ENERGY media calls

From: "Nekolaichuk, Colin (ENERGY)" <colin.nekolaichuk@ontario.ca>
To: "@OPO-Media Relations and Issues Management" <opo-mediarelationsandissuesmgmt@msgov.gov.on.ca>
Cc: "Berry, James (ENERGY)" <james.berry5@ontario.ca>
Date: Wed, 18 Apr 2018 18:57:00 -0400

Hi all,

A few requests to report. Both OPG and the OEB sent responses to Matt McClearn at The Globe and Mail. The responses are below.

In addition, The Globe and Mail ROB is writing a story on recent changes to Hydro One's executive compensation framework. I've included Hydro One's response, as well as a response from ENERGY.

As always, let me know if you have any questions.

Cheers,
Colin

Agency: OEB

Topic: IESO and OEB

Reporter & Outlet: Matthew McClearn, Globe and Mail

Questions:

1. **What regulatory authority concerning rates does the Ontario Energy Board wield over the IESO?**
2. **What rates does it set?**
3. **What is the Ontario Energy Board's role in the Fair Hydro Plan?**

Response:

Under section 25 of the *Electricity Act, 1998*, the Ontario Energy Board's (OEB) role is to approve the Independent Electricity System Operator's (IESO) expenditure and revenue requirements for a given fiscal year and the fees that the IESO proposes to charge during the fiscal year. Fees as defined in the *Electricity Act, 1998* are amounts charged by the IESO to recover its costs of operations; for example, staff salaries and office space.
The IESO cannot establish, eliminate or change any fees without OEB approval. If the OEB disagrees with the IESO's proposed expenditure and revenue requirements and proposed fees for a given year, the OEB may refer them back to the IESO for further consideration with the OEB's recommendations.
Under the *Electricity Act, 1998*:

the IESO cannot file its fees application for OEB review until the Minister has approved the IESO's proposed business plan for the fiscal year in question;

the OEB is deemed to have approved recovery by the IESO of its costs and payments related to procurement contracts (as defined); and

in reviewing the IESO's proposed expenditures and revenue requirements and its proposed

fees, the OEB cannot take into consideration the remuneration and benefits of the chair and other members of the board of directors of the IESO.

The fees approved by the OEB for 2017 are: $1.2187/MWh for domestic customers and $0.9872/MWh for export customers. These fees also apply, on an interim basis, from January 1, 2018 until such time as new fees are approved by the OEB.

IESO fees do not include the cost of services required to operate the electricity system and administer the wholesale market that the IESO bills market participants under the market rules; for example, the cost of operating reserve, market costs related to system congestion and losses on the IESO-controlled grid. These costs (and the IESO's fees) are ultimately passed through by electricity distributors to consumers as part of the wholesale market service charge set by the OEB. More detail about the wholesale market service charge is available on our website at https://www.oeb.ca/rates-and-your-bill/electricity-rates/understanding-your-electricity-bill.

Under the *Ontario Fair Hydro Plan Act, 2017* (OFHP Act), the OEB has a number of new or modified responsibilities:

- Setting Regulated Price Plan (RPP) prices to give RPP consumers the benefit of electricity price mitigation under the OFHP Act.
- Setting a GA "modifier" or credit to give eligible consumers that are not on the RPP the benefit of electricity price mitigation under the OFHP Act.
- Setting rates to enable recovery by the IESO of the balance recorded in the variance account that the IESO was required to establish under the OFHP Act.
- Setting the rates at which the Clean Energy Adjustment will be recovered from consumers.
- Approving fees that can be charged by the Financial Services Manager.
- Enforcing compliance with the OFHP Act by electricity distributors and unit sub-meter providers.

The OEB is also responsible for setting the cap on monthly base distribution charges for residential customers served by certain named electricity distributors under the Distribution Rate Protection program.

Agency: OPG

Topic: Fair Hydro Trust

Reporter & Outlet: Matthew McClearn, Globe and Mail

Questions:

1. What regulatory authority concerning rates does the Ontario Energy Board wield over the IESO?
2. What rates does it set?
3. What is the Ontario Energy Board's role in the Fair Hydro Plan?

