Reducing Rates

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Hi Serge and Gadi:

Hope all is well and that you are not too disappointed (or elated) regarding the Grey Cup result. Crazy game....

Anyway, I am writing this as a citizen and not any other hat. But I did thing there was an opportunity to reduce rates in a better way than the Fair Hydro plan and potentially the PC platform - although I need to understand the total mechanics better.

I would suggest that a preferred approach would have been to negotiate directly (or offer a standard buy down rate) with counter-parties. This would take longer and may not yield the same headlines that the Fair Hydro Plan did, but I think would make more sense and could even result in more cost savings. Obviously, I do not think it would be appropriate nor feasible to unilateraly change or cancel contracts.

So instead of reducing rates across the board and then financing it through OPG, I would suggest:

- negotiating or offering a buy down of existing contracts so that the price paid is more in line with market. The government would pay for this amount up-front to the power supplier in return for a new price. For instance, instead of paying $130/MWH for the next 20 years, the new price would $70.

The benefit of this would be three fold:

1) it would result in power prices that are more in line with market rates
2) there is a financial arbitrage between the cost of borrowing for the government and the discount rate of the suppliers for that cash flow (and that arbitrage to go to the consumers' benefit)
3) there is an ability to amortize the amount for longer than 20 years
4) the carrying cost of this would be borne by tax payers - and since a large element of the Green Energy Act was for industrial policy and health benefits, that is a more logical place to leave that cost. Makes much more sense than burdening electricity customers and harming industry for these non-electricity policy objectives.

So some math:

Assume the government's cost of borrowing is 2.5%. And the discount rate for suppliers is 7.5%.

This would result in a savings of 35% since the government could effectively pay $40 instead of $60 / MWh by using the financial arbitrage to lower rates (point 2).

Should the government wish to amortize the payments over a longer period (and this directly and not through OPG), there would be an extra 10% saving for doing this over 25 years or 15% for 30 years.

There is a flaw in this concept if the cost of borrowing for the Province would go up - not sure if the rating agencies (to the degree relevant) and market already reflect this borrowing cost. So if absolutely necessary, OPG could offer the buy downs through the existing structure, with a higher borrowing cost.

There would be some other benefits of such a program as well (align incentives for maximizing asset production at reasonable rates and without government interference).

Happy to discuss further if that would be useful or even to send my mini-model!

All the best,

Michael