February 27, 2017

Mr. Serge Imbrogno
Deputy Minister,
Ministry of Energy
4th Floor, Hearst Block
900 Bay Street
Toronto, Ontario
M7A 2E1

Dear Deputy:

Below is a summary of OPG's preliminary views on the implementation of the Province's proposed Global Adjustment Smoothing Account and financing structure. These views are contingent on the proposed terms and conditions that were sent to the Ministry of Energy on February 21, 2017.

Understanding that the finalization of the legal terms, the Trust indentures, financing structure and other detailed terms will take several months and will involve collaboration between legal counsel, input from capital markets, parties involved and other stakeholders, this letter is intended to provide the guideline and framework which could form the foundation of the plan.

Please do not hesitate to contact me if you have any questions regarding this summary.

Sincerely,

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cc. Jeff Lyash, President and CEO, OPG

Background:

The Province has indicated that it will take steps to reduce electricity bills in the near term. It has identified reductions in the Global Adjustment Charge (GAC) charged to electricity customers as a means to achieve its policy goals. The Province is proposing to temporarily reduce the amount of the GAC charged to electricity customers (primarily RPP-eligible customers). The exact quantum and duration of the program is still not known but based on discussions with the Province GAC charges of approximately $2-5B per year for the next 5-10 years would be deferred and collected over future periods commencing after the deferral period. A combination of senior debt and subordinated debt (mainly sourced by additional equity from the shareholder) would be issued to fund the amount deferred. The financing cost of the debt and other costs of running the program would form part of the amounts recovered from customers over the term of the program.

The Province has requested that OPG administer the GAC deferral, because of OPG's participation in the market, regulatory knowledge and the potential ability to consolidate the activity and accounting with OPG. Given the significant amount of financing required for the GAC deferral, OPG has developed a financing structure (depicted below) to:

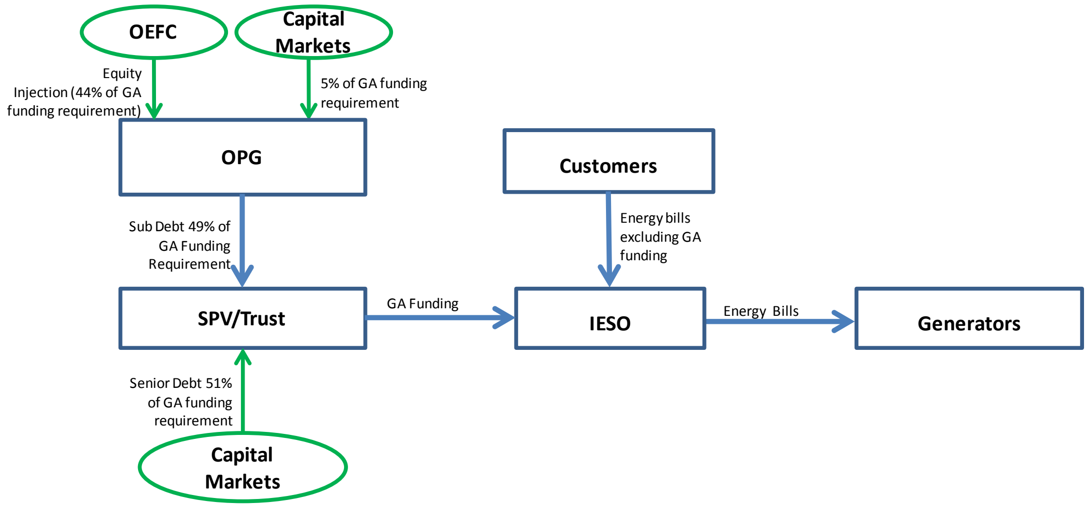
- restrict the risk to OPG;

- maximize the cost-effectiveness of the Trust or the Special Purpose Vehicle ("SPV") financing vehicle; and
- allow for consolidation into OPG financial statements.

The success of this structure is dependent on achieving a number of objectives which are reviewed in the following sections:

A. Ability to Recognize an Asset and Record Revenue
B. Ability to Consolidate the SPV into OPG
C. Ability to Finance
D. External Assessment
E. Risk Summary

All of the percentages shown in the graphic below are indicative and will be highly dependent on the legislation that the Province will enact:



Process:

The IESO will effectively sell the 'right to collect' deferred future revenue from ratepayers (GA Recovery Right asset) to the SPV in return for cash proceeds. In order for the SPV to purchase this asset the SPV will obtain the financing from two key sources: 51% directly from capital markets and 49% as subordinated debt from OPG. OPG will obtain 44% of this financing as an equity injection from the Province and 5% from capital markets.

