Comments on Ministry of Energy's Draft "Proposed Initiatives to Transform Ontario's Electricity Sector"

The Ministry of Energy (Energy) is providing an update on progress related to transforming the province's electricity sector by elaborating on potential price mitigation initiatives, as outlined in its deck.

CONTEXT

- As outlined in Energy's update, electricity costs have been increasing following investments to transform towards cleaner generation (i.e., meeting goals to decarbonize) and modernize the electricity infrastructure (e.g., more than $35 billion in cleaner generation and $15.5 billion investment by Hydro One alone in transmission and distribution systems).

- The government has taken action to lower electricity cost pressures to all consumers by taking actions, including deferring investments in generation (e.g., new build nuclear), improving market efficiency and decreasing costs related to renewable procurement (e.g. GEIA renegotiation, decreasing FIT prices, etc).

- The government introduced the Ontario Rebate for Electricity Consumers (OREC) which will provide a rebate equal to the 8% provincial portion of the Harmonized Sales Tax, saving $11 per month starting January 1, 2017 for eligible small businesses, farms and residential consumers and has taken steps to expand the Rural or Remote Electricity Rate Protection program, expected to save eligible RRRP customers about $45 per month, when combined with OREC.

COMMENTS

Energy's proposals generally involve shifting costs from the rate base to the tax base. While the subset of costed proposals may have a fairly limited residential rate payer impact (e.g. about $5-6/month for residential, less than 5% of the average monthly bill), those proposals would come at a material incremental fiscal cost ($1 billion to $1.3 billion). Note these impacts are lower than those presented in an earlier deck ($1.3 billion to $1.9 billion). Energy also presents other proposals where costs and impacts are "TBD".

Over the past five years, the existing fiscally funded electricity price mitigation efforts have averaged about $1.5 billion and is already expected to increase to about $2 billion with the introduction of OREC. The existing program costs are summarized in the table below:

($M)	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17[1]	2017-18[1]
OCEB	1,033	994	1,006	1,078	860	-	-
OREC	-	-	-	-	-	300	1,100*
Ending DRC[2]	-	-	-	-	85	330	330
NIERP	120	120	115	108	120	120	120
NOEC	23	24	25	24	26	25	25
OEPTC[3]	354	406	418	429	444	450	460
TOTAL	1,530	1,544	1,564	1,639	1,525	1,225	2,005

1. 2016-17, 2017-18 based on forecasted numbers
2. 2015-16 estimated for 3 months of reduced DRC revenue
3. OEPTC amounts in all years based on energy component of the rebate.

* Sourced from Energy PRRT submission

OCEB – Ontario Clean Energy Benefit
NIERP – Northern Industrial Electricity Rate program
DRC – Debt etirement Charge
OREC – Ont. Rebate for Electricity Consumers
NOEC – Northern Ontario Energy Credit
OEPTC – Ont. Energy & Property Tax Credit

Energy's Broad Policy Themes / Rationales

A key theme / rationale cited by Energy is to no longer use rate-base to pay for "social programs" by shifting cost of OESP, RRRP and proposed First Nation Rate to tax-base.

- Energy has typically in the past provided a constitutional law assessment on these programs, providing support for these programs to be ratepayer-supported programs as they provide electricity system benefits / are part of a comprehensive regulatory framework.
- Switching messaging may risk criticism and legal challenges on these and other remaining rate-base funded programs.

Energy Theme / Rationale	Key Staff Comments
Provide greater support for lower income Ontarians by enhancing the OESP or expanding eligibility	• Significant fiscal exposure -- $0.4-0.45 bn at current levels, higher if enhanced. On-bill benefits. • Could contemplate phase-in to manage fiscal impact. • Could look at phasing out existing fiscal-funded programs also targeted to low income or identified groups (e.g., OEPTC, NOEC). ○ Not on the bill, so less direct and visible electricity cost mitigation. ○ Phase-out to reflect time to increase application based OESP reaching an increasing portion of eligible households.
Fund conservation programs through the tax-base for the remaining term of the existing CDM framework and transition costs to the new "green bank entity" over time	• Potentially significant fiscal impact – current program costs are about $0.45 bn • Conservation programs do provide an electricity system benefits, but would now be fiscally-funded, so a cross-subsidisation from tax-base • Accessing the cap&trade amount in the GGRA would crowd-out other GGRA programs, affecting overall GHG reductions and negatively affect the diccal plan
Expand the scope of the "Trillium Trust" to make investments in energy infrastructure eligible for funding	• Would require either squeezing out existing Moving Ontario Forward project funding from the Trillium Trust, requiring funding from another source; or additional funding from asset optimization, given that the government is committed to using the targeted $5.7 billion to fund across Moving Ontario Forward projects • Would have little near-term impact, unless TT funding displaces near-term, non-incremental projects coming onto service • Could lower utility value, including Hydro One, by removing projects, currently and prospectively, that they might have been able to add to their ratebase and earn a return
End the Debt Retirement Charge (DRC) early for commercial and small industrial Class B electricity consumers	• End of the DRC had previously been linked with a balance between rate mitigation and managing stranded debt • Provides only temporary incremental mitigation, as DRC legislated to end April 1, 2018. • End of the DRC had previously been linked to retirement of residual stranded debt • Removing additional DRC revenue from the OEFC would call into question the position that the debt and liabilities of the old Ontario Hydro can continue to be supported

