Briefing Note

Office of the Treasury Board
Office of the Provincial Controller Division
Program Expenditure Management Division

Debt Financing the Global Adjustment: Preliminary Accounting and Fiscal Analysis

Issue:

The Ministry of Energy is exploring an electricity rate mitigation option in which the impact of the Global Adjustment (GA) on consumers would be reprofiled to a lower, longer timeframe, and the resulting extra cost to electricity GBEs would be financed through debt.

Current Status:

The Ministry of Energy has requested comments from the Ministry of Finance and Treasury Board Secretariat.

Background:

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The current proposal would appear to be that the debt is issued by the Province, to finance payments made by Ministry of Energy to IESO to offset the timing gaps between producer/program expenses and proceeds collected from energy consumers through the GA. **[I cant tell whether this is actually the proposal, but the deck talks about provincial borrowing, so I am guessing this is the actual proposal. Nadine, it seems to me that therefore there is TP expense in the amounts of the GA gap, so I don't understand how this would work to bury the costs in the GA? I am probably missing something here – maybe James has a better understanding?]**

Energy's proposal includes scenarios that set the 2017 amount of GA paid by ratepayers at a value lower than the true cost of GA and increasing that amount year-over-year at inflation (assumed to be 2%) until the debt has been paid off.

The proposal would have impacts on the Province's consolidated debt position, in addition to any fiscal impacts that would arise through consolidation of IESO.

[james – pls edit the below, if you think it should stay in]

The assumptions and numbers in the proposal would need further review. However, Ministry of Energy notes a number of impacts on ratepayers. It is unclear whether these could result in further pressure on government to offset these. These include:

- Incurring debt to finance the GA, while lowering costs in the short term, results in a more rapid rise in electricity prices beyond the rate of increase already expected.

- The GA financing proposal involves accruing large amounts of debt to reduce electricity rates. This debt would be highly sensitive to interest rates which could extend repayment timelines or put significant pressure on rates (see Scenario 3 for an example of such interest rate risk).
- GA and HOEP provide a natural hedge against each other. Smoothing only one component would lead to greater price volatility. For example, if HOEP is higher than expected (due to higher gas or carbon prices, for example), all-in rates will rise significantly as the natural decrease in GA would not occur given the prescribed GA rate.
- Conversely, if GA is higher than forecast (i.e., because of lower HOEP or additional out-of-market costs), the debt would increase to a higher amount, requiring additional debt service payments and/or a longer recovery period.
- Should Ontario demand be lower than forecasted, the cost of paying off the debt will be shared by a smaller pool of consumption, further increasing future costs for individual ratepayers.

<u>Accounting Treatment</u>

IESO is subject to the Ontario Energy Board's approval for its rate proposals, including what costs can be included as recoverable. The Global Adjustment is accounted for by the IESO similarly to a rate regulated asset/liability. If the OEB were to agree that the proposal would not change the nature of the accounting for the Global Adjustment, then the IESO could receive approval for rates calculated on that basis.

The impacts on the Province's consolidated financial position and on IESO's financial position would be reviewed by the Ontario Auditor General, as well as the presentation. It is not known whether the AG may argue that the reprofiled costs are not fairly reflected on the IESO's and the Province's financial statements due to the accounting treatment. The IESO should be asked to provide an assessment of potential accounting risks based on discussion with their external auditors.

In addition, whether rate regulated assets/liabilities will continue to be allowed by accounting standards is under review and may change in subsequent years. [**Nadine – do you want a sentence on this?]**

There is also a risk that the Auditor General may comment on the proposal from a value-for-money basis, including the issue that the significant deferral of electricity system costs over a long time-horizon and associated interest costs may appear to create new "stranded debt" of the sector. This could be seen to challenge the government's taking credit for the end of the Debt Retirement Charge.

Prepared by: Line 1
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Line 3
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Approved by: Line 1
Line 2
Line 3
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Date: Line 1