A. Ability to Recognize an Asset and Record Revenue

Accounting Requirements under International Financial Reporting Standards (IFRS)

1) It is our understanding that the IESO and KPMG have concluded that the sale of this 'right to collect' future revenue (or regulatory asset) is not a financing transaction and will not be recorded as a financial liability. Based on that conclusion, the right to collect will be accounted for as an intangible asset in the SPV.

2) In order to the SPV to record this right as an intangible asset, the right must meet the following conditions:
   - The intangible asset must be separable and arise from a contractual or legal right (i.e. mandated by the Legislation and SPV Indenture Agreement).
   - The SPV must have the control and power to obtain future economic benefits from the intangible asset.
   - The SPV must be able to demonstrate that the intangible asset is purchased at fair value.

3) In order for the SPV to recognize appropriate revenue to offset any ongoing costs, the Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis. This may result in additional amounts to be deferred to achieve the desired customer impact. Payment of revenue to the SPV is also important to service the interest expenses of the debt.

B. Ability to Consolidate the SPV into OPG under IFRS

OPG 'Control' of the SPV - Accounting Requirements

1) In order to meet the accounting definition of 'control', accounting guidance must be considered. There are no bright lines to determine whether OPG has exposure, or rights, to variable returns from its involvement with the SPV, or whether it has the ability to affect the returns of the SPV through its power over the SPV. Rather, all facts and circumstances are considered when assessing whether an entity has control over another entity. Based on the relevant accounting guidance under IFRS, OPG has proposed terms necessary to demonstrate that OPG has control over the SPV. OPG's external auditors, Ernst & Young, has provided their concurrence that based on the information provided to them to date that the following conditions should permit consolidation of the SPV by OPG.

Directive:

1. The SPV must be undertaken by OPG as a business initiative on its merits. A Shareholder Directive is to be limited to direct OPG to investigate the option of establishing a SPV vehicle to administer, finance and operate the Global Adjustment plan. The control, risk and rewards of that SPV will determine its consolidation into OPG as a business enterprise.

SPV:

2. The SPV should not operate in a predetermined way such that OPG does not have decision-making authority over the SPV's ongoing activities after its formation (i.e. should not operate on 'autopilot').
3. OPG must have the ability to appoint and remove the Trustee (or Board of Trustees), with no veto right by the Province. No party shall have the ability to remove OPG from its role and authority in the SPV.
4. The Province cannot have the right to veto OPG's decisions about the relevant activities of the SPV. OPG must have the power over the relevant activities of the SPV and be compensated. The relevant activities of the SPV include (but are not limited to) the evaluation and decisions on financing alternatives, duration, and the strategy to minimize financing costs. OPG must have the power to establish operating and capital budgets of the SPV.
5. OPG must have the power to determine or change operating and financing policies of the SPV, which will affect the variability of risks and returns.
6. The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
    - The SPV
    - Any of OPG's investments in the most subordinated debt of the Trust
7. OPG must own greater than 50% of the most subordinated debt and targeted to be no less than 5%[1] of the total debt of the SPV. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources. A quantitative analysis should be performed at a later date to corroborate the appropriateness of the 5% threshold to support that the 5% subordinated debt investment is sufficient to absorb most of the expected variability in the SPV.
8. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:

[1] While the rest of the letter refers to a 10% investment in the most junior subordinated debt with OPG owning 5%, it should be noted that OPG should own more than 50% of the most subordinate debt. For simplicity, the degree to which OPG's ownership beyond 50% is not shown in this letter.

a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks
b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV to delineate financing of lower risk investment and investment that would bear higher residual risk. The delineation would limit OPG's self-funded investment to a reasonable level in order to allow OPG to remain a self-sustaining entity.
d. OPG shall, through its ownership of the most subordinated liability, be able to capture and retain the pricing difference between cost of financing and benchmark for interest on the restructured asset, or any residual risk of restructured asset. The targeted return of the subordinated liability should be reflective of the underlying risks and compensate holders for active management that would be required.
e. OPG should participate in the detailed design of the above and the SPV documentation to ensure that it has substantive power and variability, which will allow OPG's Board of Directors to evaluate the opportunity as a business initiative instead of through a shareholder directive.

Nothwithstanding the above, under certain Defined Forced Majeure for emergency events (e.g. unlikely credit market event or disruption where it is not possible to borrow from the market at a reasonable rate), the OEFC may provide bridge financing beyond the designated percentage for a defined period. The relevant terms should ensure that this temporary measure does not detract from the rights of OPG to direct all of the relevant activities of the SPV. Additionally, OPG should not be protected from risk of loss by the OEFC with respect to its subordinated investment, nor should it lose its right to derive the residual returns should such bridge financing be required.

