Ontario

CABINET BRIEFING NOTE
AND LRC RECOMMENDATION

Energy
Fair Hydro Plan Regulations
DRAFT prepared with no materials

Cabinet (info) Feb 15, 2017	TB/MBC and Cabinet March 1, 2017	Announcement March 2, 2017	TB/MBC May 9, 2017	Cabinet May 10, 2017	Introduction May 11, 2017
Royal Assent June 1, 2017	TB/MBC June 27, 2017	Cabinet June 27, 2017		Program Effective Date July 1, 2017	

Summary of Proposal

The proposed regulations are consistent with Cabinet direction.

Context for Decision:

On March 2, 2017, the government announced Ontario's Fair Hydro Plan (OFHP), which would lower bills by 25% for a typical residential consumer, starting in the summer of 2017. OFHP includes some benefits for all consumer classes as well as targeted benefits to those identified as having the greatest need, and includes the following major components:

- Refinancing a portion of the Global Adjustment (GA);
- Helping vulnerable electricity consumers ("social programs");
- Expanding the Industrial Conservation Initiative (ICI);
- Improving sector efficiency; and
- Modernizing Ontario's electricity market.

The *Fair Hydro Act, 2017,* was introduced on May 11, 2017 and received Royal Assent on June 1, 2017.

Proposal

This proposal is the second batch of regulations and next step in the implementation of the OFHP and would establish the necessary Order in Council (OIC) under the *Capital Investment Plan Act, 1993* (CIPA) and regulations under the *Ontario Energy Board Act, 1998* (OEBA)*,* and the *Ontario Fair Hydro Plan Act, 2017* (OFHPA) related to:

1. <u>Partial Refinancing of the Global Adjustment (GA):</u>

The ministry is proposing a new regulation under the OFHPA to provide clarity for and implementation of the roles and responsibilities of the Financial Services Manager (FSM, i.e. Ontario Power Generation (OPG)) and the Independent Electricity System Operator (IESO) under the OFHPA, as well as to provide further criteria related to the development and implementation of the Financing Plan by the FSM and the setting of the Fair Allocation Amount by the Minister of Energy, as required under the OFHPA.

The Ministry of Finance (MOF) is also seeking an OIC under CIPA to authorize the Minister of Finance to provide loan(s) to the Ontario Financing Authority (OFA) in an amount of up to $2-billion.

2. <u>Social Programs:</u>

The ministry is proposing amendments to existing regulations under the OEBA to allow for the orderly transition of the Ontario Electricity Support Program (OESP) from the electricity rate base to government funding.

Why does Ontario need these changes? Why now?

Addressing rising electricity prices is among the highest priorities for Ontarians. Since the OFHP was announced there has been increased media attention and public pressure for the government to take the necessary steps to enact the commitments made in the plan. The *Fair Hydro Act, 2017,* identifies a July 1 implementation date for the various price mitigation initiatives contained within. Pending approval of the regulations, the OEB will recalculate rates to be implemented for July 1, 2017.

What is the expected cost to government?

The estimate for the combined impact of the social programs in this proposal is expected to be $140M in 2017-18. The ministry will return to TB/MBC with updated out-year figures following program implementation. This investment has been factored into the fiscal plan in the 2017 Ontario Budget. These estimates are based on variable inputs such as program uptake and are therefore subject to change.

TABLE 1: Fiscal Impact ($M) of Social Program	2017-18 Budget
Ontario Electricity Support Program	140

Note: As approved in the TB/MBC submission of Mach 1, 2017, and confirmed in Vote-Item 2905-1, the financial impacts of the social program for the period July 1 2017- March 31, 2018.

Comment [HT1]: Energy to confirm. Is the $140M for the time period after the variance account has run out? Or an annualized number, and the impact in 2017-18 would actually be much lower?

With the proposed OIC to enable the IESO credit facility, the Minister of Finance will be authorized to lend an additional amount of $2B to the OFA. Loans advanced will result in increased borrowing in the debt markets by the Province. Loans are expected to be repaid and, therefore, no fiscal impact is expected.

What are the key steps to deliver this proposal?

