Ontario

CABINET BRIEFING NOTE
AND LRC RECOMMENDATION

Energy
Fair Hydro Plan Implementation

DRAFT

Prepared without benefit of 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 (DTC) June 14, 2017	Cabinet (DTC) June 27, 2017
Program Effective Date July 1, 2017	TB/MBC September 25, 2017	Cabinet September 27, 2017	Cabinet (DTC) October 18, 2017 (TBC)	

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). One component of the OFHP is refinancing a portion of the Global Adjustment (GA). The implementing legislation for GA refinancing, the *Ontario Fair Hydro Plan Act, 2017* (OFHPA), was introduced May 11, 2017 and received Royal Assent on June 1, 2017. The OFHP expands the powers of Ontario Power Generation (OPG), the Ontario Energy Board (OEB) and the Independent Electricity System Operator (IESO) and puts in place mechanisms including appropriate payment settlement and cost-recovery authorities for and through the IESO to manage the deferred GA costs.

On June 14, 2017 new regulations were created under the OFHPA that support calculations related to GA financing and O. Reg. 280/14 was amended to authorize IESO to borrow to fund the regulatory asset as part of the financing structure. On June 27, 2017 a new regulation was created under the OFHPA that details the roles and responsibilities of the Financial Services Manager (i.e., OPG), IESO and OEB.

Proposal:
This proposal is the next step in the implementation of GA refinancing as part of the OFHP and would amend regulations under the OFHPA including:

Commented [TR(1]: ENERGY to confirm proposed amendments

Commented [TR(2]: Is ENERGY proposing any new regulations?

1. Amendments to O. Reg. 206/17 (i.e., general regulation) that would establish the role of OEB in determining fees OPG charges and enable fees and interest amounts to be recovered during the Inflationary Cap period from July 1, 2017 to April 30, 2021.

2. Amendments to O. Reg. XX that would allow costs to be recovered in the event of a Local Distribution Company (LDC) default through the investment asset purchased by OPG.

3. Amendments regarding OPG securitization. [NTD: Placeholder for additional details]

Commented [TR(3]: Please advise which regulation would be amended?

Commented [TR(4]: Please provide additional details

Why does Ontario need these changes? Why now?

Commented [TR(5]: Please advise on the timing for when OPG is going to market, why OPG is tracking to those timelines, and how these timelines relate to the overall key steps for the delivery of this initiative

Addressing rising electricity prices is among the highest priorities for Ontarians. The ratepayer benefit of the OFHP has been in place since July 1, 2017. Approval of the proposed regulations is needed now for OPG to begin financing the debt incurred from GA cost deferral.

How will this proposal impact Ontario?

Commented [TR(6]: Are the proposed amendments expected to have any ratepayer impacts, for example through FSM fees? Can estimated impacts be provided?

Commented [TR(7]: Can estimated fees range that the FSM could charge be provided?

Refinancing a portion of the GA is expected to lower bills by 25% for a typical residential consumer, starting in the summer of 2017. The proposed amendments would affect all specified consumers to whom the "Fair Adjustment" applies. Prescribed consumers include residential consumers, farms, small businesses, condominiums, long-term care homes and co-operative housing. These are primarily consumers eligible for the Regulated Price Plan (RPP), and aligns with the eligibility under the *Ontario Rebate for Electricity Consumers Act, 2016* (ORECA).

What is the expected cost to government?

Commented [TR(8]: Is TB/MBC approval required?

Commented [TR(9]: Are there any fiscal impacts associated with the proposed amendments?

The structure of the GA refinancing was designed to result in: (1) increase in provincial gross debt (to finance the equity injection in OPG) offset by an equivalent in regulatory assets resulting in no change in net debt, and (2) an increase in interest on debt paid by the province offset by higher earnings from OPG resulting in no impact on annual deficit of the province. The proposed regulations would support the implementation of this refinancing structure.

What are the key steps to deliver this proposal?

Commented [TR(10]: Please provide details on the roles of OPG and the OEB in implementing the regulatory amendments.

Commented [TR(11]: Please advise on the timelines and next steps for implementation associated with each proposed regulatory amendment

Commented [TR(12]: Is ENERGY requesting an exemption from the Twice Annual Effective Date?

The proposed regulations would take effect [NTD: placeholder for timelines].

It is expected that OPG would begin purchasing monthly regulatory assets from the IESO [NTD: placeholder for timelines]. It would then sell or securitize all or part of the regulatory asset to other parties in exchange for a funding obligation [NTD: placeholder for timelines].

OPG would begin recovering management fees [NTD: placeholder for timelines] and the OEB would review those fees as per the methodology established in the regulation beginning in 2018/2019 [NTD: placeholder for timelines].

Commented [TR(13]: Please confirm

How will the changes be communicated?

Commented [TR(14]: CO Comms to review

[NTD: CO Comms to provide]

Notes and Recommendation from LRC

LRC item direct to Cabinet.

Cabinet Office Analysis

On March 2, 2017, the government announced Ontario's Fair Hydro Plan (OFHP), which is expected to lower bills by 25% for a typical residential consumer, starting in the summer of 2017. The *Fair Hydro Act, 2017* (OFHPA) establishes the framework to refinance a portion of current Global Adjustment (GA) costs as part of the OFHP. The refinancing methodology defers a portion of the current GA costs to future ratepayers, recognizing the longer term benefit of many of these generating assets to the electricity system. ENERGY is proposing to establish regulations that would support the implementation of this initiative.