Legislation

9. The Legislation must require interest, carrying and administrative costs to be paid to the SPV on a monthly basis, so that the SPV is able to recognize appropriate revenue to offset any ongoing costs.
10. The Legislation must dictate the manner in which the restructured asset would be determined, collected, and the period of collection, so that the determination of the restructured asset will not be subject to the Province's decisions on an ongoing basis, but determined based on a formula. Alternatively, the Legislation may allow for an adjustment to the pre-determined deferral formula based on specific parameters that would limit the adjustment to the restructured asset. Adjustments beyond the specific parameters would require approval by the Board of Trustees.
11. The Legislation must be written to avoid legal or constitutional challenges and be irrevocable to reduce the cost of borrowing and with a specific formula which determines the deferral amount. As irrevocability would be difficult under Canadian law one mitigation would be to provide a Provincial guarantee which only applies with cancellation or amendment of the legislation.
12. The spirit of the above terms should be reflected in the SPV Indenture Agreement as well as Legislation, wherever possible.

2) The Trust is expected to be financed as follows:

- 51% senior secured debt from external markets
- 39% senior subordinated debt from OPG (via Province equity injection into OPG)

- 10% junior subordinated debt from OPG (5% from external markets and 5% from Province equity injection into OPG).

When assessing control, an investor shall consider the nature of its relationship with other parties and whether those parties are acting on the investor's behalf (i.e. they are 'de facto agents'). If OPG is assessed to be a 'de facto agent' of the Province, it will compromise the ability for OPG to consolidate the Trust. The split above is to meet the following conditions to ensure that OPG is not considered a 'de facto agent' of the Province:

- The Province or its agencies must not directly or indirectly fund (through debt or equity) more than 50% of the following:
  - The Trust
  - Any of OPG's investments in the most subordinated debt of the Trust
- OPG must own greater than 50% of the most subordinated debt and targeted to own no less than 5% of the total debt of the Trust. Such ownership must be financed entirely by OPG through operating cash flows or external debt, without assistance from Provincial sources.

3) The Province will need to conclude on whether OPG still meets the definition of a Government Business Enterprise as defined under Public Sector Accounting Board standards in order to obtain the preferred consolidation treatment after the transaction. We also recommend that the Province to undertake the analysis deemed necessary to confirm the accounting treatment in its consolidated Public Accounts, including if the recognition of the intangible asset would result in an offsetting liability in the Public Accounts.

C. Ability to Finance

Property Right or Right to Collect
Legislative Requirements for Financing

The GA Recovery Right must be structured to encompass the following elements:

- Right to recover from and bill Ontario electricity customers for (1) the principal amount of GA that is being deferred, (2) all interest and other financing costs incurred in respect of the deferral of the GA, (3) all fees, expenses and other administrative costs associated with such financing;
- Repayment/amortization schedule as agreed by the IESO and any purchaser of such GA Recovery Right (or pursuant to a pre-defined schedule/formula that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis);
- Repayment/amortization schedule must include a true up mechanism to ensure all costs associated with the deferral can be recovered from customers;
- IESO may dispose of the GA Recovery Right, provided that any such disposition shall be a true sale and absolute transfer to the purchaser of the IESO's right, title and interest in and to the GA Recovery Right;
- Purchaser will have the right to require the IESO (or any successor) to collect the principal amount of GA Recovery Right, together with interest, financing and administration costs, on the agreed repayment/amortization schedule;
- Right must be irrevocable and, if amended by future governments, debt holders have the right of action against the government to recover the amount outstanding including interest, fees, expenses and any damages resulting from the amendment;
- GA Recovery Right will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity; and
- Make certain amendments to the Electricity Act to allow OPG to implement the SPV financing structure (e.g. allowing OPG to create subsidiaries and holding companies, and to have a beneficial interest in the SPV, etc). This would provide flexibility to accommodate possible variations to the financing structure that may be desirable over time.

Detailed legislative requirements are specified in the attachments as follows:

Attachment 1 Legislative requirements to allow deferral of global adjustment amounts to be financeable

Attachment 2 Statutory amendments

The proposed financing structure for the SPV is:

	Risk Profile	Source	% of Total Funding Requirements
Tranche A Senior Debt	The least risky	Capital Markets	51%
Tranche B Sub Debt	In between A&C	OPG via OEFC	39%
Tranche C Sub Debt)	The most risky	OPG via OEFC	5%
		OPG via Capital Markets	5%

SPV structure is used to accomplish the following:

- SPV holds right to charge customers for the benefit of debt holders;
- Allows the financing vehicle to be ring-fenced from OPG as an SPV structure is set up as generally single purpose entities with no other operations that could add risk to the SPV, dilute debt holder rights, allow parties from other operations to claim rights to the future recovery from customers or allow these other parties to initiate bankruptcy proceedings;
- Enables SPV to potentially get a higher credit rating than OPG;
- Supports consolidation with OPG provided accounting requirements are satisfied;

This approach supports a number of objectives of the GA Recovery Right:

- 51% external senior debt supports separation of the SPV from the Province
- 5% junior subordinated debt establishes OPG's "at risk" equity which supports separation of the SPV from the Province
- Subordinated debt provides flexibility to the financing structure and additional credit support to external debt holders
- Subordinated debt sourced from OPG (mainly funded by equity injection from the Province) minimizes impact on OPG credit metrics reducing risk of an OPG rating downgrade that could result in the SPV being consolidated directly with the Province as the SPV would be considered an arm of the Province.