- Summer- Fall 2017- Energy to work with IESO, OEB, OPG, OFA and LDCs on the implementation of OFHP, including:
    - IESO to establish the regulatory asset;
    - Minister to set the Fair Allocation Amount;
    - OPG SPV expected to begin purchasing of investment asset;
    - OPG to determine the clean energy adjustment;
    - OPG to work with lenders and credit rating agencies in establishing the vehicles for selling of investment asset interests;
- OEB to calculate rates for July 1, 2017 (June 22 target announcement)
- July 1, 2017- the remaining reductions and initiatives associated with the OFHP would take effect. Customers would see reductions on their first bill after July 1.
- Fall 2017- Energy to return to LRC/Cabinet with proclamation OIC to finalize transfer of OESP to from IESO variance account to government funding.

Comment [HT2]: This is a rough sketch. Energy, please refine and elaborate as appropriate.

How will the changes be communicated?

The proposed changes will be communicated via a news release or backgrounder in late June.

Cabinet Office Analysis

The proposed new regulations under the *Ontario Fair Hydro Plan Act, 2017* (OFHPA) and the regulatory amendments under the *Ontario Energy Board Act, 1998* (OEBA), allow for the implementation of the key elements of Ontario's Fair Hydro Plan (OFHP) announced on March 2, 2017 and are consistent with Cabinet direction.

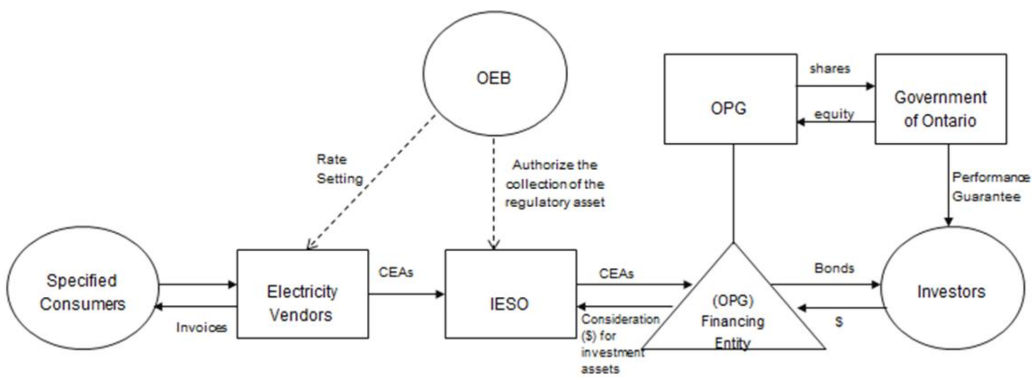
1. Partial Refinancing of the Global Adjustment:

The OFHPA establishes the framework to refinance a portion of the current Global Adjustment (GA) costs. Under the structure the Independent Electricity System Operator (IESO) will record the GA cost recovery deferral as a "regulatory asset", regulated by the Ontario Energy Board (OEB). IESO may then sell the regulatory asset, at which time it becomes an "investment asset." The investment asset owner (OPG Trust/Special Purpose Vehicle (SPV) or "financing entities") may then further sell or securitize all or part of the regulatory asset to other parties in exchange for a funding obligation.

The Minister of Energy, following the principles in the bill and the proposed regulations, would regularly calculate the "Fair Allocation Amount" to ensure a proper alignment of the allocation of the intergenerational costs and benefits in relation to each of the next 60 six month "reference periods." The financings will be backed primarily by the clean energy adjustments payable by specified consumers. The clean energy adjustments will track the actual payment obligations incurred by the financing entities when they become due and payable.

OPG, in its role as the Financial Services Manager (FSM), will calculate the aggregate clean energy adjustment payable in each month of the reference period, and, to ensure intergenerational fairness, these amounts will be managed to align with the fair allocation amounts. OEB would calculate the rates at which the clean energy adjustment could be collected from specified consumers. Consumers would be invoiced the clean energy adjustment on their electricity bills through existing IESO and Local Distribution Companies' (LDC) processes, which will be channeled through to pay each financing entity's related funding obligations. The clean energy benefit will appear on customer's bills once repayment of the accumulated debt begins.

Figure 1: Financing Structure



Note: CEAs are "clean energy adjustments".

