STANDING COMMITTEE ON PUBLIC ACCOUNTS

Chapter 2, Public Accounts of the Province
Key Messages, Q&A Response and Issues
February 2018

KEY MESSAGES

Ontario's Fair Hydro Plan

- The government has been making important investments in a cleaner and more reliable electricity system, but these investments have led to higher electricity bills.
- Ontario's Fair Hydro Plan has lowered electricity bills by 25 per cent for a typical residential consumer, and will hold increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting from a reduction.
- These measures include the 8 per cent rebate introduced in January 2017, which is equivalent to the provincial portion of the HST and build on previously announced initiatives to deliver broad-based rate relief on all electricity bills.
- Lower-income Ontarians and those living in eligible rural communities are receiving even greater reductions, as much as 40 to 50 per cent.
- Taken together, these changes have delivered the single largest reduction to electricity rates in Ontario's history.

Records Disclosure/Process

- The Ministry of Energy conducted a records search consistent with the 40 plus search terms provided by the Auditor General (AG).
- The Ministry selected McCarthys/Wortzmans to assist with processing and analysis of approximately 2.2 million records that resulted from the search of 81 custodians. The Ministry provided all responsive records to the AG (i.e., more than 73,000 emails).
- The Ministry provided regularly the AG with batches of responsive documents. The Ministry completed its response to the AG on October 26, 2017.

Affordability Fund / Arm's Length Trusts

- A Trust structure was selected to implement the Affordability Fund in order to provide an effective solution to distributing funds to electricity distributors. With approximately 65 distributors across Ontario, it was not feasible for the Province to enter into agreements with each distributor.
- The Trust structure establishes an independent entity with expertise from the electricity distributor and community sectors.

- In terms of governance and accountability, there are report-back requirements on the use of funds transferred as well as the ability for the government to conduct an audit to gain assurance that the funds have been used for the purposes intended.

Electricity Bill Re-Design

- Electricity bills are a customer's main window into the electricity system. Through the 2017 Long-Term Energy Plan (2017 LTEP) consultation process, the Ministry of Energy heard that customers found their bills confusing and inaccessible.

- The objective of the bill redesign initiative is to make bills easier for customers to understand and ensure that they get the most useful information out of their bills. Comparisons of costs from previous billing periods will continue to be possible.

- Hydro One has been a leader in consumer research on ways to improve the appearance and comprehension of its bill. Hydro One enlisted the services of a behavioural research firm and engaged with thousands of customers to develop a new bill design which has been observed to increase customer satisfaction and comprehension.

- Building on this research, the Ministry of Energy launched the Bill Redesign Action Plan with the aim of revising the regulatory framework on invoicing to improve the value of electricity bills for consumers. The Ministry continues to engage with industry and consumers to better understand consumer concerns and preferences with respect to the bill to ensure that any proposed changes to the bill's design will meet consumer's needs.

<u>Q&AS RESPONSE</u>

<u>Ontario's Fair Hydro Plan</u>

Q. Why did the government introduce Ontario's Fair Hydro Plan?

The government has been making important investments in a cleaner and more reliable electricity system, but these investments have led to higher bills. Nearly $70 billion[1] has been invested in the electricity system since 2003, including more than $37[2] billion in electricity generation to ensure the system is clean and reliable.

Ontario's Fair Hydro Plan (OFHP) is delivering the single-largest reduction in electricity rates in the province's history. OFHP lowered electricity bills by 25 per cent for a typical residential consumer and will hold increases to the rate of inflation for four years. As many as half a million small businesses and farms are also benefitting from a reduction.

To address the impact of our electricity system investments on consumers, OFHP includes:

- Refinancing the Global Adjustment (GA) over a longer term period for eligible consumers, including residents, small businesses, farms and long-term care homes.