Recent transactions used as precedents are:

<u>Duke Energy Florida Project Finance LLC</u>
June 2016
5 series of bonds totalling USD$1.3B
Weighted average life from 2 to 19 years with interest rates from 1.2% to 3.1%
Credit rating AAA

<u>Utility Debt Securitization Authority</u>
<u>Sponsored by Long Island Power Authority</u>
March 2016
Amount issued USD$0.6B
Weighted average life of 12 years and weighted average yield of 2.7%

August 2016
Amount issued USD$0.5B
Weighted average life of 7 years and weighted average yield of 2.0%

Credit rating AAA

Cumulative outstanding (including previous issuances): USD$4.2B

D. External Assessment

Shakerhill Partners, an external advisor, identified the following items in an assessment of the structure and financeability of the structure:

- The structure is financeable however there are a number of significant risks to the structure:
  - Canadian and Ontario law does not provide the same protection to property right as exists in the US federal and state constitutions to limit the ability of governments to adversely impair contracts to the detriment of the holder;
  - Legislation could mitigate some of the risks – deferred recovery asset to be "uncapped", regular semi-annual true up to ensure recovery, Province provides sufficient committed liquidity to the IESO so that temporary shortfall in recovery does not affect payments to SPV, term of the deferral recovery substantially exceeds the longest maturity of debt of the SPV and that true-up mechanism take account of potential for currency, interest rate and duration mis-match between the debt of the SPV and the recovery mechanism;
  - Size of the program may be too large for Canadian securitization market requiring access to the US securitization market;
- Final maturity of debt should not exceed 30 years from inception of the program
- True up mechanism should be designed such that the forecast of recovery is less than 10% of the customer bill under downside scenarios to limit growth of the deferral balance as a higher portion of the customer bill increases the political risk to debt holders which could result in a lower credit rating and potential impact on financeability
- Securitized debt products are specialized and price at a premium to other fixed rate instruments however a successful program supported by a strong credit rating this premium could shrink over time to a minor spread over Provincial debt
- OPG's credit rating should be maintained provided sufficient equity is injected to maintain credit metrics
- While the structure is not expected to impact the Province there are risks that the program could negatively impact the rating agencies view of the Province's financial management.

E. Risk Summary

i. Consolidation

- Elements of the proposed structure were established to support consolidation of the SPV into OPG. These items may not be sufficient to establish OPG as risk owner of the SPV and the SPV may need to be consolidated directly with the Province.

ii. Financeability

- The legislation establishing the structure and the property right for recovering the financing and associated costs may not be adequate for financing purposes resulting in more expensive financing or an inability to obtain the required external financing.

iii. Cost of Financing

- Future governments may enact legislation that changes the right of the SPV to recover amounts from customers.
- The right to recover amounts from future customers must be irrevocable and subject to full recovery from the government in the event that future governments reduce or eliminate the recovery. A legal structure that is weaker than the precedent US transactions increases the risk to debt holders and the cost of financing.
- Interest rates on bonds in the securitization market are higher than equivalent rated bonds. Rate for a AAA securitization credit is about 50 bps higher than GOC (rated AAA) for a 5 year term. This difference is attributable to the specialized structure of the bond, smaller investor pool for this bond, smaller size of the market and higher perceived risks of the bond.
- Any regulator involvement must not be seen to modify any terms of debt issued or the property right securing the debt as this would increase risk to debt holders.

- It may not be possible to issue debt to match the terms of the deferred asset so shorter term debt would be used which raises risk to re-finance the maturing debt as the market may no longer be interested in this product. As well, underlying reference interest rates may be higher and the market may require a higher spread to invest in this product.
- With the GA Recovery Right program continuing for 10 years, debt issued over this period is subject to changes in both the underlying reference interest rates and appetite of the market for this product.

iv. OPG Credit Rating

- Minimizing the impact of significant additional debt on OPG's credit rating is dependent on higher EBITDA arising from earned income on the GA Recovery Right in excess of external debt. Ability of the SPV to record revenue reflecting the growth in asset value.
- Potential OPG credit rating downgrade if legislative structure is not adequate to support long term recoverability, inability to record revenue from growth in asset value or agencies view equity injection as debt.
- OPG credit rating downgrade could result in loss of GBE status or result in SPV being consolidated directly with the Province.

