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Ministry of the Attorney General
Briefing Note
Legal Services Division
Legal Services Branch – ENERGY/MEDG/MRIS/MOI/ADO

ISSUE

Oversight of the Financial Services Manager's establishment of fees under the *Ontario Fair Hydro Plan Act, 2017*

OPTIONS

1. Financial Services Manager's (FSM) fixed costs are subject to a prudence review by the OEB.

2. Fees are determined in accordance with formulas set out in the regulation; OEB has discretion to determine comparators and benchmarks as inputs to the formulas.

3. Fees are set by formula set out in the regulation and OEB verifies FSM calculation of fees in accordance with the formulas.

BACKGROUND

The Ministry, Ontario Power Generation (OPG) and the Ontario Energy Board (OEB) have been in discussions about the role of the OEB in overseeing the fees set by OPG in its role as Financial Services Manager under the *Ontario Fair Hydro Plan Act, 2017* (the Act). The Ministry, OEB and OPG generally agree on the following:

- The fee will have a fixed component based on actual costs of providing services and a performance based, variable component.
- The variable component will measure the interest rates that the FSM is able to secure against benchmark interest rates.
- The variable component will have a cap and a floor. If the variable fee is negative, then that amount will be deducted against fixed fees in the following year.
- Fees will be determined annually.
- The Board will have 120 days upon a request for approval to make its determination.
- The Board will be able to approve or refer back to OPG with recommendations for further consideration.
- Fees are "expenses" for the purposes of the Act and are part of the "finance amount", meaning they are ultimately paid by rate payers.

OPG proposes that the fixed and variable components be determined by formulas set out in regulation (Option 3). OPG recommends a fixed fee based on market comparators for similar services. OPG's variable fee is based on the difference between forecast and actual interest rates achieved for its new funding tranches (excluding refinancing). The variable component of the fee is estimated to be about $1.2M per year.

OPG prefers that the OEB's role be limited to verifying OPG's calculations using the prescribed formulas. Of particular concern for OPG is the amount of discretion to be accorded the Board through the fee-setting process.

The OEB takes the position that if it is to have a role, that role must be meaningful, meaning that the OEB should be positioned to apply judgment and have the ability to make real determinations regarding fees.

OPG argues that its position is based on two statements in its February 27, 2017 accounting "white paper" on its preliminary views on the implementation of Global Adjustment refinancing. OPG asserts that failure to adopt the model that OPG proposes will prevent OPG from receiving a favourable accounting opinion that it has appropriately consolidated financing entities. OPG relies on these statements from the white paper:

> 4. Province cannot have the right to be able to veto OPG's decisions about the relevant activities of the Trust. OPG must have the power over the relevant activities of the Trust and be compensated. The relevant activities of the Trust include (but are not limited to) the evaluation and decisions on financing alternatives, duration, and the strategy to minimize financing costs. OPG must have the power to establish operating and capital budgets of the SPV.
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> 10. OPG must have the ability to earn variable returns by exercising its authority, which shall be accomplished as follows:
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> a. The cash flow from the restructured asset shall include interest determined based on a relevant benchmark that is appropriate relative to the restructured asset, plus an appropriate margin consistent with the relevant market and other risks.
> b. OPG shall have the authority to determine the financing strategy, which will vary the financing costs with the objective of enabling the SPV to achieve a more favourable return compared to the return from the restructured asset
> c. The SPV shall establish classes of liabilities (senior, subordinated and the most subordinated). The classes would allow the SPV to delineate financing of lower risk investment and investment that would bear higher residual risk. The delineation would limit OPG's self-funded investment to a reasonable level in order to allow OPG to remain a self-sustaining entity.
> d. OPG shall, through its ownership of the most subordinated liability, be able to capture and retain the pricing difference between cost of financing and benchmark for interest on the restructured asset, or any residual risk of restructured asset. The targeted return of the subordinated liability should be reflective of the underlying risks and compensate holders for active management that would be required.
> e. OPG should participate in the detailed design of the above and the SPV documentation to ensure that it has substantive power and variability, which will allow OPG's Board of Directors to evaluate the opportunity as a business initiative instead of through a shareholder directive.

OFA has flagged that OPG is proposing fees on the 44% debt to be issued by OPG to the financing entity/trust to be created by OPG, which is funded by the Province's equity injection. OFA is reluctant to sign off on OPG's fees methodology because there is no capital market decision-making associated with this component of the financing. OFA has asked OPG for more detail about its accounting requirements.

LSB has considered whether the Ontario Nuclear Funds Agreement, the IESO rate order or the Distribution Rate Protection Program offer any useful insight into how to structure the fees arrangement for this program. LSB will continue to look for precedents.

OPTIONS - CONSIDERATIONS

1. **FSM fixed costs are subject to a prudence review by the OEB** (greatest discretion for the OEB)

- The OEB could apply a prudence analysis to the actual costs of services provided by the FSM. This would entail OEB review of the actual costs incurred by the FSM. OEB would be empowered to approve or deny those costs and provide recommendations about how the FSM performs its role. OPG would be required to justify to the OEB its actual costs and that any comparables are reasonable.
- The OEB could also review inputs to a variable rate, such as OPG's determination of forecast interest rates.
- This option provides the greatest level of OEB oversight and discretion.
- This approach also accords most closely with the Board's general role as an independent quasi-judicial administrative tribunal where the Board exercises a true rate-making or fee-setting function.
- A hearing would likely be required. The Ministry has not canvassed whether the OEB would prefer an oral or written hearing in these circumstances.
- OEB oversight ensures that OPG does not use its regulatory generation business to cross-subsidize its work as FSM, which is not regulated.
- It is not clear that this role for the OEB undermines OPG's power over the relevant activities of the financing entity or its ability to establish capital and operating budgets.

2. **Fees are determined in accordance with formulas set out in the regulation; OEB has discretion to determine comparators and benchmarks as inputs to the formulas.** (limited discretion for the OEB)

- This option is an attempt to find a middle ground to OPG's position.
- OPG's proposal would have OPG determine its fixed rate based on "market comparable fees determined by the FSM". OPG would also have the variable fee based on forecast interest rates for the following year, also determined by the FSM.
- This option could replace the discretion of the FSM to determine comparable and forecast interests with the discretion of the OEB.
- In reviewing the fixed fee, the OEB would have broad discretion to review the services provided by the FSM and the comparators that OPG has selected. These inputs would impact only one part, albeit a significant part, of the formula proposed by OPG.
- In reviewing the variable fee, the OEB would examine the forecast interest rate proposed by the FSM and would determine whether the actual interest rate and the principle amounts of funding obligations as determined by the FSM are correct.

3. **Fees are set by formula set out in the regulation and OEB verifies FSM calculation of fees in accordance with the formulas.** (no discretion for the OEB)

- With this option, the regulatory framework constrains OPG's ability to impose fees.
- The OEB role would be minimized to confirming OPG's calculations.

- The OEB may take the view that the limited nature of its review would not benefit from a full and transparent hearing process.
- OPG argues that this approach is critical to achieve its accounting requirements.

NEXT STEPS

Ministry to meet with OPG to discuss options. OPCD should be included.

LSB will continue to look for precedents.

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Prepared by: Legal Service Branch

Reviewed by: Energy Supply Policy
Investment Governance Secretariat