- Helping vulnerable electricity consumers by enhancing electricity support programs and shifting costs off the electricity bill. Eligible consumers will receive additional funding through assistance programs including:

    - Establishing a new Affordability Fund which will support Ontarians who are not eligible for the Home Assistance Program and who have difficulty paying their electricity bills.
    - Broadening Rural or Remote Rate Protection (RRRP) to provide distribution charge relief for the customers of the local distribution companies (LDCs) with the highest distribution charges.
    - Expanding the Ontario Electricity Support Program (OESP) to increase participation and provide further assistance to eligible participants.
    - Establishing a new On-Reserve First Nations Delivery Rate.

- Improving sector efficiency and modernizing Ontario's electricity market, working in collaboration with the Independent Electricity System Operator (IESO) and the Ontario Energy Board (OEB).

- Any rate increases over the next four years will be held to the rate of inflation.

In the development of Ontario's Fair Hydro Plan, the government made the policy decision to provide rate relief to specific residential consumers thought the introduction of new and enhanced electricity social programs, such as OESP and RRRP. At the same time, the government also made a policy decision that these new measures would be more appropriately funded from the tax-base, not the rate-base.

[1] Ministry of Energy, *2017 Long-Term Energy Plan*
[2] Ministry of Energy, *2017 Long-Term Energy Plan*

If pressed on the cost of these new and enhanced social programs:

On March 2, 2017, the government publicly announced the enhancement of the existing OESP and RRRP and the new Affordability Fund and on-reserve First Nations delivery credit. At the time, the government indicated that these new measures would cost the government up to $2.5 billion over the next three years.

Q. Why is the government refinancing the Global Adjustment? It seems like overly complex way to provide lower electricity rates.

To reduce pressure on today's electricity consumers, a portion of Global Adjustment (GA) costs is being refinanced. In later years, the cost of financing will be recovered from consumers.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. The majority of the province's electricity generators have 20-year contracts. Many of these generators will be able to operate past their contract term, meaning that generating assets are expected to have ongoing useful life and will benefit future ratepayers by reducing the need to finance the development of new generating assets.

Electricity bills have been reduced for current ratepayers, and future ratepayers will in turn pay for their fair share of the significant investments that the province has made to build a clean and reliable electricity system. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Given that the policy objective of Ontario Fair Hydro Plan (OFHP) is to more fairly allocate the cost to ratepayers over the useful life, not the contractual term, of the electricity generating assets, it was a primary policy objective to ensure that the costs are borne by the beneficiaries of the electricity system – the rate-base – not the tax-base. We believe it is appropriate for ratepayers to pay for the financing of electricity assets.

In addition, the rate-base has a different risk profile than the tax-base, which is reflected in different financing costs. Having the rate-base pay for financing of electricity system assets is not a new policy; for example Hydro One has borrowed in the capital markets since the early 2000s.

Based on this policy decision, it was decided that the debt obligation would be recognized as a regulatory asset that would be sold and securitized. This design appropriately aligns the costs and benefits within the group of eligible electricity consumers.

In developing the policy to refinance the GA, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.

If pressed:

Ontario's Fair Hydro Plan (OFHP) operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. You say the $4 billion Financial Accountability Office (FAO) number is wrong? So how much will it cost?

In the development of Ontario's Fair Hydro Plan (OFHP), the government made the policy decision that deferred electricity system costs should be borne by the rate-base and not the tax-base.

Based on this policy decision, it was decided that the debt obligation would be recognized as a regulatory asset that would be sold and securitized. This design appropriately aligns the costs and benefits within the group of eligible consumers.

The $4 billion[3] figure referenced by the Financial Accountability Office (FAO) in its May 2017 report, was based on initial Ministry of Energy estimates from March 2017. Subsequent analysis conducted by the Ministry refined a number of variables, including the cost of borrowing and electricity system cost forecasts.

Since a number of variables (i.e., including interest rates, electricity demand and electricity costs) will vary over the thirty-year life of OFHP and cost estimates will continue to be revised to reflect these changing conditions.

