PROVINCIAL GUARANTEE TO OPG FINANCING ENTITY

1. PROGRAM/BRANCH: Ontario Financing Authority

2. SUMMARY OF REQUEST:

Under the *Ontario Fair Hydro Plan Act, 2017* ("OFHPA"), the Minister of Energy and the Minister of Finance, acting on behalf of the Province, may, if authorized by order by the Lieutenant Governor in Council, agree to guarantee or indemnify any debts, obligations, securities or undertakings associated with an investment interest.

In order to facilitate the funding of the OFHPA debt obligation, the Ontario Financing Authority (OFA) requests that Treasury Board:

(a) Approve that the Minister of Finance and Minister of Energy, acting on behalf of the Province, provide a guarantee, as contemplated under the OFHPA to one or more Ontario Power Generation (OPG) Financing Entities under the terms set out in Appendix;

(b) Recommend to Cabinet an Order in Council, in accordance with section 5 of the OFHPA , that authorizes the Minister of Energy 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;
(ii) to determine terms and conditions of the guarantee or indemnity and the maximum liability for the guarantee or indemnity;
(iii) specify terms and conditions that must be included in any guarantee or indemnity given by the Minister and the Minister of Finance; and
(iv) specify a maximum liability for the guarantee or indemnity.

(c) Note that the Minister of Energy and the Ministry of Finance will also be submitting to the Minister of Finance a request for approval, under Section 28 of the Financial Administration Act, contingent liabilities arising from the provision of the guarantee.

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Commented [ESP3]: This guarantee is to OPG Financing Entities only (i.e., not any other entity that may hold an investment interest in the future)?

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3. BACKGROUND:

On March 2, 2017, the government announced its proposed Ontario's Fair Hydro Plan (OFHP), which would lower bills by 25% for a typical residential consumer, starting in the summer of 2017. As part of OFHP, it was announced that a portion of the Global Adjustment (GA) would be refinanced in order to fairly allocate costs across present and future generations of electricity consumers with respect to investments made to decarbonize (i.e., phase-out coal) and modernize Ontario's electricity system (i.e., build and maintain a reliable electricity system).This would be achieved by spreading the cost of electricity investments so that they are shared proportionately by future consumers who cause a need for or benefit from the province's multi-billion dollar investments in electricity infrastructure.

To this end, immediate rate relief to eligible ratepayers is provided by spreading the cost of electricity investments over a longer period of time. Under forecasts provided by the Ministry of Energy at the time of the OFHP announcement in March, the immediate reduction would be about $2.5 billion per year on average over the first ten years. The Ministry of Energy will report back to TB/MBC in fall 2017-18 with an update on out-year projections following analysis on rate applications before the Ontario Energy Board.

Under the OFHPA, which enables GA Refinancing, the Independent Electricity System Operator (IESO) will have a funding gap resulting from the reduction in amounts collected over four years. 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 the IESO to sell all or a portion of the regulatory asset and the right to recover those deferred amounts from specified consumers in the future. Under the OFHPA, a Financing Entity (i.e., an entity established or caused to be established by OPG as the Financial Services Manager under the OFHPA) will purchase the regulatory asset, effectively financing the shortfall in current rates not received from the ratepayers.

To purchase the regulatory asset from IESO, the Financing Entity must 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; however, OPG's financial advisors have indicated that without adequate protection against legislative, judicial and organizational risk, the debt would not be financeable. OPG , therefore, has advised that the Government of Ontario provide a guarantee to the Financing Entity and prospective debt holders such that, under certain circumstances, the Province would step in and assume the funding obligations of the Financing Entity.

OFA, the Ministry of Finance and external advisors – consistent with OPG advice

– recommend limiting activation of the provincial guarantee to the following circumstances:

- Actions of the Legislative Assembly that undermine the financing arrangement, i.e., repeal or amendment of the OFHPA, or new legislation that adversely affect the Financing Entity;
- A court decision that declares any funding obligations of the Financing Entity to be invalid or unenforceable; and
- Changes to the organization, structure or operations of IESO adversely impacting the Financing Entity.

In the event the guarantee is triggered by one of these events, the Province would take over the obligations of the Financing Entity, including principal and interest payments on debt issued to date and any outstanding payments to service providers.

The guarantee would continue until all obligations of the Financing Entity are fully discharged.

5. ADMINISTRATIVE IMPACTS:

To be managed by existing staff.

6. RISKS:

If the guarantee is not approved, the Financing Entity would either be unable to raise sufficient financing from capital markets to purchase the regulatory asset from IESO or the cost of the financing would be potentially materially greater than it otherwise would be.

If the guarantee is approved, the Government of Ontario takes on a contingent liability. The amount of the liability will increase over the duration of the Fair Hydro Plan and peak at an estimated $24billion to $26 billion of debt, including principal and accumulated interest.

In the event the guarantee is triggered, the Province's net debt will increase by an amount equal to the contingent liability at that point in time. The Province's interest payments will also increase by an amount equal to the weighted average cost of the debt it has assumed under the guarantee.

While it is difficult to estimate the actual impact to the Province's interest on debt (IOD) expense, the worst case scenario would be the Province assuming the debt at its peak. If so, IOD expense may increase between [$0.8B and $1.3B]

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per annum, depending on the interest rate at which the Financing entity will be able to borrow at.

It is important to note that, if the guarantee is triggered, and the Province assumes 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 or not, in some form. If the payment streams from ratepayers via collection of the Clean Energy Adjustment (CEA) continue, this would offset the debt and interest payments; 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 would impact the Government's fiscal plan and likely takes away fiscal resources that can be otherwise used. Also, debt incurred to benefit the ratepayer becomes the responsibility of the taxpayer.

7. RECOMMENDATION

The Ontario Financing Authority (OFA) requests that Treasury Board:

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(a) Approve that the Minister of Finance and Minister of Energy provide a provincial guarantee, as contemplated under the *Ontario Fair Hydro Plan Act*, to one or more OPG Financing Entities under the terms set out in Appendix;

(b) Recommend to Cabinet an Order in Council, in accordance with section 5 of the Ontario Fair Hydro Act, that authorizes the Minister of Energy 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;
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(c) Note that the Ministry of Energy and Ministry of Finance will also be submitting to the Minister of Finance a request for approval, under Section 28 of the Financial Administration Act, contingent liabilities arising from the provision of the guarantee.

APPENDIX

[Insert Final Term Sheet]