Attachment 1

LEGISLATIVE REQUIREMENTS TO ALLOW DEFERRAL OF GLOBAL ADJUSTMENT AMOUNTS TO BE FINANCEABLE

The IESO currently has a right to collect GA monthly from ratepayers through provisions in the *Electricity Act, 1998*. It is proposed that collection of a certain portion of the monthly GA be deferred for collection in the future, and that the right to recover the deferred GA from ratepayers be used as a basis for structured financing/securitization.

The current proposal is for a trust to be created as a financing vehicle (the "**Trust**") in connection the deferred GA. The Trust will finance the deferral of the GA by purchasing the right to recover such deferred GA from the IESO for the principal amount of the GA being deferred. For example, if the amount of GA that is being deferred is $200 million in a given month, the Trust will purchase from the IESO the right to future recovery of the deferred GA and the associated financing costs (including interest and transaction costs) for $200 million in cash.

The Trust is expected to finance these purchases from the IESO through a combination of senior secured financing raised in the capital markets and subordinated financing from OPG (the funding for which will mostly be from equity injections from the OEFC/Province).

For accounting purposes, OPG will need to have the ability to direct the activities of the Trust, through a services agreement and/or through the Trust's constating document.

Based on securitized financing raised by utilities in the US (backed by utility cost recovery orders) and the current regulatory framework in Ontario, the legislation in Ontario would need to be amended to provide the following, at a minimum:

1. The IESO will be empowered to create an asset (the "**Regulatory Asset**") consisting of all right, title and interest in and to:

   (a) right to recover from and bill Ontario electricity ratepayers for:

   (i) the principal amount of GA that is being deferred for collection;

   (ii) all interest and other financing costs incurred in respect of the deferral of the GA (whether through senior debt raised in the public markets or subordinated debt raised from OPG or others); and

   (iii) (subject to the comments in paragraph 5 below in respect of OPG's internal administrative costs only) all fees, expenses and other administrative costs associated with such financing, including up-front and ongoing financing costs and any indemnity payments;

all on such repayment/amortization schedule as agreed by the IESO and any purchaser of such right (or pursuant to a pre-defined schedule/formula in the legislation that covers all of the purchaser's principal, interest and ongoing financing costs on a monthly basis); and

(b) all revenues, collections, claims, rights to payments, money or proceeds arising from the rights and interests set out in paragraph (a) above, regardless of whether such revenues, collections, claims, rights to payments, money or proceeds are imposed, billed, received, collected or maintained together with or commingled with other revenues, collections, rights to payments, payments, money or proceeds.

2. The IESO may dispose of the Regulatory Assets created from time to time on such terms as the IESO determines in accordance with the terms of directives to be issued to the IESO from time to time by the Minister, provided that any such disposition shall be a true sale and absolute transfer of the IESO's right, title and interest in and to a Regulatory Asset to the purchaser of the Regulatory Asset.

3. The Regulatory Assets will not be subject to any set-off, counterclaim or other defence by the IESO or any successor or affiliated entity thereof.

4. The legislation will need to recognize the Regulatory Assets as amounts that may be recovered by the IESO (e.g. it could be designated as a "GA Deferral" and would be included in the amounts collectible by the IESO through the GA collection mechanism, and would include interest and financing costs).

5. The purchaser of the Regulatory Asset will have the right to require the IESO (or any successor) to collect the principal amount of GA deferred, together with interest, financing and administration costs, on the agreed repayment/amortization schedule. **[NTD: In the LIPA securitization rate order, if the entity that is authorized to collect rates to service the bonds ends up defaulting, there is the ability to request a court to order "sequestration" and payments of amounts owing to the owner of the Regulatory Asset. Consider whether to include a similar right here. Alternatively, consider whether a security interest over the moneys collected by the IESO could be provided to the purchaser.]**

OEB would be provided with oversight over the internal administrative costs collected by the Financing Trust. This could be accomplished by (a) providing the purchaser of the Regulatory Asset with the right to require the IESO or a successor to collect only the principal amount of GA together with interest and financing costs and third party fees and expenses, and (b) requiring the IESO to collect amounts through the global adjustment and make payments to the purchaser of the Regulatory Asset with respect to the internal administrative costs incurred by the purchaser in connection with the purchase and management of the Regulatory Asset and the Financing Trust, in accordance with the order of the OEB then in effect. Under this mechanism, the OEB would be required to review the purchaser's internal administrative costs through a streamlined process and issue such orders in accordance with rules to be prescribed under a new regulation under the OEB Act, which would clearly limit the OEB's scope of review and could establish the basis for the purchaser to receive an appropriate fee for its services.

