Finance determine to be appropriate. This Term Sheet is not intended to create any obligations or be binding.*

Change of Law Protection Agreement:	A Change of Law Protection Agreement will be among the Obligor, a Financing Entity and an Indenture Trustee, acting for and on behalf of the Beneficiaries in accordance with a Trust Indenture.
Obligor:	The Province of Ontario, by the Minister of Energy and the Minister of Finance acting together.
Indenture Trustee:	An indenture trustee, acting for itself and on behalf of other persons entitled under an applicable Trust Indenture.
Beneficiaries:	The Indenture Trustee, acting for itself and on behalf of other persons entitled under Specified Claims.
Specified Claims:	Payment obligations of the Financing Entity that are secured under the Trust Indenture and that are approved as contemplated below under Obligor Approval.
Protection Events:	Any of the following would constitute a Protection Event: (A) (1) the Legislature repeals (and does not replace on an equivalent basis) or amends the Act or any portion thereof; (2) the Legislature enacts or amends any other statute; (3) the Lieutenant Governor in Council repeals (and does not replace on an equivalent basis) or amends the Regulation made under the Act or any portion thereof; or (4) the Lieutenant Governor in Council, a minister of the Crown, an official of the government or a board or commission all the members of which are appointed by the Lieutenant Governor in Council makes or amends any "regulation" (as defined in Part III of the *Legislation Act, 2006*);

	(5) there is a change in the organization or structure of the IESO or Ontario's electricity market undertaken at the initiative of the Province or an entity controlled by the Province, in each case, that [materially][1] and adversely affects (a) the ability of the Financing Entity to receive amounts on its investment interest so that it can pay Specified Claims, or (b) the Change of Law Protection Agreement or any of the agreements under which Specified Claims arise, other than if the Indenture Trustee has confirmed in writing that the affect under such agreements is otherwise acceptable; or (B) a court of competent jurisdiction [in a final and non-appealable judgement][2] determines that all or a portion of the Act or the Regulation is *ultra vires* or invalid in a way that [materially][3] and adversely affects the ability of the Financing Entity to receive amounts on its investment interest so that it can pay Specified Claims.
Obligation to Pay Specified Claims:	Upon the occurrence of a Protection Event, the Indenture Trustee will have the right to require the Obligor to pay the Specified Claims owing by the Financing Entity when they become due and payable (without acceleration). The exercise of such right by the Indenture Trustee in accordance with the Trust Indenture shall constitute the only remedy available under the Change of Law Protection Agreement. Under no circumstances shall the Obligor be obligated to pay or indemnify a Beneficiary for consequential, special or punitive damages, or for economic loss or loss of profits.
Subrogation:	Upon paying a Specified Claim to a Beneficiary, the Obligor as guarantor shall have rights of subrogation, including becoming entitled to all of the applicable Beneficiary's rights and interests under and in respect of the Specified Claim, including the security interest in each related investment interest and related property of the Financing Entity.

[1] Under consideration to assess the marketability implications of materiality threshold.

[2] Under consideration to assess the marketability implications of this phrase.

[3] See footnote 1, above.

Optional Assumption:	At any time following the occurrence of a Protection Event, the Obligor shall be entitled (but not obligated) to assume the Financing Entity's obligations in respect of Specified Claims as obligor and debtor. The Financing Entity (including through the Financial Services Manager) will ensure that Specified Claims permit such an assumption by the Obligor without any penalty or make-whole payment (or, in the case of any contract for the provision of on-going services to the Financing Entity, the satisfaction and termination of the Specified Claims without any acceleration of future fees, profits or other like amounts), or any requirement for further consent, approval or agreement.
Term:	The Change of Law Protection Agreement will continue for as long as any Specified Claim remains outstanding.
Obligor Approval:	The process by which a Specified Claim will become subject to the Change of Law Protection Agreement will be determined by the Minister of Finance and Minister of Energy in negotiation with the Financing Entity.
FIPPA:	The Change of Law Protection Agreement will acknowledge that the Obligor will be bound by the *Freedom of Information and Protection of Privacy Act* (Ontario) and that any information provided to the Obligor, or any agent or representative of the Obligor in connection with the Change of Law Protection Agreement, may be subject to disclosure in accordance with the act or as otherwise required by law.
Representations and Warranties:	To be determined by the Minister of Finance and Minister of Energy in negotiation with the Financing Entity.
Confidentiality Obligations:	To be determined based on what would be customary and appropriate for similar types of arrangements and is acceptable to the Obligor and the Financing Entity.
Governing Law:	Province of Ontario.

APPENDIX F: RISK UPDATE

The current submission, Provincial Protection Agreement, is reflected under the risk “Refinancing GA costs through an OPG SPV Trust may increase costs and/or require provincial funding” as part of risk mitigating strategy.

Risk	Level of Risk	Risk Response
Refinancing GA costs through an OPG SPV Trust may increase costs and/or require provincial funding.	**Risk Likelihood:** Possible **Risk Impact:** Major **Time Scale:** 12 to 24 months **Rationale** • The proposed borrowing structure will be reviewed by credit agencies to allow OPG to borrow in the open market. Depending on assessment, there may be an impact on the interest rate for borrowing, the amount of equity / funding the province may need to provide and the requirement for a provincial guarantee. • As the OPG SPV/Trust will be borrowing in its own corporate capacity from the public markets, it will likely incur a higher interest cost compared to the Province’s borrowing. • There is a risk that credit rating agencies may perceive OPG SPV/Trust’s borrowing as debt supported by Province, impacting Province’s own ratings and cost of borrowing. • If the Trust can’t raise the full funding requirements, additional cash injections would be required. If the borrowing cap of $28B (in the March 1, 2017 Cabinet Submission) is reached sooner than forecast, the province may have to provide incremental funding to float the program to 2047. • Beyond 2022, when steep increases are required, there will likely be additional pressure on the province to offset a part of the scheduled increases. • Fiscal impacts will be subject to fluctuations in Ontario electricity demand, GA and interests rates in the medium-to long term. As well as if a protection agreement is called upon: o OPG, has advised that the Government of Ontario provide a change of law protection agreement to the Financing Entity and prospective debt holders such that, under certain circumstances, the Province would pay the funding obligations of the Financing Entity.	Risk can be mitigated by: • Providing a “provincial guarantee” for the cost of borrowing. • Drafting legislation to provide assurance to OPG and investors regarding the permanence of the GA refinancing framework and the authority of the legislation to pass the legislation; and enable the Province to guarantee borrowing of the trust in the event of a market disruption. • Specifics of a guarantee are dependent on the negotiation of agreements not yet initiated. Limiting triggers of a protection agreement to legislative (regulatory) changes and/or judicial decisions etc. • Equity injections from the province to support OPG as the owner and manager of GA refinancing and allow OPG to strengthen the capital structure of the Trust in order to secure financing at a reasonable cost.