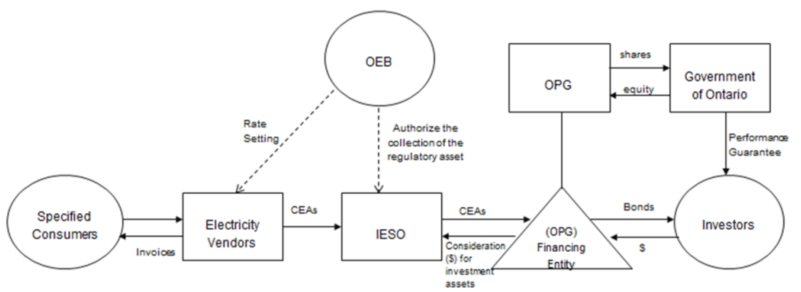
Financing Structure

Under the GA financing structure, the Independent Electricity System Operator (IESO) records the GA cost recovery deferral as a "regulatory asset" (regulated by the Ontario Energy Board (OEB)) to be collected at a future time from "specified consumers" ("the Fair Adjustment" and "IESO deferral"). As a result, specified consumers will receive a reduction in electricity rates from July 1, 2017 to June 30, 2018. IESO may then sell the regulatory asset, at which time it becomes an "investment asset."

The Minister of Energy, following the principles in the Act and regulations, will 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." Based on the Fair Allocation Amount, the Financial Services Manager (OPG), through financing entities, will debt finance a portion of the GA costs. 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, will calculate the aggregate clean energy adjustment payable in each month of the reference period, and, to ensure intergenerational fairness, these amounts would be managed to ensure consistency with the fair allocation amounts. OEB will calculate the rates at which the clean energy adjustment would be collected from specified consumers.

To recoup the costs associated with the fair adjustment, consumers will 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 adjustments will appear on customer's bills once repayment of the accumulated debt begins.



Note: CEAs are "clean energy adjustments".

Proposal

OPG is the Financial Services Manager under the GA refinancing structure. In this capacity it will take on the risk and responsibility of financing the deferral by purchasing monthly regulatory assets from IESO. OPG will finance these purchases through a combination of an equity investment by the Province and external private sector financing. The proposed regulatory amendments would allow OPG to begin financing the debt incurred from GA cost deferral:

OPG Management Fees and Interest Recovery during the Inflationary Cap Period: OPG is allowed to charge a management fee for its services made up of a base fee, variable fee and Third-party costs (e.g. banking fees). According to OPG accounting advice, interest and fees must be recovered during the "inflationary cap" period (July 1, 2017 to April 30, 2021) for GA refinancing to proceed as planned under the OFHPA. The proposed amendments to O.Reg. 206/17 would establish OPG's base fee for 2017/18 at 7.5 basis points as well as the role of the OEB in determining fees OPG charges for future years by reviewing comprables. Internal OPG costs would become a pass through.

Letter of Credit: A letter of credit is needed between OPG and IESO to backstop smaller Local Distribution Companies (LDCs) in the event of a default. Proposed amendments would allow these costs to be recovered through the investment asset purchased by OPG.

Commented [TR(15]: Please confirm / provide additional details

Commented [TR(16]: Please provide rationale for why fees must be recovered during this timeframe

Commented [TR(17]: Please provide rationale for this fee structure

Commented [TR(18]: Would the OEB also have a role in determining fees beyond the base fee? Would fees be determined through the OEB's hearing process?

Commented [TR(19]: Please confirm / provide details

Commented [TR(20]: Would this amendment impact the saleability of the investment asset?

OPG Securitization: [NTD: placeholder for additional details]

Commented [TR(21]: Please provide details

Stakeholder response:

General public – Generally supports the GA refinancing initiative, which is projected to provide up to 25% in rate relief (including the 8% announced in 2016) for a typical residential consumer, but also question the longer term implications. Some individuals and organizations perceive the GA smoothing as unduly burdening future generations.

Commented [TR(22]: Is the general public expected to have any reactions that are specific to the proposed amendments?

OPG-

Commented [TR(23]: What is OPG's view on the proposed amendments?

OEB-

Commented [TR(24]: What is the OEB's view on the proposed amendments?

Risks:

Commented [TR(25]: Are there any risks associated with the proposed management fees, for example rate impact or perception?

Commented [TR(26]: Are there any accounting risks associated with the proposed amendments?

Commented [TR(27]: Are the amendments expected to have an impact on the financeability/saleability of the investment asset?

Commented [TR(28]: Do the proposed amendments introduce any new risks with respect to the OPG/SPV mechanism?

Commented [TR(29]: Does the role of the OEB in overseeing OPG fees take into account the risk that OPG could make the case to be exempted from compensation rules because there is no national comparator for this aspect of their work?

Fiscal

OESP does not have a scheduled end date and represents an ongoing fiscal pressure, which will likely increase over time.

OPG/SPV Mechanism

There are several risks associated with the proposed OPG/SPV mechanism that remain. OPG/SPV could continue to be criticised for not having 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 and the government remains the sole shareholder of OPG.

Proposed regulations build on a complex financing structure that is unique to Canada—uniqueness reduces likelihood of all risks being known/mitigated. Highly specialized expertise has been required to get to this point. Financing is still not certain.

Legal

In principle, refinancing the GA to spread the costs of generation and conservation assets over the useful life of the assets present only a low risk of being 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 result in an unconstitutional tax.

The legislation contains provisions to mitigate the 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:
Long-Term Energy Plan (LTEP) – Ontario is preparing to release a new LTEP in 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 Consumers Act, 2016*, (ORECA) put in place a rebate for an amount equivalent to the 8% provincial portion of the HST for eligible 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.

Other Jurisdictions:
The established GA financing structure is unique to Canada.

Commented [TR(30]: How do the specific amendments compare to other jurisdictions / organizations, for example, how do proposed management fees compare to other financial service managers that provide similar services?

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.