6. In the event that any action is taken or permitted by the Province or any regulatory authority that limits, alters, or impairs the value of a Regulatory Asset or reduces the ability of the IESO or the purchaser of the Regulatory Asset to collect or recover the costs associated therewith, the owner of the Regulatory Asset and the holders of any bonds or other securities issued to finance the purchase of the Regulatory Asset, will have a right of action against the Province for any damages suffered as a result of such amendment.

Attachment 2

STATUTORY AMENDMENTS

The following is preliminary and is based on our current understanding of the proposed structure and objectives. For example, we have assumed that the structure will not entail the insertion of a new Holdco between OPG and the Province. As these aspects are refined, some of the suggested amendments described below may not be needed and other aspects that we are not aware of may need to be considered. Accordingly, these suggested amendments are provided for discussion purposes and are subject to change. We would welcome the opportunity to work with OPG and the Ministry on refining the scope and substance of required legislative and regulatory amendments.

A. Amendments to Implement Structure

Certain *Electricity Act, 1998* amendments would be needed to implement the anticipated structure (which we understand, as noted above, would not include a Holdco), as follows:

- **Section 53.1(1):** Amend to permit owning and operating generation facilities through subsidiaries (not only directly through OPG). In addition, amend to permit OPG to administer, manage, loan moneys to and have a beneficial interest in, if applicable, Financing Trust.

- **Section 53.2:** Amend to permit the Minister to acquire, hold, dispose of or otherwise deal with securities or debt obligations of, or any other interest in, OPG or any subsidiaries. This is to accommodate possible variations to the financing structure that may be desirable over time.

- **Section 53.■ (new):** New statutory section to permit the Minister to enter into arrangements relating to an exercise of powers under 53.2.

- **Section 53.■ (new)**: New statutory section providing that creditors of Financing Trust have no recourse to the assets of OPG or any of its subsidiaries (other than Financing Trust, if applicable). In addition, consideration should be given as to whether the Act should be amended so that the Financing Trust cannot be wound up or liquidated.

B. Miscellaneous Corporate Items to Address

- **OPG Articles:** Amend the OPG's articles to remove the private company restrictions.

- **MOA with Province:** Consider whether any amendments to OPG's MOA with the Province are required to contemplate the Financing Trust.

C. Amendments Under Electricity Act to Implement GA Smoothing

Based on our understanding that the global adjustment smoothing mechanism is intended to benefit residential and small business customers only and that the Minister will be responsible for determining how much global adjustment smoothing is to be applied in a given month, if any, amendments to the *Electricity Act, 1998* and Ontario Regulation 429/04 (Adjustments Under Section 25.33 of the Act) would be needed to implement the mechanism, as follows:

(i) Electricity Act:

- **Section ■ (New):** Establish a new power for the Minister to make directives to the IESO in relation to the global adjustment smoothing mechanism and, particularly, for purposes of establishing global adjustment smoothing amounts from time to time (expected to be monthly). To the extent possible, the directive power should be drafted so as to limit the ability for a future Minister to require the IESO to do anything that would materially and adversely affect the Financing Trust or its lenders. **[NTD: While our understanding is that the Minister would direct this, we note from other materials we have seen that OPG may instead be recommending a formula approach. It is not clear what the formula would look like, where it would be set out or how it would be applied and by whom]**

- **Paragraph 25.33(1):** This section says that IESO shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of market participants reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require IESO to ensure that, over time, payments by prescribed classes of market participants also reflect amounts paid to Financing Trust. **[NTD: Not certain this is needed if only to benefit residential and small business consumers, who are not market participants. May be needed in reference to payments from distributors and retailers]**

- **Paragraph 25.33(2):** This section says that distributors and retailers shall make adjustments in accordance with the regulations to ensure that, over time, payments by prescribed classes of consumers reflect amounts paid to OPG, OEFC and distributors, as well as amounts paid to entities with whom IESO has a procurement contract. Add new subsection (c) so as to require distributors and retailers to ensure that, over time, payments by prescribed classes of consumers also reflect amounts paid to Financing Trust.

- **<u>Note</u>**: As described below, the regulation will need to include new requirements for the IESO to record the global adjustment smoothing amounts in one or more variance accounts and to use those amounts to offset amounts otherwise recorded in the variance accounts under Section 25.33(3) of the Act. For context, we note:

    - Section 25.33(3) says that adjustments under (1) or (2) relating to electricity consumed by consumers whose rates are determined by the OEB under s. 79.16 of the OEB Act (i.e. RPP Customers) shall instead be made in accordance with the regulations to one or more variance accounts established and maintained by the IESO.

