Ontario

Ontario's Fair Hydro Plan – Status Update

WORKING DRAFT

Technical Briefing

October 2017

Ontario's Electricity System

- Ontario's electricity system is a $20 billion annual sector that serves the needs of nearly 5 million homes, businesses, farms and industries.

- The costs of generating and transmitting electricity around the province are transparently recovered from consumers (i.e., ratepayers). As these costs are recovered directly from consumers, the electricity system is kept separate from the Province's fiscal plan.

- The Ontario Energy Board (OEB) is the independent regulator of Ontario's energy sector. It establishes rates and prices that are reasonable to consumers and allow utilities and generators to invest in the system.

- The Independent Electricity System Operator (IESO) is a not-for-profit entity that manages the province's power system to ensure Ontarians receive power when and where they need it, as well as contracts with non-regulated generators. The IESO also plans and prepares for future electricity needs, and works with its partners to guide conservation-related efforts.

Ontario's Fair Hydro Plan

- OFHP is delivering rate relief to approximately 5 million residential, small business and farm consumers.

- Ontario's Fair Hydro Plan (OFHP) is comprised of a series of initiatives, some of which will be borne by taxpayers where appropriate, such as sales tax relief and shifting electricity social programs to the tax-base, and some will be borne by ratepayers, such as spreading the generation investment costs and benefits across ratepayers more fairly.

- The government, the Ontario Power Generation (OPG), the Independent Electricity System Operator (IESO), the Ontario Energy Board (OEB), key stakeholders and legal, financial and energy sector third-party experts continue to implement OFHP.

- Since the March 2, 2017 OFHP announcement, a number of key milestones have been reached in the implementation of OFHP, including:
  - January 1, 2017: 8% rebate came into effect;
  - May 1, 2017: Partial Global Adjustment (GA) refinancing incorporated into the OEB's Regulated Price Plan (RPP) report;
  - June 1, 2017: The *Fair Hydro Act, 2017* (FHA) received Royal Assent;
  - June 15, 2017: Regulations to enable new and enhanced electricity social programs and shift associated program cost from the rate-base to tax-base came into effect; and
  - July 1, 2017: 25 per cent reduction of electricity bill came into effect on July 1, 2017, including the 8% rebate.

- 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.

Funding Electricity Social Programs and 8% Rebate From Provincial Revenues

- The government made the decision to introduce an 8% rebate program and new and enhanced electricity social programs that provide relief to specific residential consumer groups. At the same time it was decided that the 8% rebate and the social programs would be more appropriately funded from the tax-base, not the rate-base.

- The new and enhanced existing electricity social programs include:
  - Enhanced Rural or Remote Rate Protection through the creation of new Distribution Rate Protection;
  - Expanded Ontario Electricity Support Program;
  - New First Nations On-Reserve Delivery Credit; and
  - New Affordability Fund.

- Local Distribution Companies have implemented these measures and benefits are flowing to customers.

Fiscal Cost to the Province ($M)	16-17	17-18	18-19	19-20	20-21
RRRP Enhancements	-	459	472	484	497
Ontario Electricity Support Program	-	186	261	325	375
On-Reserve First Nation Delivery Credit	-	20	20	20	20
Affordability Fund	200	-	-	-	-
Ontario Rebate for Electricity Consumers (i.e., 8% Rebate)	883	860	861	871	915
Total Fiscal Cost to the Province	1,083	1,525	1,614	1,700	1,807

Note: Program costs are subject to change based on variables that affect consumption levels, such as weather.

Global Adjustment (GA) Refinancing Through the Rate-Base

- Since 2003, nearly $70 billion has been invested in the electricity system, including more than $37 billion in electricity generation to ensure the system is clean and reliable.
- The majority of the province's electricity generators are under 20-year contracts. Analysis conducted by Navigant Consulting confirms that many of these generators will be able to operate beyond their contract lives.
- Refinancing the GA, which pays for the bulk of the recent investments in the electricity system, provides significant and immediate rate relief by matching the cost of electricity investments with the expected useful life of the generation that has been built.
- Electricity consumers will benefit from the ongoing useful life of these generating assets, and will be responsible for the costs of these assets over the same timeframe.
- The decisions made to implement GA refinancing most effectively achieve the goals of the refinancing program and ensure that the deferred costs are borne by the rate-base, as the beneficiaries of the electricity system, and not the tax-base.
- In developing GA refinancing, the government considered a range of implementation options and consulted with legal, accounting, financial and energy sector third-party experts (i.e., Navigant, KPMG, E&Y and Deloitte) to provide advice and ensure due diligence was completed.