The government will continue to identify and implement initiatives to take costs out of the electricity system, which would reduce the cost of the GA refinancing program

Ontario Power Generation (OPG), who has been identified as the Financial Services Manager (FSM) responsible for the financing plans and the Fair Hydro Trust (i.e., the entity that will manage the debt obligations), has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.

If pressed on the details of the revised peak debt number and interest costs:

Peak debt for OFHP has been revised down from March 2017, from about $ 28 billion[4] to approximately $20 billion[5]. The higher March 2017 estimate was used by the FAO in its May 2017 report.

The estimates of total interest cost also decreased from $25 billion[6] to less than $19 billion[7].

Updated estimates are consistent with 2017 Long-Term Energy Plan (2017 LTEP) projections, and include fees charged by OPG in its role as financial service manage (FSM) and assume a 5 per cent interest rate.

[3] Financial Accountability Officer, *An Assessment of the Fiscal Impact of the Province's Fair Hydro Plan*
[4] Ministry of Energy
[5] Ministry of Energy
[6] Ministry of Energy
[7] Ministry of Energy

Q. How does the 3.357 per cent price of the Ontario Power Generation's Fair Hydro Trust's first issuance of senior notes compare with the Ministry of Energy's Fair Allocation Amount (FAA) assumptions?

A number of inputs will vary over the thirty-year life of the Global Adjustment (GA) refinancing program and will continue to be revised to reflect changing conditions (e.g., changes in interest rates).

The Ministry analysis underpinning the *2017 Fair Allocation Amount* (2017 FAA) included a 5.0 per cent average interest rate over the life of the GA refinancing program (i.e., 30 years). Note: Navigant's modelling of GA refinancing assumed an interest rate of 4.5 per cent. In the development of the 2017 FAA the interest rate assumptions were revised to 5 per cent based on consultations with OPG.

On February 6, 2017, OPG announced that it was able to secure an interest rate of 3.357 per cent for the senior debt on its first issuance that has a 15 year term and a value of $500 million.

On February 8, 2017, OPG advised that the remainder of the debt is split between $382 million of "subordinated" debt at an interest rate of 3.637 per cent and $98 million of "junior subordinated" debt at 3.957 per cent.

The effective interest rate of 3.526 per cent is the weighted average of these three series of debt (i.e., senior, subordinated and junior subordinated).

If pressed about future debt offerings:

OPG advises that another debt offering is planned for the near future (i.e., likely April).

Q. Why is the government using Ontario Power Generation (OPG) as a borrowing agent for Ontario's Fair Hydro Plan? Wouldn't it be easier to use a traditional government borrowing agent like the Ontario Financing Authority (OFA)?

Ontario Power Generation (OPG) has the necessary financing and commercial expertise to assist with refinancing the Global Adjustment (GA) and will ensure that it is done in an efficient and cost-effective manner.

OPG currently manages approximately $20 billion[8] in segregated nuclear funds to manage nuclear liabilities, and, is an electricity sector entity regulated by the Ontario Energy Board (OEB) with extensive experience with regulatory deferral and variance accounts.

OPG also has the breadth and demonstrated track record in the financial markets with its Corporate Debt platform, private placement of insurance linked bonds, participation in securitization programs and highly successful project debt issuances tied to new hydroelectric developments. These financing initiatives have been well received by investors at a reasonable cost to OPG. The innovative, cost saving and precedent setting aspects of these structures have resulted in international recognition.

In addition, OPG has developed solid investor relationships and has a large investor base in the structured finance space that are the target market for financing Ontario's Fair Hydro Plan

[8] Ontario Financing Authority

(OFHP) initiative. For example, Lower Mattagami project financing attracted a broad investor base of ~80 institutional investors[9], including major investors in the Canadian power and utility bonds market.

In terms of administration, OPG is currently managing its own Corporate public debt program and three project financing programs totalling more than $2 billion[10] and two commercial paper programs.