- Section 25.33(4) says IESO, distributors and retailers shall make and receive such payments, set-offs and credits as may be required or permitted by the regulations with respect to consumers described in (3), i.e. RPP Customers.

- Section 25.33(5) says that IESO shall establish and maintain such variance accounts as may be needed to record all amounts payable or receivable by it under 25.33.

(ii) O. Reg. 429/04 (Adjustments Under Section 25.33 of the Act):

- **Section 1(1):** Consider adding definitions for “Financing Trust” and “global adjustment smoothing amount” or such other terms as may be preferred.

- **Section 1.2(1) (New):** Add section providing that, for the purposes of this Regulation, the global adjustment smoothing amount for a month is the amount determined by the IESO in accordance with a directive from the Minister under section ■ of the Electricity Act in respect of the month. **[NTD: See above note re use of Minister directives]**

- **Section 1.2(2) (New):** Consider adding a section providing that the IESO shall publish the global adjustment smoothing amount for a month by no later than the 10th business day of the following month [to align with general publication requirements for global adjustment under s. 1.1(2)].

- **Section 10(1):** Amend formula for calculating Class B GA rate by subtracting the global adjustment smoothing amount for a month from "M", which is the total amount of the global adjustment for the month. The global adjustment smoothing amount could be designated as "X", such that the formula would be (M-X-N)/(P-Q). Define "X" as the global adjustment smoothing amount for the month as determined by the IESO in accordance with the Minister’s directive under section ■ of the Electricity Act for the month. **[NTD: See above note re use of Minister directives]**

- **Section 10.1 (New):** Add new section to deal with adjustments under subsection 25.33(3) of the Act, i.e. in respect of RPP consumers. This section should require the IESO to establish, within the variance account(s) it maintains pursuant to subsection 25.33(3) of the Act, one or more subaccounts in which it shall record the global adjustment smoothing amounts applicable to the classes of consumers described in subsection 25.33(3) of the Act. This section must also specify that the IESO shall apply the amounts recorded in the subaccounts against the balances in the variance accounts for purposes of section 79.16(3) of the OEB Act.

- **Note:** This is a key aspect because, when the OEB determines RPP rates, it must take into account the balances in the variance accounts established by the IESO under s. 25.33 of the Electricity Act and make adjustments with a view to eliminating the balances within 12 months. This proposed new section 10.1 causes the IESO to reduce (in the near term) the variance account balances by the global adjustment smoothing amounts, as provided by Financing Trust, thereby enabling the OEB to determine RPP rates that, despite being lower for RPP consumers in the near term, still eliminate the relevant variance account balances within 12 months.

- **Paragraph 11(2)2.ii:** Amend the formula for calculating the allocation of global adjustment for a month to a licensed distributor that is a market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x (R+S-T)]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 11(2)3:** Amend the formula for calculating the allocation of global adjustment for a month to each Class B market participant by subtracting the global adjustment smoothing amount for a month from "M", which has the same meaning as under section 10(1). The global adjustment smoothing amount could be designated as "X", such that the formula would be [(M-X-N) x U]/(P-Q). Define "X" as suggested under section 10(1).

- **Paragraph 16(7)4:** Consider amending the description of "Global Adjustment" that is required to be included on certain invoices so as to inform consumers that their portion of the global adjustment for the month (i) may have been reduced by the application of a global adjustment smoothing amount from the Financing Trust, or (ii) may include amounts payable to the Financing Trust in respect of global adjustment smoothing amounts previously applied.

- **Section 20(1):** This section establishes an obligation for the Ontario Electricity Financial Corporation and every licensed distributor that is a market participant to give the IESO such information as the IESO may require for the purposes of the Regulation in the form specified by the IESO and before the expiry of the period specified by the IESO. Consider amending to extend this obligation to the Financing Trust.

- **Section 20(6):** This section provides that on request by the OEB, the IESO, a licensed distributor, an embedded generator, a retailer or the OEFC shall give the OEB such information relating to this Regulation as the OEB may require, in the form and within the period specified by the OEB. Consider amending to extend this obligation to the Financing Trust.

D. Amendments Under OEB Act to Implement Cost Recovery for Financing Trust

Amendments to the *Ontario Energy Board Act*, including amendments to O. Reg. 95/05 (Classes of Consumers and Determination of Rates) and the introduction of a new regulation, would be needed to implement a cost recovery process for the Financing Trust in relation to the global adjustment smoothing mechanism, potentially with limited OEB oversight, as follows:

(i) Ontario Energy Board Act:

- **Section 78(3.3):** This provision establishes an obligation for the OEB, when determining rates for the retailing of electricity, to take into account balances in variance accounts established under section 25.33 of the Electricity Act and to make adjustments "with a view to eliminating those balances within 12 months or such shorter time periods as the Minister may direct." Consider whether any amendments are needed, and confirm this works with the framework being proposed.