Response:

1. Which persons are responsible for running the Fair Hydro Trust?

- OPG's Board of Directors approved a separate group within the Treasury department to operate the Fair Hydro Trust. As of March 31, 2018, there are four full-time employees assigned to the Fair Hydro Trust group. This group is qualified to manage the ongoing activities of the Fair Hydro Trust, and to effectively keep ratepayer costs for running the program to a minimum.

2. Mr. Hartwick said: "We were also successful in establishing the Fair Hydro Trust which we expect to have a positive contribution to our financial results going

forward." How does the Fair Hydro Trust have a positive contribution on OPG's financial results? Please walk me through it.

OPG earns interest income on funds it loans to the Trust, which rank as subordinated debt of the Trust. OPG also receives a management fee for services provided to the Trust as its Financial Services Manager, including determining whether to acquire Investment Interests from the IESO, negotiating and executing all agreements, fulfilling reporting requirements, and administering the Trust's day-to-day activities.

OPG's services in relation to the Fair Hydro Plan are an essential part of delivering value for ratepayers. For example, OPG used its expertise in managing other large funds and worked with its advisors to successfully market Fair Hydro Trust Bonds. In the February 2018 offering, there was strong investor appetite and it resulted in an interest rate of 3.357%, one of the lowest financing costs in the Canadian energy sector.

- **Fees charged by OPG to the Trust are in accordance with sections 10.1 to 10.15 of *Ontario Regulation 206/17,* and are at the lower end of benchmarked companies' fees. OPG's management fees are subject to an annual review by the Ontario Energy Board (OEB). Management fees for 2017 and the January 2018 to March 2019 period have been submitted to the OEB for review.**

3. **Mr. Hartwick said "The Fair Hydro Trust expects to acquire another tranche of investment interest from the IESO in March 2018." Did that transaction happen? If so, please describe that transaction.**

Yes, on March 22, 2018, the Fair Hydro Trust purchased its second tranche of Investment Interest from the IESO in the amount of $460 million. Fifty-one percent of the funding requirement or $235 million was financed by the Trust through a revolving warehouse facility ranked as senior notes, and the remaining 49 percent or $225 million was funded through the issuance of short-term subordinated debt to OPG.

The Trust plans to issue debt two to three times per year. The next issuance will be in late April 2018.

4. **In its October 2017 report on the Fair Hydro Plan, the Auditor General of Ontario said the Fair Hydro Trust will borrow an average of $2.5 billion a year. What's OPG's current expectation?**

OPG's current expectation is that the average borrowing will be less than $2 billion per year. This amount is an estimate and actual borrowing is dependent on changes in various factors.

5. **When will the Fair Hydro Trust's first set of financial statements be published?**

The first set of the Trust's financial statements is for the 12-day period ended December 31, 2017. Since the Fair Hydro Trust is a private entity, the financial statements are not required to be publicly posted. However, in support of OPG's commitment to

transparent reporting, the Trust's 2017 audited financial statements will be posted on OPG.com before the end of May 2018.

6. When will the first audited set of FHT financial statements be published?

As noted in the previous response, the Trust's 2017 audited financial statements will be posted on OPG.com in May 2018.

7. Who's auditing the FHT's books?

- OPG, as the Financial Services Manager, appointed Ernst & Young to perform the audit of the Trust's 2017 financial statements. The audit is currently ongoing.

8. How are the borrowing of the FHT recorded on OPG's books?

- As OPG owns the subordinated debt issued by the Trust, OPG's consolidated financial statements only reflect the senior debt issued to external investors. For OPG's 2017 financial statements, senior notes payable of $601 million is reflected as Long-term debt. This amount represents 51% of the total financing receivable asset acquired from the IESO of $1.179 billion.