Finally, OPG's Treasury functions are well positioned given their management of existing multiple debt programs.

If pressed, details of OPG's Fair Hydro Trust's first successful issuance and future activities:

On February 6, 2017, OPG announced that it was able to secure an interest rate of 3.357 per cent for the senior debt on its first issuance that has a 15 year term and a value of $500 million.

On February 8, 2017, OPG advised that the remainder of the debt is split between $382 million of "subordinated" debt at an interest rate of 3.637 per cent and $98 million of "junior subordinated" debt at 3.957 per cent.

The effective interest rate of 3.526 per cent is the weighted average of these three series of debt (i.e., senior, subordinated and junior subordinated).

OPG advises that another debt offering is planned for the near future (i.e., likely April).

Q. Who was involved in the policy and implementation of refinancing the Global Adjustment?

In developing Ontario's Fair Hydro Plan (OFHP) and the policy to refinance the GA, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts to provide advice and ensure due diligence was completed.

In addition, senior officials and staff from several departments and agencies, led by the Ministry of Energy, met regularly in the development of the policy and structure of OFHP.

The senior officials and staff were from:
- Ministry of Energy;
- Ministry of Finance;
- Treasury Board Secretariat;
- Office of the Provincial Controller;
- Cabinet Office;
- Ontario Financing Authority (OFA);
- Independent Electricity System Operator (IESO); and
- Ontario Power Generation Inc. (OPG).

[9] Ontario Power Generation
[10] Ontario Power Generation

Ontario's Fair Hydro Plan (OFHP) operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. When do we start paying the clean energy adjustment?

In order to ensure the cost of investments in the electricity are allocated fairly amongst current and future ratepayers, a portion of Global Adjustment (GA) costs is being refinanced.

Beginning in 2021, financing costs will be recovered from consumers through the clean energy adjustment, while borrowing will continue until approximately 2028.

Q. Does OPG make money running the Fair Hydro Trust?

Ontario Power Generation was identified as the Financial Services Manager (FSM) responsible for the Financing Plans and the financing entity (i.e., Fair Hydro Trust) that will manage the debt obligations under the Global Adjustment (GA) refinancing program.

OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in an efficient and cost-effective manner.

Under the *Ontario Fair Hydro Plan Act, 2017* and associated regulations, OPG is permitted to charge fees in its role as FSM. This ensures OPG is able to recover costs incurred in relation to its activities as FSM. The methodology for the calculation of fees is set out in regulation and includes performance-based components. The regulation also sets out the role of the Ontario's Energy Board (OEB) in reviewing and approving the fees.

In accordance with OPG's Financing Plan, 49 per cent of the debt obligations are purchased by OPG, funded by periodic equity injections from the Province and OPG's own corporate borrowing program.

OPG earns a return on its investment in the Trust, which ensures the transactions are commercial and meets accounting requirements. The remaining 51 per cent of the debt obligations are funded through the capital markets.

Q. In the development of Ontario's Fair Hydro Plan, did the government set up the financing structure intentionally to keep it off government books?

No. Global Adjustment (GA) refinancing was designed so that deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.

GA refinancing operates under a financial and accounting framework that is appropriate for the intended purpose and in accordance with Public Sector Accounting Standards (PSAS) and ensures that the fairness goals underlying the program are achieved in a cost-effective manner.

Q. How much is the tax-base paying to keep electricity rates low? Aren't these cost that should be borne by the rate-base?

In the development of Ontario's Fair Hydro Plan, the government made the decision to provide rate relief to specific residential consumers through the introduction of new and enhanced electricity support programs, such as the Ontario Electricity Support Program (OESP) and Rural or Remote Rate Protection (RRRP).

At the same time, the government also made a policy decision that cost recovery for OESP and the majority of RRRP should be shifted off electricity bills to provincial revenues. This decision has lowered regulatory charges on <u>all</u> electricity bills by approximately $3/MWh.