- **Section 78.7 (New):** We understand that the Province may want the OEB to have an oversight role. One possible approach would be to establish a new statutory section establishing that the IESO shall make payments to the Financing Trust with respect to the internal administrative costs incurred by the Financing Trust in connection with the purchase and management of the Regulatory Asset and the Financing Trust. Such payments by the IESO would need to be made in accordance with the order of the OEB then in effect, which orders shall be made by the OEB in accordance with rules prescribed under a new regulation.

    - The new regulation would need to be clear that the OEB does not have jurisdiction to consider the principal amount or any interest, financing costs, third party fees or expenses. Rather, OEB's role would be limited to considering the internal administrative costs of the Financing Trust and ensuring the Financing Trust receives an appropriate fee for its services, all of which would be recovered by the Financing Trust from the IESO, which would collect those amounts in the global adjustment. Note that, if this approach is accepted, the IESO and distributors and retailers would need the authority to collect such amounts as part of the GA and IESO would need the authority to pay such amounts to the Financing Trust. As such, additional amendments would be needed under O. Reg. 429/04.

- **Note:** Section 79.16 of the OEB Act does not require changes, but the significance of this provision should be understood.

    - Section 79.16 gives the OEB responsibility for determining electricity commodity prices for eligible consumers. Eligibility is determined under Reg. 95/05 (Classes of Consumers and Determination of Rates), which is also known as the Regulated Price Plan (RPP) Regulation.
    - Section 4(2) of the RPP Regulation defines RPP-eligible consumers as low volume consumers (i.e. those who annually use less than 150,000 kWh

or such other amount as prescribed), consumers with demand of 50 kW or less, residential consumers that have accounts with distributors, consumers who annually use 150,000 to 250,000 kW of electricity, and consumers who have accounts with distributors if in the farming business.

- Paragraph 6(1)3 of the RPP Regulation provides that "In determining the rates (for RPP-eligible consumers), the Board shall forecast the cost of electricity to be consumed by the consumers to whom the rates apply, taking into consideration adjustments required under section 25.33 of the *Electricity Act, 1998* and shall ensure that the rates reflect those costs."
- The Ontario Energy Board has developed a Regulated Price Plan Manual (revised February 16, 2016) to describe the processes and methodologies it uses for determining electricity commodity prices that are charged to RPP consumers pursuant to Section 79.16 of the OEB Act and paragraph 6(1)3 of the RPP Regulation.

(ii) O. Reg. 95/05 (Classes of Consumers and Determination of Rates)

- **Paragraph 6(1)3:** Amend so as to require the Board, when forecasting the cost of electricity to be consumed by the consumers to whom the rates apply, to take into consideration not only the adjustments required under section 25.33 of the Electricity Act but also the application or prior application of global adjustment smoothing amounts determined by the IESO in accordance with Minister directives under section ■ of the Electricity Act, and to ensure that the RPP rates reflect those amounts. **[NTD: See above note re use of Minister directives]**

(iii) New Regulation (Payments to the Financing Trust)

- If the OEB is to be given the role of reviewing and approving the recovery of OPG's internal administrative costs for the Financing Trust under the potential section 78.7 (see above), then this regulation should describe the process and criteria pursuant through which the OEB would determine the amounts that the IESO would be required to collect through the global adjustment, in accordance with section 25.33 of the Electricity Act, and pay to the Financing Trust in respect of the provision of global adjustment smoothing amounts. This part of the regulation should establish:

  - any reporting requirements from the Financing Trust and/or the IESO to the OEB in connection with the global adjustment smoothing mechanism;
  - the frequency of the OEB making determinations under this part of the regulation;
  - the process through which the OEB shall make these determinations, which should be a streamlined administrative process rather than a public hearing process or, if a hearing is needed, then the scope of the proceeding should be clearly and narrowly constrained so as to deter intervenor involvement, lengthy proceedings and reduce/eliminate risk to recovery by Financing Trust;

- the basis for the OEB's determinations as to the payments that shall be made to the Financing Trust, which should specify that:
  - the Financing Trust shall recover its prudently incurred internal administrative costs on a forecast basis each year;
  - the Financing Trust shall receive an appropriate fee each year (with some guidance as to what would be appropriate); and
  - the approved payment amounts shall be collected by the IESO through the global adjustment and paid to the Financing Trust in accordance with the order of the OEB then in effect. Note that O. Reg. 429/04 would likely need amendments to permit IESO (and distributors and retailers) to collect these amounts through the global adjustment.