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September 15, 2017

Commented [HS(1]: Note: This letter was not formal sent from the CEO to the DM.

The draft was provided as background on this matter.

MEMORANDUM TO: Serge Imbrogno
Deputy Minister of Energy

FROM: Gadi Mayman
Vice-Chair and Chief Executive Officer, Ontario Electricity Financial Corporation

SUBJECT: **Fair Hydro Plan Implications for Non-Utility Generators**

I am writing concerning the potential impact of Ontario's Fair Hydro Plan ("FHP") on the price escalation provisions contained in certain legacy Ontario Hydro Power Purchase Agreements ("PPAs") with non-utility generators ("NUGs") managed by the Ontario Electricity Financial Corporation ("OEFC"). OEFC is seeking advice from the Minister of Energy as to the Ministry of Energy's view of the intention of the Province with respect to the impact of the FHP on NUGs.

The rate escalation provisions for certain PPAs are based on changes in a price index called the Total Market Cost ("TMC") index. TMC is comprised of various cost components paid for delivered electricity by consumers, including the Global Adjustment ("GA"). The main impact of the FHP is through the timing of the payment of GA costs by FHP eligible consumers, deferring the payment of a portion of total GA costs in the early years of the FHP and recovering the deferred amounts from electricity consumers in the later years.

Under the current administration of the definition of TMC in the PPAs, consistent with the language of the March 2015 Global Adjustment lawsuit decision, the deferral of GA costs in the early years and recovery in the later years would result in the amount of the calculated TMC index being lower in the early, GA deferral years and greater in the GA recovery years than would have been the case in the absence of the FHP. This would result in lower rates under the affected PPAs in the deferral years and higher rates in the recovery years. The overall, aggregate result would be a net reduction in payments under the PPAs.

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OEFC is seeking advice from the Minister of Energy on the intent of the Province as to the impact of FHP on NUGs. In particular, is it the intent of the Province that deferral of a portion of the GA costs under the FHP not affect rates payable under the PPAs , or is it the intention of the Province that the NUGs with relevant PPA price escalation clauses be affected through the continued administration of the PPAs in accordance with their terms.

Absent any policy advice to the contrary from the Minister of Energy, and direction from the Minister of Finance, OEFC would contact the affected NUGs in the fall, and advise them that, under the terms of the PPAs, the annual calculation of TMC would include the GA costs as they are passed through for recovery from consumers, such that the deferred portion of GA costs would not be included in the calculation of TMC during the deferral period, and that the Clean Energy Adjustment charged to ratepayers in later years of the FHP would be included in the calculation of TMC.

Based on preliminary estimates, the impact of the FHP on the calculation of TMC would result in power supply contracts costs recovered from ratepayers being reduced, over the remaining lives of the PPAs, by approximately $65 million on a present value basis. This estimate includes both decreases in power supply contract costs in the deferral years of approximately $95 million and increases of $30 million in the recovery years, on a present value basis. These estimates are preliminary and based on a GA deferral and financing forecast provided by Ministry of Energy staff that corresponds with estimates used in early March. The impact on individual NUG PPAs would vary, depending on their escalation clauses and lengths of their PPAs, for example.

OEFC has not yet communicated to NUGs about this impact. One NUG owner has written to OEFC, enquiring about the impact of the FHP, reminding OEFC of its position that any adjustments to TMC would require OEFC to undertake industry consultations and final agreement of the NUG counterparties.

OEFC's position is that there is no change in the definition or formula for TMC; however, a change in the value of the input components would affect the value of the TMC, which is normal PPA administration of the existing TMC and not a change.

NUGs that contest the inclusion of GA costs as they are charged to ratepayers may attempt to argue that the contract calculations should not be affected as a result of a policy change by the government. Should OEFC eventually take the position that the deferred GA costs not be included in TMC, NUGs may commence a court challenge to obtain a judicial interpretation on the issue.

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OEFC's legal advice is that the definition of TMC, as confirmed in the March 2015 reasons for decision in the Global Adjustment lawsuit, requires OEFC to include GA costs in calculations of TMC as they are charged to consumers. A unilateral decision by OEFC to include deferred GA costs in TMC as those costs are accrued, would not enable OEFC to avoid the offsetting exclusion of the deferred costs from TMC when they are recovered from ratepayers. Explicit agreement from the NUGs would be required in order to allow deferred GA costs and interest to be omitted from TMC when these costs are recovered from ratepayers through the Clean Energy Adjustment.

If the Minister of Energy provides a letter of advice to the Minister of Finance confirming that the intention of the Province is that the NUGs not be affected by FHP deferral of GA costs, OEFC would be able to, with direction from the Minister of Finance, undertake broader consultations with NUGs on how the definition of TMC could be amended in the context of FHP to eliminate the impact of the deferral of GA on the calculation of the index.

Policy direction from the government is required if it is intended for OEFC to consider an option that allows NUGs to be unaffected by the GA deferral provisions of the FHP. A decision to consider such an option is a policy decision, and would require policy advice from the Minister of Energy to support the issuance of a direction by the Minister of Finance to OEFC to engage in such broader consultations with affected NUGs on the impact of FHP plan on NUG PPAs.

If such direction were received, an alternative TMC calculation would need to be discussed with and offered to NUGs, outlining what would and would not be included in the calculation over the expected period of the FHP. Discussions could include as an objective unanimous agreement amongst the NUGs and OEFC on how to calculate TMC in the context of the FHP, such that the TMC would include deferred GA costs in TMC as those costs are accrued, and exclude from the TMC calculation the deferred GA costs and interest when they are later recovered from eligible ratepayers.

Should you have any questions, I and staff are available to meet with you, at your request. Thank you for your attention to this matter.

Sincerely,

Gadi Mayman
Vice-Chair and Chief Executive Officer

c. Ronald Kwan, Vice President