The ministry is proposing a new General Regulation under the OFHPA that would support the implementation of the refinancing of the Global Adjustment (GA), including:

- provide for the implementation of the roles and responsibilities of the FSM (i.e., Ontario Power Generation (OPG)) and, OEB and IESO in relation to the refinancing of GA:
    - methodology for calculating the clean energy adjustment, the finance amount, the true-up amount;
    - required communications by FSM with OEB on clean energy adjustment for each reference period;
    - requiring that OEB review the FSM calculations of clean energy adjustment for accuracy and to determine a kWh amount for the clean energy adjustment for each reference period using IESO demand forecasts;

   - clarify FSM's ability to charge fees to the financing entities for the costs of its services and required activities under the OFHPA. FSM to submit methodology used for determining fees to the OEB for review and approval;

   - requiring the FSM to prepare report for the minister on affairs within 90 days of the end of each fiscal year or as required.

- require that the clean energy adjustment be a specific line item on bills and that LDCs keep separate records of amounts invoiced to be produced at the request of specified parties (e.g., IESO, FSM);

- provide criteria and detail to support key aspects of the OFHPA, including IESO deferral and the establishment and transfer of portions of the regulatory asset, as well as the establishment of the related variance account;

- provide further criteria related to the development and implementation of the financing plan by the FSM;

   - reasonable assumptions and additional principles and that the FSM must make or take into account, such as seeking to incur funding obligations on the best terms available and flexibility to cope with changes to future fair allocation amounts; and,

- provide for further principles that must be taken into account by the Minister of Energy in the calculation of the fair allocation amount (commodity prices, interest rates, inflation, population, consumption, and the useful life of assets) and a methodology for making adjustments to the fair allocation amount for a reference period, if required.

<u>IESO Credit Facility</u>

The Ministry of Finance (MOF) is seeking an Order in Council (OIC) to authorize the Minister of Finance to provide loan(s) to the Ontario Financing Authority (OFA) in an amount of up to $2B, which will provide the OFA with the capacity to provide additional loans to the Independent Electricity System Operator (IESO) in order to fulfil the commitments under the *Fair Hydro Act, 2017*.

The IESO is responsible for financing short to medium term funding shortfalls in the implementation of the Fair Hydro Plan. The proposed OIC is required to support the timely and successful implementation of the OFHP.

The Capital Investment Plan Act (CIPA) authorizes the Minister of Finance to make loans to the OFA in the amounts, times and on the terms and conditions authorized by Lieutenant Governor in Council ("LGIC"). Under other OICs, the Minister of Finance is already authorized to provide loans to the OFA, and in turn the OFA has provided loans and credit facilities to other public bodies (e.g., colleges, school boards, Ontario Lottery and Gaming Corporation, etc.).

2. Ontario Electricity Support Program (OESP)

The OESP is an income-tested, application based program that lowers electricity costs of the most vulnerable consumers by providing a rebate directly on electricity bills. The *Fair Hydro Act, 2017* amended the OEBA to allow for the program to transition from the electricity rate base to government funded, and allow for the potential transition of the program administration to the Crown or other entity.

The ministry is proposing amendments to O. Reg. 314/15 under the OEBA to implement an approach to proclaim the relevant section of the OEBA into force on a future date to be named by proclamation. The proclamation OIC would be brought forward for approval at a later date. This would allow time for the funds accumulated in the IESO's OESP variance account to be more fully expended prior to the repeal and replacement of the relevant section. However, the MCSS data sharing provisions, along with ss. Amendments to s. 79, the new sections 79.3 and 79.4, would came into force at Royal Assent of the *Fair Hydro Act, 2017* on June 1, 2017.

The ministry is also proposing amendments to O. Reg. 314/15 made under the OEBA to include a "General Rule" that would enable Ministry of Community and Social Services staff to sign up social assistance clients for OESP based upon Ontario Works (OW) and Ontario Disability Support Program (ODSP) eligibility criteria, and matching this eligibility to the existing OESP household size / income credit table. The amendment is in support of efforts to increase enrollment by reducing application burdens on target populations and enable the development of automatic enrollment procedures for some populations already receiving other government programming.

Comment [HT3]: Energy: Would third party community providers also be able to do this, or only MCSS?

Risks

Comment [HT4]: Still under development. Suggestions welcome.