GA Refinancing – Update

- Since the March announcement, the total cost of refinancing the Global Adjustment (GA) has been revised downwards substantially:
  - The Ministry of Energy's estimates of peak debt decreased between March 1, 2017 and August 31, 2017 from approximately $28 billion to $20 billion and the estimates of total interest cost decreased from approximately $25 billion to $18 billion.

- The revised debt and interest estimates are the result of the following factors:
  - The Independent Electricity System Operator (IESO) updated its long-term cost projections for the electricity system and residential bills;
  - The Ontario Energy Board (OEB) provided "actual data" with respect to residential bills for the May 1, 2017 to April 30, 2018 period; and
  - Based on Navigant's analysis, the interest rate assumptions for OFHP were updated (i.e., from 5% to 4.5%).

- It should be noted that a number of variables, including interest rates, electricity demand and electricity costs, will vary over the 30-year life of the program and cost estimates will continue to be revised to reflect these changing conditions.

GA Refinancing – Role of Ontario Power Generation

- With respect to delivery, OPG has been identified as the Financial Services Manager (FSM) to develop the financing plans and act as the financing entity (i.e., Fair Hydro Plan Trust) responsible for managing the debt obligations associated with GA refinancing.
  - OPG has the necessary financing and commercial expertise to assist with refinancing the GA and will ensure that it is done in the most efficient and cost-effective manner.
  - OPG is currently in preliminary discussions with rating agencies and plans to be in the market in November 2017.
- OPG currently manages approximately $20 billion nuclear funds and as an entity regulated by the Ontario Energy Board (OEB), OPG also has extensive experience with regulatory deferral and variance accounts.
- OPG has also developed solid investor relationships and has a large investor base in the structured finance space who would be the target market for financing Ontario's Fair Hydro Plan initiative. For example, the Lower Mattagami project financing attracted a broad investor base of about 80 institutional investors, including major investors in the Canadian power and utility bonds market.
- 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. Further details will be released in the 2017 Long-Term Energy Plan, which will be released on October 26, 2017.

GA Refinancing – Role of Role of the Independent Electricity Operator (IESO)

- IESO will recognize impact of deferring certain costs that will be recovered in the future from ratepayers as a rate-regulated asset; periodically that asset, or the right to recover those costs from future ratepayers, will be sold to OPG and financed through borrowing by OPG.

- IESO will reflect the impact of the GA refinancing using rate-regulated accounting similar to other regulated entities in Ontario, including Ontario Power Generation and Hydro One:
  - Rate-regulated accounting reflects the economic substance of the government's policy decision to recover the costs of the GA refinancing fully from the ratepayers;
  - Rate-regulated accounting is well understood in the electricity sector; and
  - Six other IESO like entities in other North American jurisdictions recognize the economic effects of rate-regulated accounting (i.e., in AESO, ISO, NYISO, MISO, PJM and ERCOT)

[NTD: Slide shared with IESO for input]

GA Refinancing – Accounting Considerations

- The government's financial statements are prepared in accordance with Public Sector Accounting Standards (PSAS), and will continue to follow these standards for the transactions resulting from Ontario's Fair Hydro Plan in 2017-18 and in future years.

- PSAS is silent on the use of regulated accounting:
  - PSAS acknowledges that it does not provide guidance on all possible transactions and notes that it is necessary to refer to other sources of guidance that are consistent with the PSAS framework; and
  - US GAAP, with the most developed guidance on rate-regulated accounting, is the appropriate guidance to reference in this scenario.

- In the development of GA refinancing, the government consulted with several third party advisors (e.g., KPMG, E&Y, Deloitte) in the application of accounting standards. This is normal course of business governments take for complex transactions.

Questions?