The OESP and RRRP are programs designed to support electricity consumers that are most vulnerable to increasing electricity costs. The government's decision to fund these programs through provincial revenues was taken in recognition of the fact that these programs are for the common good and are more appropriately supported by the tax-base rather than the rate-base.

Similarly, the 8 per cent rebate introduced in January 2017, which is equivalent to the provincial portion of the HST, is also funded through provincial revenues in recognition of the social, environmental and economic goals that were achieved through the transformation of the electricity system, including the phase out of coal-fired electricity generation.

On the other hand, given that the policy objective of GA refinancing is to more fairly allocate the cost of our investments over the useful life, not the contractual term, of electricity generating assets, it was our primary policy objective to ensure that the costs are borne by the beneficiaries of the electricity system – the rate-base – not the tax-base. We believe it is appropriate for ratepayers to pay for the refinancing of electricity assets.

If pressed on the cost of the new and enhanced social programs and the 8 per cent rebate:

On March 2, 2017, the government publicly announced the enhancement of the existing OESP and RRRP, the new Affordability Fund, and on-reserve First Nations delivery credit. At the time, the government indicated that these new measures would cost the government up to $2.5 billion over the next three years.

Over this same three year period, the 8 per cent rebate introduced in January 2017, which is equivalent to the provincial portion of the HST, was forecast to cost the government roughly $1 billion dollar per year.

Q. What is Global Adjustment (GA)?

Global Adjustment (GA) is a mechanism that recovers certain electricity system costs, such as capital costs incurred by generators. GA is calculated by the Independent Electricity System Operator (IESO) based on the difference between the market price for electricity, which represents the marginal cost of electricity production, and rates paid to regulated and contracted generators to ensure they can recover their fixed costs. It also recovers costs associated with running conservation programs in the province.

GA has been an important factor in providing stable prices while ensuring that sufficient generating capacity is in place to deliver a clean, reliable supply of electricity.

GA pays for the bulk of the recent investments in the electricity system. The majority of the province's renewable electricity generators operate under 20-year contracts. Third-party experts have confirmed that many of these generators will be able to continue to operate beyond the end of their contract. This means that renewable generating assets are expected to have ongoing useful life and benefit future ratepayers by reducing the need to finance the development of new generating assets. This is the basis for the spreading of the costs across present and future generations of rate-payers.

Refinancing the GA is providing significant and immediate rate relief by spreading the cost of electricity investments over the expected lifecycle of the infrastructure that has been built. This more fairly shares the cost of our investments across the generations of electricity ratepayers who will benefit from them.

Records Disclosure / Process

Q. Why has the Ministry of Energy not provided all e-mails requested by the Auditor General?

The Ministry of Energy completed its response to the AG on October 26, 2017. The Ministry has provided all responsive records (more than 73,000 emails) to the AG.

Q. How much money did the Ministry spend on lawyers?

Although the retainer agreement includes a cap of up to $500,000, the Ministry of Energy spent approximately $150,000 on the retainer.

Q. What was the Ministry of Energy's process for providing the emails requested by the Auditor General?

The Ministry conducted a search consistent with the 40 plus search terms provided to the AG. In order to manage the approximately 2.2 million records resulted from the search of 81 custodians, the Ministry of Energy selected McCarthys/Wortzmans to assist with processing and analysis of the documents.

No legal advice on relevancy of documents was provided by Wortzmans. The Ministry completed its response to the AG on October 26, 2017.

Affordability Fund

Q. Why is there a need for an Affordability Fund?

From 2015 to early 2017, electricity distributors and other stakeholders indicated to the government that there was an immediate need to help customers struggling with their electricity bills, such as those in bill arrears and facing service disconnection.

Electricity distributors reported to the Ontario Energy Board (OEB) that around 56,500 customers were disconnected in 2015 and over 58,000 customers were disconnected in 2016. Electricity distributors also reported about 400,000 residential electricity accounts in arrears in 2016.