Fiscal

OESP does not have a scheduled end date and represents an ongoing fiscal pressure, which will likely increase over time. The cost estimate is based on variable inputs such as program uptake, and are therefore subject to change.

OPG Mechanism

There are several risks associated with the proposed OPG mechanism that remain:

- Accountability:
    - OFHPA and the proposed regulations attempt to balance the independence of the OPG Trust/SPV with regulatory oversight and the market's need for certainty in recovering the GA financing;
    - No party will have the ability to remove OPG in its role as the investment asset owner. The mechanism could be criticised for not providing for an appropriate level of accountability to the government or the public, due to the limited amount of government control of the entity, and future rate increases. However, this is seen by the markets as an essential component for the structure to operate.
- New structure:

- The structure is complex and involves: IESO as originator of the regulated asset and responsible for flow of funds; OEB as regulator of the new mechanism; OPG responsible for financing and managing the mechanism; and Ontario providing ongoing equity capital infusions to OPG and backstop.
- The addition of financial agency to the current operational obligations of OPG is not the current expertise of OPG. However, OPG has experience managing large financial assets and liabilities through the jointly managed Ontario Nuclear Funds as well as its own pension fund. In addition, this new role may dilute OPG's focus on current high priority responsibilities (i.e., electricity generation and nuclear refurbishment).
- The financing structure is unique to Canada – uniqueness reduces likelihood of all risks being known/mitigated. Highly specialized expertise required.
- There is a risk that at the next opportunity to review the OPG compensation framework, they make the case that there is no national comparator for this aspect of their work and they should therefore receive further exemptions from the rules (OPG nuclear executives do not need to find national comparators for compensation determination).
- It is unknown what the magnitude of transaction, administrative, and consultant costs that OPG would incur would be. OEB would review OPG's cost as the FSM to ensure appropriateness.

<u>Legal</u>

In principle, refinancing the GA to spread the costs of generation and conservation assets over the useful life of the assets presents a low risk of being found to be an unconstitutional tax, as each cohort of consumers pays for a proportion of the GA cost roughly equal to the proportion of the benefit they receive from the useful life of the assets. Legal risk arises if it becomes apparent that the Government is not spreading cost so that it is shared proportionately by future consumers who cause a need for or benefit from the asset, but rather is doing so in order to lower the price in the short term by increasing the price in the long term. If the proposed financing served to encumber future consumers with a premium payment to cover the GA financing in order to subsidize current ratepayers, there would be a moderately high constitutional risk that the financing proposal would be found to be an unconstitutional tax. The legislation contains provisions to mitigate these constitutional law risks, including requiring the Minister of Energy to reallocate estimated clean energy costs attributable to each reference period in a way that takes into account the need to align those costs with the estimated clean energy benefits attributable to the same period.

Linkages

<u>Long-Term Energy Plan (LTEP)</u> – Ontario is preparing to release a new LTEP in summer 2017. The LTEP identifies needs for investments over the shorter term, while broadly mapping out the direction of the sector over a 20 year timeframe. The LTEP will balance the principles of affordability, reliability, clean energy, community and Indigenous engagement, as well as conservation and demand management.

Electricity Rate Mitigation Initiatives – The *Ontario Rebate for Electricity for Electricity Consumers Act, 2016*, (ORECA) put in place an 8% rebate for residential, small business customers and farms beginning January 1, 2017.

Rural and Remote Rate Protection (RRRP) and Delivery Rate Protection (DRP) – RRRP and DRP help to offset the higher costs to distribute electricity to Ontario residents who live in rural or remote locations all across the Province. DRP was established under the FHA and regulations approved June 14, 2017. Both the expanded RRRP and DRP will be implemented for July 1, 2017.

The Ontario Clean Energy Benefit (OCEB) – Was a five-year legislated program put in place as a broad-based, transitional measure to a cleaner electricity system. OCEB was also put in place following the implementation of the Harmonised Sales Tax (HST). Unlike the previous provincial Retail Sales Tax (RST), the HST (and GST) included electricity in the taxable base. OCEB program ended on December 31, 2015.

Debt Retirement Charge – On January 1, 2016, the government ended the electricity DRC on residential users, which was earlier than previously estimated. For all other consumers the DRC will be removed by April 2018, also earlier than previously estimated.