9. In its report on the Public Accounts of the province, the Auditor General wrote the following passage:

OPG, in its analysis regarding the asset (i.e., the shortfall from paying generators more than what is collected from distributors) that OPG Trust will be purchasing from the IESO, correctly pointed out that the OPG Trust cannot classify this asset as a rate-regulated asset because this asset does not relate to the activities of OPG Trust. OPG's analysis went on to note that this asset will be classified as an intangible asset.

a) Please provide me a copy of this analysis.

We are providing comprehensive answers below that cover the technical accounting issues that form the basis of the analyses. If you would like additional details, a member of OPG's Accounting group would be willing to meet and walk you through the analysis.

b) Why did OPG perform an analysis on the asset, as described above?

OPG, as the Financial Services Manager, is responsible for the Trust's accounting and as part of this role, it analyzed what type of asset the Fair Hydro Trust is acquiring from the IESO to determine the appropriate classification. An asset's classification determines how it will be accounted for on the transaction date and subsequently thereafter, therefore it is an important step in the process. This type of analysis is typical for any business entering into a new transaction.

c) **Who at OPG performed the analysis?**

OPG's External Reporting & Accounting Policy and Treasury groups performed the accounting analysis.

d) **On what dates did that analysis begin and end?**

OPG's accounting analysis for the Fair Hydro Plan commenced in early 2017 and continued throughout 2017 as the structure, program agreements, and financing strategy for the program developed. The ongoing effort to analyze accounting implications is typical for such a material and business transaction. The accounting was finalized in January 2018, shortly after the establishment of the Fair Hydro Trust and underlying program agreements in December 2017.

e) **Did OPG conclude (as characterized above) that the Trust "cannot classify this asset as a rate-regulated asset"? If it did not, please describe its conclusions in detail.**

OPG's accounting analyses for the impact of the Fair Hydro Plan were performed under both International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Principles (US GAAP) frameworks. The accounting impact of the transaction is required to be reported to the Province of Ontario under IFRS for the purpose of consolidating OPG's results, while US GAAP is the accounting framework used by OPG in preparing its financial statements. The use of different accounting frameworks by a parent entity (the Province) and a controlled entity (OPG) is not unusual, and is the reason for the analyses under both frameworks. OPG's analyses considered whether the asset is a financial asset, regulatory asset, or an intangible asset.

The excerpt referred to in this question relates to OPG's accounting analysis under IFRS, in which OPG concluded that the asset the Fair Hydro Trust acquired from the IESO is an intangible asset. Under US GAAP, this same asset has been classified as a financial asset, more specifically a financing receivable. The difference in classification is not unusual between two applicable bases of accounting as both sets apply their own standards and practices. Professional judgement was exercised in making these determinations and OPG received an unqualified audit opinion for its 2017 consolidated financial statements under US GAAP. Our auditors have confirmed that they agree with our interpretations under both sets of GAAP. It is important to note that the classification of the asset as an intangible under IFRS and as a financing receivable under US GAAP does not result in any material impact to OPG's income.

To reiterate, the asset the Fair Hydro Trust is acquiring does not have the same classification as the IESO's asset because the nature of the assets are different. In particular, the IESO's asset relates to a regulatory asset from the variance resulting from the electricity market settlements of the Fair Hydro Plan, whereas the Trust's asset results from the financing services it is providing in support of the Fair Hydro Plan.

10. **In OPG's 2017 financial results, OPG disclosed that "OPG's reputation could potentially be adversely impacted through its involvement as the Financial Services Manager under the Fair Hydro Act, and through stakeholder opinions related to this involvement."**

Why does OPG's involvement as the Financial Services Manager pose a potential threat to OPG's reputation? Please explain. What "stakeholder opinions" are being referred to here?

OPG is committed to managing risks and pursuing opportunities to achieve its strategic imperatives and business plan objectives.

OPG identifies, assesses, prioritizes and manages risks as an integral part of its management system. This is a normal part of our business. Because the Ontario Government's Fair Hydro Plan has received a lot of public attention, it is prudent for OPG to identify and mitigate any and all risks associated with this plan, including ensuring that its stakeholders understand its role.

OPG has operations across Ontario and has relationships with numerous community stakeholders. OPG has been working with these stakeholders to explain our role as the Financial Services Manager of the Fair Hydro Plan on behalf of the Government.

