FW: Electricity -- Notes on how I've previously explained the proposed structure

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Hi Patrick,

Cindy has outlined how she has previously explained the proposed electricity structure below. In case someone is asked to explain it at Cabinet, she thought this could be useful as a backpocket for Karen (although it's much more detailed than I would expect a response at Cabinet to be).

Happy to discuss.

Thanks
Sarah

From: Veinot, Cindy (TBS)
Sent: March-01-17 9:49 AM
To: Petsche, Nadine (TBS)
Cc: Hosick, Sarah (TBS)
Subject: Electricity -- Notes on how I've previously explained the proposed structure

I thought it could be useful to have some notes on how I've explained the structure of the transaction to SoC and FPC, in case someone is asked to explain it in cabinet.

Sarah – flip these to Patrick as well as Karen may want them.

Start with the left hand side of the diagram and a focus on the current market settlement structure. If the GA is $100 – the IESO collects $100 from the LDCs and then settles with the power generators (I would ignore the RPP 6 month price setting in this macro overview as I don't think it makes a difference to the explanation)

The proposal on the table is to reduce the GA that is paid by the current ratepayers and collect that from future ratepayers. So we are reducing the amount that is collected from the LDCs, but the amount that has to be paid to the power generators does not change.

The example I've been using is the 70/30 one. So 70 is collected from the ratepayers now through the LDCs, and the IESO has the ability to collect 30 in the future based on legislation – but it has to settle with the power generators now for $100.

The IESO has a right to collect $30 from future ratepayers – in accounting terms that is referred to as a regulatory asset, as long as it meets certain criteria (which we will come back to). However, PSAS – followed by both the IESO and the Province does not address the concept of a regulatory asset.

The first step is to determine if IESO can recognize a regulatory asset by looking to other accounting standards – almost all of the other major frameworks (US GAAP, IFRS, ASPE, GASB) recognize regulatory assets and right now all are based on US GAAP. One of the criteria is that the rates are set by a regulator, which is why we have been focused on the OEB having an oversight role in this structure.

So the IESO recognizes a regulatory asset and then sells that asset for cash to OPG Trust – for $30, which IESO uses to pay the power generators. The key issue here is that the IESO has to sell the asset – vs. just borrow against it. In selling the asset, all of the risks related to that asset transfer to OPG trust and the IESO does not take on any debt.

At the end of this stage of the transaction, IESO has fully settled with the power generators. It has no regulatory asset and no debt on its books related to this transaction.

This transaction of selling the regulatory asset to the OPG Trust would occur on a monthly basis.

OPG Trust is set up and financed by a combination of equity from the Province (which goes through OPG and is then lent to OPG Trust – 44%), debt directly from OPG (5%) and debt from 3rd party lenders (51%) The allocation of debt and equity is established to support consolidation of the OPG Trust with OPG, and enable full financing of the amount deferred.

When OPG Trust pays IESO for the regulatory asset, it records that ability to collect the cash in the future from ratepayers as an intangible asset.

OPG Trust is consolidated with OPG which results in the intangible asset and the majority of the debt used to finance the purchase of the asset in OPG consolidated statements. OPG is then consolidated with the Province using the modified equity method, which means that the net asset position of OPG is reflected as a single financial asset on the books of the province and the earnings from OPG is reflected as one line on the statement of operations.

For OPG Trust to be consolidated with OPG, OPG must have the power to control the activities of OPG Trust that will impact the earnings of OPG Trust. In this structure, most of the variability in the earnings of OPG Trust are expected to come from the financing decisions (vs. the collection of the deferred amounts from the ratepayers in the future). Therefore OPG will have control over the financing decisions of the Trust.

OPG has provided a series of conditions necessary for OPG to be able to consolidate the trust (outlined in the deck) -- one key condition is that the legislation that provides for collection of the amount deferred from future ratepayers be as "irrevocable" as possible – this will provide the 3rd party lenders with certainty regarding the future collection of the deferral. However, since it is not possible to make the legislation fully irrevocable, the Province will need to provide a conditional guarantee to allow the private lenders to recover their capital in the event of a future change to the legislation that would result in the ratepayers not fully paying the deferred amount with interest as expected.

Should this transaction be successfully implemented, the result at the consolidated level is that the Province borrows money to make the equity injection in OPG – so its total debt increases. Its investment in OPG increases as well as OPG records the intangible asset that is the right to collect from future ratepayers for the amount deferred and the related interest, and partially offsetting this is the debt OPG takes on and the debt that OPG Trust takes on directly. The net debt of the province should not increase as the increase in the investment in OPG (which is a financial asset) will offset the increase in the debt that the province takes on. In order to support this accounting, it is important that OPG remain a government business enterprise – and the key criteria to consider regarding this structure is that OPG will be able to continue to be able to be self-sustaining in the normal course of operations.

Interest on debt will increase by the interest on the debt the province takes on to make an additional equity investment in OPG. Offsetting that is the increase in the income of OPG which is the net of interest income from the ratepayers and their own interest expense on the OPG and OPG Trust debt. There will be some impact based on the difference in interest rates (rates charged to the ratepayers vs. rates on debt)

[I wouldn't explain the market books issue as part of the explanation of the structure – just be ready to explain it if asked.]

I've been asked to be available by cell phone between 1 and 3 and will be. I'll be checking messages before then as well.

Hope everything goes well.

Cindy

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