Industrial Conservation Initiative (ICI) – Implemented in January 2011 to help large industrial consumers reduce electricity costs by reducing consumption in peak periods. As part of OFHP, ICI eligibility has been expanded several times, and was most recently expanded to allow for the participation of the manufacturing and, e.g., greenhouse sectors with an average month peak demand greater than 500 kilowatts (kW) and less than or equal to 1 megawatt (MW). ICI provides a benefit to all consumers by decreasing the need for costly peaking generation over the long term.

Affordability Fund – Approved as part of OFHP, and under development, the Affordability Fund is intended to provide energy efficiency measures to Ontarians who are not eligible for low income conservation programs, and who are otherwise unable to make energy efficiency improvements without financial assistance.

Ontario's Climate Change Action Plan (CCAP) – The CCAP, released in summer 2016, reiterated the 2016 Budget commitment and stated that Ontario intends to invest in initiatives that both reduce greenhouse gas (GHG) emissions and ensure that the net impact of cap and trade would not result in an overall increase in electricity costs for commercial and industrial consumers, and that there would be a modest benefit of up to $2 per month, on average, to residential consumers. This commitment to residential consumers was exceeded by the January 2017 8% rebate.

The commitment to mitigate the cap and trade impact on electricity costs for commercial and industrial consumers (i.e., Class A and B) has not been fully addressed, though the two recent expansions to the ICI provides for significant potential savings. Funding electricity social programs through government funds rather than the rate base will also provide saving to all electricity consumers.

The CCAP committed to a new Climate Change agency that would act as one window for the delivery of climate change-related programs. The Green Ontario Fund (GreenON) - is tasked to develop programs and services designed to:

- Reduce greenhouse gas emissions from housing, buildings and the production of goods; and,
- Increase uptake and overcome market barriers of low-carbon technologies and processes.

The CCAP committed that the government consult on and develop options to mitigate the impact of carbon pricing and resulting increased utility costs on residential tenants. The mitigation is proposed because tenants do not usually have the opportunity to make changes to their building envelope (e.g. windows, insulation) or major appliances that would allow them to address utility costs themselves.

The *Rental Fairness Act, 2017* received Royal Assent on May 30, 2017. The legislation amends the *Residential Tenancies Act, 2006* (RTA) and removes above-guideline rent increases for utilities, to protect tenants from carbon costs and encourage landlords to make their buildings more energy efficient. The removal of above-guideline increases for utilities will take effect on proclamation. To help protect tenants in the interim prior to the legislative amendment coming into force, regulations under the RTA have been amended to remove carbon costs from the calculation for above-guideline increases for utility charges.

Delivery

The proposed regulations are required under the major components of the *Fair Hydro Act, 2017* in order to fully implement the initiative and clarify program details.

1. Partial Refinancing of the Global Adjustment:

The ratepayer benefit of the OFHP will be in place as of July 1, 2017, however it may take until the end of July for recipients to see their first bill as a result of variations in billing cycles. The establishment of the regulatory asset and purchase by the OPG trust is expected to take three to six months to implement following the June 1, 2017 Royal Assent of the *Fair Hydro Act, 2017*.

2. Social Program:

<u>OESP</u>

The amendments made through the *Fair Hydro Act, 2017* allow for a transition period where the program continues to draw on the existing IESO variance account. IESO is required to notify the Ministry of Energy when it expects the variance account to be depleted (likely sometime in the fall).

Current proposed regulatory amendments will enable the sharing of information between the MCSS and the OEB to help streamline OESP enrollment for ODSP and

OW recipients. This will begin with manual enrollment of eligible recipients by program staff this fall, followed by the development of automatic enrollment procedures.

Stakeholder and Partner Considerations

Comment [HT5]: Energy: Please provide summary of results from the regulatory posting comments so we can make this section more focussed on the regs being proposed.

General Public (including residential and small businesses) – Likely support a proposal that is projected to provide 25% in average rate relief (including the 8% announced in 2016) and other targeted relief for vulnerable Ontarians, but there has been public discussion of the longer term implications. Some individuals and organizations will perceive the GA smoothing as unduly burdening future generations. Ability of the public to understand current and recent changes will heavily depend on government communications. There may be also some criticism that additional fiscal pressure and risk is being taken to benefit some customers that are not in as much need of rate relief as others (e.g., those that own second homes or cottages).