Through our stakeholder engagement process, we have been able to ensure that our stakeholders are informed of the Fair Hydro Trust structure and understand that they can direct any questions to our management team.

11. Is OPG profiting off of the Fair Hydro Trust interest?

The income is for OPG providing services to the Trust. The FHT was set up as a commercial transaction in order to obtain financing to fund the rate reduction. OPG is doing the work at the lowest cost.

OPG's services in relation to the Fair Hydro Plan are an essential part of delivering value for ratepayers. For example, OPG used its expertise in managing other large funds and worked with its advisors to successfully market Fair Hydro Trust Bonds. In the February 2018 offering, there was strong investor appetite and it resulted in an interest rate of 3.357%, one of the lowest financing costs in the Canadian energy sector.

Topic: Hydro One Executive Compensation

Reporter & Outlet: Janet MacFarland, Globe and Mail

Questions:

I'm Janet McFarland, a business reporter at The Globe and Mail. I'm getting in touch to ask about a change to Hydro One's change of control provisions, which are disclosed in your latest proxy circular. It's been pointed out to us that a couple of new provisions have been added, expanding the definition of a change in control to include a change of board members. This wasn't included in the definition last year. I'm wondering if someone (perhaps your board chair?) would be able to explain when and why this change was made? It would appear to have implications for the amount of severance that could be paid to executives, if they lost their jobs due to a change of control involving replacement of the board, which is obviously a sensitive topic right now given Doug Ford's comments. I can be reached at 416-585-5378.

Hydro One Response:

Attribute to David F. Denison, Chair of the board :

"At the time of the IPO Hydro One introduced a Long Term Incentive Plan with standard Change in Control terms typical of publically traded companies. During our annual review of compensation practices in early 2017, we identified these terms were not directly applicable to Hydro One's circumstances. The revision to the change in control terms that we identified was adopted to address Hydro One's unique ownership structure and the provisions of the Governance Agreement with the Province of Ontario.

No other changes to the severance policy or Change in Control provisions have been approved by the Board since that time."

ENERGY Response:

We recognize that executive salaries are high compared to the vast majority of Ontario salaries and we remain committed to Hydro One's regulation, accountability and transparency through our government's involvement as a majority shareholder.

That said, Hydro One is now a publicly traded company, not a government entity. Decisions made regarding executive compensation are made by the Board of Hydro One.

Since broadening ownership of Hydro One, the company's leadership has delivered $114 million in savings. These savings have been realized through enhancements to customer service and the company's commitment to lowering costs for ratepayers.

Hydro One's rates continue to be set by the Ontario Energy Board. The Board is the energy sector's independent regulator with a mandate to protect the province's electricity consumers and it continues to deliver on its mandate. For instance, last Fall the Ontario Energy Board capped the portion of executive compensation Hydro One electricity customers are required to fund at 10 per cent of base salaries – saving ratepayers $30 million over this year and next.
Completely eliminating the CEO's salary would not even take pennies off of peoples' bills.

It's up to Doug Ford to try to explain exactly how his policy would work. We've already seen the chaos created by a man in the White House who's governing by firing people all the time. Ford's gimmick will drag us down into the same mess and won't actually do anything to reduce hydro bills either.

Compare Ford's chaotic scheme to our Fair Hydro Plan, which has lowered bills by 25 per cent on average for families and as many as half a million small businesses and farms. Low-income families and those in eligible rural and remote areas are seeing decreases as high as 40 to 50 per cent as well. Thanks to our plan, Ontario families and small businesses are now paying less on average here than in many other similar jurisdictions. Moving forward, our Long-Term Energy Plan lays out a path for predictable, affordable electricity prices with no sudden jumps too. That's real relief Ontario families can depend on and it's all part of our plan to invest in care and create more opportunity for everyone.

Colin Nekolaichuk | Senior Communications Advisor
Office of the Hon. Glenn Thibeault | Minister of Energy
T: 416-325-2690 C: 647-504-4928
colin.nekolaichuk@ontario.ca