PROVINCIAL SUPPORT AGREEMENT TO OPG FINANCING ENTITY

1. PROGRAM/BRANCH: Ontario Financing Authority

2. SUMMARY OF REQUEST:

Provide a guarantee or guarantees in respect of debts, obligations, securities or undertakings associated with investment interests acquired by one or more financing entities established by Ontario Power Generation Inc. pursuant to s. 22 of the Ontario Fair Hydro Plan Act, 2017 (“OPG Financing Entities”), that, under certain circumstances as set out in the support agreement, the Province would pay when due amounts in respect of the obligations of the Financing Entity.

This submission is to request that Treasury Board:

(a) Authorize that the Minister of Finance and Minister of Energy, on behalf of Ontario, provide a support agreement, to be authorized by Order in Council under the *Ontario Fair Hydro Plan Act, 2017* in respect of the debts, obligations, securities and undertakings of one or more OPG Financing Entities under the terms set out in Appendix;

(b) Recommend to Cabinet an Order in Council, to be made under subsection 5(3) of the Ontario Fair Hydro Plan Act, 2017 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;

(iii) specify terms and conditions that must be included in any guarantee or indemnity given by the Minister of Energy and the Minister of Finance; and

(iv) specify a maximum liability for the guarantee or indemnity.

Commented [RK1]: In this case, could it be tied to the requirements of the Act, without a specific maximum, or tied to amount consistent to some determination under the Act, such as the fair allocation amount determination, or cumulative annual fair adjustment amounts under the Act (including financing costs)?

Commented [AS2]: Analysis on maximum liability still underway by energy, working with OPG (Matt).

3. BACKGROUND:

On March 2, 2017, the government announced its proposed Ontario’s Fair Hydro Plan (OFHP) to lower electricity bills by 25%, for a typical residential consumer, and holding increases to the rate of inflation for four years. 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 deferring and spreading the cost recovery 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 *Ontario Fair Hydro Plan Act, 2017,* (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; i.e., 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.

Commented [ESP3]: Suggest use of this language (from an earlier "version 3" of this document).

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 support agreement 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 or a change in the electricity market structure or operations that adversely affects the ability of the Financing Entity to receive amounts on its investment interest such that it can pay its specified creditors, including making payments on its debt obligations.]

In the event the support agreement is triggered by one of these events, the Province would be required to pay principal and interest on debt issued by the Financing Entity and other obligations of the Financing Entity as it comes due (without acceleration). In addition, the Province would also have the option to assume the Financing Entity's outstanding obligations and liabilities..

The support agreement would continue until all guaranteed obligations of the Financing Entity are fully discharged.

Section 28 of the *Financial Administration Act (FAA), 1990* requires that the Minister of Finance's approval is required before a ministry seeks an Order in Council authorizing a guarantee or indemnity or before a ministry enters into a guarantee or indemnity that would increase the contingent liabilities of Ontario. In this case, the Minister of Finance, together with the Minister of Energy, is recommending the OIC to Cabinet and will, acting together with the Minister of Energy, determine the terms and conditions of and execute the proposed guarantee/indemnity in accordance with the OIC, if approved.

5. ADMINISTRATIVE IMPACTS:

To be managed by existing staff.

6. RISKS:

If the support agreement 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 will be potentially materially greater than it otherwise would be.

If the support agreement is provided the Province of Ontario takes on a contingent liability. The amount of the liability would increase over the duration of the Fair Hydro Plan and peak at an estimated [$24B to $26B (to be revised as Energy re-estimates)] of debt, including principal and accumulated interest.

Commented [AS4]:

Commented [ESP5]: Recommend deleting.

This does not appear to be consistent with the latest term sheet shared on Wednesday Sept. 6. That version did not include this circumstance/event in its list of "Assumption Events"

Commented [ESP6]: Is this consistent with Term Sheet?

Commented [ESP7]: Believe this is what is being referenced?

Commented [ESP8]: Is there an OIC drafted or is this just a proposed approach should an OIC be required?

Commented [ESP9]: Pending finalization of costs forecasts – this work is still ongoing with OPG.

In the event the support agreement is triggered, the Province's net debt would be expected to increase by an amount equal to the contingent liability for the debt outstanding at that point in time. The Province's interest payments will also increase by the debt interest servicing of the debt payment obligations 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] 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 support agreement 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 the 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. COMMUNICATION PLAN

Key Messages

- Ontario's Fair Hydro Plan has resulted in the biggest electricity rate reduction in Ontario's history.
- We have heard from Ontarians across the province that the price of electricity has risen too quickly, which is why we moved forward with a plan to ensure the costs are shared more evenly over the years ahead.
- The government is following through on its commitment to balance the books as announced in its 2017 Budget, while continuing to make investments in priority areas such as electricity price relief.

Strategic Approach

- Low-profile, reactive and targeted to industry stakeholders and government employees as necessary. Reactive messaging contingent upon legislative changes only with back-pocket QAs to support as needed.
- Communications support will continue to be led by the Ministry of Energy.

Commented [MOF LSB10]: OPCD to review

Commented [RK11]: Could include Energy's curve from the March 2nd CabSub, as well as the interim update in the more recent LTEP deck--- but would be subject to updates per Energy's anticipated forthcoming submissions cited above.

Commented [ESP12]: Work is still ongoing between ENERGY and OPG regarding finalizing amounts – including interest.

Commented [MOF LSB13]: Include of a discussion of the risk associated with the trigger events – what are the risks – are there legal risks regarding the legislation and whether a court might find it to be invalid for some reason – have legal opinions been obtained on this? Are some of these risks within the control of the government so can be mitigated in some way?

Commented [ESP14]: I don't believe our TB Subs spoke to this point.

Commented [ESP15]: This section was not in earlier version – unsure of its necessity?

9. RECOMMENDATION

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

Commented [MOF LSB16]: It may be the case that this is a more general approval and the 2 Ministers will determine the terms and condition in accordance with the authorization given to them by the OIC. It depends on how soon the actual wording of the guarantee can be confirmed as opposed to the draft term sheet – The province should not sign of commit to the term sheet as the province's authority comes from the OIC.

(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;
(iii) specify terms and conditions that must be included in any guarantee or indemnity given by the Minister of Energy and the Minister of Finance; and
(iv) specify a maximum liability for the guarantee or indemnity.

APPENDIX

[Insert Final Term Sheet]