Large Industrial and Commercial Consumers – Will continue to be concerned with the impact of cap and trade on electricity prices and the commitment in the Climate Change Action Plan to use GGRA funds to “keep electricity rate affordable”. Will likely respond positively to the recent changes to expand ICI eligibility to some manufacturing and greenhouse Class B customers, but may be more neutral on the rest of the initiatives.

The impact of cap and trade has been added to electricity bills as of January 2017. Class B consumers have raised concerns about the cost of electricity and its impact on their business competitiveness. Although Class A electricity consumers have access to ICI, they are also concerned about the impact of cap and trade on their electricity costs. They are expecting that GGRA funds will be used to mitigate their costs. There is an expectation government is going to take specific action to mitigate their increases due to cap and trade, and given the initiatives proposed in this submission, there is no plan to provide further relief through the Greenhouse Gas Reduction Account. Funding electricity support programs through government funding rather than the rate base will provide some saving to both Class A and B consumers.

Tenants – Likely to support any future price mitigation measures that directly benefit them; likely to react negatively if no mitigation measures target them.

Northern communities – Likely to support the targeted RRRP delivery relief.

Indigenous communities – First Nation members who live on reserves are likely to support the proposal because of the targeted delivery relief. Other Indigenous communities (i.e., Métis, non-status, First Nations without reserve land bases) are likely to react negatively at being ineligible for the delivery charge relief.

NGOs – May react negatively towards any price relief that is not directly tied to energy conservation. May criticize the inclusion of natural gas electricity generators as part of the clean energy costs.

Solar PV sector – May react negatively to price relief as it can be seen to undercut the economics of net metering.

LDCs – Have expressed the need for an additional tool to provide assistance to their customers who are having difficulty with their electricity bills.

Terms you need to know

- **Global Adjustment (GA) –** The GA accounts for the difference between generation costs (contracted and rate-regulated) and the wholesale market price in order to recover fixed costs, including capital costs, of putting in place and operating Ontario's generation fleet, as well as the cost of conservation and demand management programs. The GA is instrumental in maintaining a reliable electricity system by ensuring that sufficient generating capacity is available.
- **Local Distribution Companies (LDCs) –** Local electricity utilities, responsible for distributing power from transmission lines to people's homes (e.g., Hydro Ottawa, Toronto Hydro, etc.) LDCs recover their costs through distribution rates. LDCs are licensed to serve a specific geographic area by the Ontario Energy Board (OEB). An LDC must receive Ontario Energy Board approval to charge a distribution rate.
- **Regulated Price Plan (RPP) –** Since April 2005, the Ontario Energy Board (OEB) has administered an electricity price plan that provides stable and predictable electricity pricing, encourages conservation and ensures the price consumers pay for electricity better reflects the price paid to generators. This pricing plan is known as the Regulated Price Plan (RPP). About 5 million residential consumers, small businesses and farms are eligible for the RPP.
- **Ontario Power Generation (OPG) –** A business corporation owned by the Province that owns and operates generation assets, including nuclear and hydro, and generates almost half of Ontario's electricity.
- **Ontario Energy Board (OEB) –** A Crown Agency that independently regulates Ontario's electricity and natural gas sectors in the public interest. Implements an open and transparent process to allow for stakeholders to participate in quasi-judicial proceedings and formal stakeholder consultations.
- **Independent Electricity System Operator (IESO) –** An independent corporation established under the *Electricity Act, 1998* that operates the electricity market in Ontario. Balances the supply of and demand for electricity in Ontario and then directs its flow across the province's transmission lines, including interties with other jurisdictions.
- **Rental Housing Affordability- *Residential Tenancies Act, 2006* (RTA) amendments –** To mitigate the costs of carbon pricing on tenants, who are not able to control major building features that impact energy use (like insulation and windows) or major appliances, the government has amended the RTA to remove the ability for landlords to increase rents above the guideline based on extraordinary increases in utility costs. The removal of above-guideline increases for utilities will take effect on proclamation. Interim regulatory amendments were also made under the RTA to remove carbon costs from the calculation for above-guideline increases for utilities charges.