In January 2017, Hydro One submitted to the Ministry a report, "Addressing Affordability" which outlined a number of recommendations on electricity rate mitigation, including a recommendation to establish an Affordability Fund to assist struggling customers who do not qualify for low-income conservation programs.

Q. Who is eligible to benefit through the Affordability Fund and what measures will the average household receive?

Affordability Fund was established to provide energy efficiency measures to help those Ontarians not eligible for the Save on Energy Home Assistance Program, and who need support to improve the energy efficiency of their homes.

There are three levels of support available. The level each home qualifies for depends on net household income and average electricity bill. Measures offered may vary by participating electricity distributors:

- Level 1: households receive a Home Energy Kit with energy-saving products they can install themselves (e.g. LEDs, power bars, hot water pipe insulation).

- Level 2: Households may receive an in-home visit from a professional Home Energy Advisor, a Home Energy Plan and upgrades that may include ENERGY STAR appliances (e.g. efficient air conditioners, refrigerators, and dehumidifiers).

- Level 3: For electrically-heated homes only, households that qualify for this level may receive an in-home visit from a professional Home Energy Advisor, a Home Energy Plan and upgrades that may include insulation and/or an ENERGYSTAR heat pump.

Q. How many households are expected to benefit from the Affordability Fund?

Number of households that the $100 million investment in the Affordability Fund will support will depend on the types of measures installed per household. Customers may be eligible to receive varying levels of support based on their total household income and average electricity bill.

As of January 12, 2018, 2,522 applications had been received by the Affordability Fund Trust, of which 1,794 have been delivered to 47 active LDCs. Eligible customers are expected to start receiving benefits through the Affordability Fund in early 2018. **Note:** Numbers are not static and should be updated (closer to Public Accounts) as they become available.

Electricity Bill Re-Design

Q. Isn't the problem the amount on people's bills, not the design?

The government recognizes that the much-needed investments in our electricity system have led to higher electricity prices. That's why the government developed Ontario's Fair Hydro Plan (OFHP) – to relieve the cost pressures caused by these system improvements.

Through the 2017 Long-Term Energy Plan (2017 LTEP) consultation process, the government heard that consumers find their current bills confusing and inaccessible, as part of 2017 LTEP, the Ministry committed to continue to work with the Ontario Energy Board (OEB), industry and consumers to explore opportunities to redesign electricity bills to make them easier for customers to understand.

Q. How can Ontarian's know redesigning bills isn't just a way to hide increases?

The objective of the bill redesign initiative is to make bills easier for customers to understand and ensure that they get the most useful information out of their bills. Comparisons of costs from previous billing periods will continue to be possible.

Q. What is the overall cost of the bill redesign?

Each LDC will have different costs to implement a re-designed bill depending on current billing and customer information systems. Changes to billing systems are a part of an LDC's cost of doing business.

Q. Are all customers in Ontario getting redesigned bills, or just in some areas?

All LDCs will be required to comply with any new requirements implemented as part of a bill-redesign initiative. By March 31, 2018, all LDCs will come into compliance with the new requirement to provide customer-specific OFHP savings on invoices.

Q How do the new regulatory amendments to require that LDCs provide customer-specific savings associated with Ontario's Fair Hydro Plan on invoices fit in to the broader redesign action plan?

The requirement for dynamic messaging or customer-specific Fair Hydro savings on invoices is the first step in the broader, longer term bill re-design project. Providing customer specific savings promotes greater understanding of the associated bill impacts of Ontario's Fair Hydro Plan (OFHP) for consumers.

The new regulatory amendments are being discussed with industry stakeholders as part of the bill redesign working group.

The Ministry of Energy is continuing to work with stakeholders to examine opportunities to redesign electricity bills to make them more understandable and to give consumers the information that they want on the bill.