Detail on Proposals

Energy has outlined the following rate mitigation proposals with significant bearing on the fiscal plan:

<u>OESP & RRRP (Total of about $0.4 to 0.45 Billion/year)</u>:

This would shift the cost of the current and proposed expanded Ontario Electricity Support Program (OESP), and the Rural or Remote Electricity Rate Program (RRRP), to the tax base. *Note: that the fiscal exposure would increase if the OESP take up rate is larger, and faster than assumed.*

- The fiscal impact from shifting OESP and RRRP to the tax base may also be larger if future changes are made to the programs. Energy notes that
  - The programs could provide greater support for lower income Ontarians by enhancing the OESP or expanding eligibility (e.g., by 50% in the table).
  - The RRRP regulation provides a funding mechanism for transmission infrastructure required to grid connect remote First Nation communities. Considerations for how that funding will be supported by the tax base will need to be determined. [The current deck links Trillium Trust for remote electrification.]

<u>Fund Conservation Programs through the Tax-Base</u>:

This would be for the remaining term of the existing Conservation and Demand Management framework. Over time, the costs would be transitioned to the new "green bank entity", to shift cost recovery from ratepayers to cap and trade revenues.

- Energy's rationale for the cost shift would be in recognition of the burden borne by ratepayers in phasing out coal generation.

<u>Expanding the scope of the Trillium Trust to invest in energy infrastructure:</u>

The Province is currently targeting $5.7 billion from asset optimization to dedicate to the Trillium Trust for investment in infrastructure under Moving Ontario Forward.

- Expanding access to natural gas is already included under Moving Ontario Forward.
- Using the Trillium Trust for additional energy projects would require either
  - squeeze out existing Moving Ontario Forward project funding from the Trillium Trust, requiring funding from another source, or
  - additional funding from asset optimization, given that the government is committed to using the targeted $5.7 billion to fund across Moving Ontario Forward projects,
  - in effect, in both cases above, incremental investments for energy infrastructure from the Trillium Trust would have negative fiscal impacts once the assets are in-service and amortized.
- Investments through the Trillium Trust instead of through other electricity sector entities (Hydro One, OPG, LDCs) could have additional negative fiscal impacts as these entities could see reduced ratebase growth, lowering the revenues that the Province realizes from these entities (e.g., consolidated net income, payments-in-lieu of taxes, etc.).
  - May also negatively impact Hydro One share price if the measure is perceived by the market as reducing Hydro One's potential ratebase growth.
- Unless applied to existing projects, to displace ratepayer-supported costs, this measure would have little or no near-term rate impact.

Departure Tax:

As a result of the IPO, Hydro One paid a "departure tax" payment in lieu of tax (PIL) of $2.6 billion, as a final true-up of its PILs tax obligation. Energy lists using some or all of this departure tax for price mitigation.

- This was paid to the Ontario Electricity Financial Corporation (OEFC). The departure tax payment was fiscally neutral to the Province as the income to the OEFC was fully offset by a reduction in ESDI resulting from reduced net income of Hydro One.
- Using some or all of it for price mitigation would require restating the net stranded debt paydown by OEFC related to the IPO. [As the departure tax paid was fiscally neutral, OEFC's uplift was primarily the result of the related deferred tax benefit, as well as the s.50.3 benefit under the *Electricity Act, 1998*.]
- This would be a one-time measure, potentially spread out over a few years, and fiscal impact, as the departure tax amount was one-time.

Debt Retirement Charge (Total of about $0.45 Billion in annualized rate to 2017-18):
Ending the DRC early for Class B customers (commercial, small industrial) would have an impact of about $0.45 billion in 2017-18.

- The end of the DRC had previously been linked with balancing mitigation and progress on stranded debt reductionthe end retirement of the residual stranded debt.
- Removing additional DRC revenue from the OEFC would call into question the position that the debt and liabilities of the old Ontario Hydro can continue to be supported.

($M)	2016-17[1]	2017-18[1]	2018-19[1]	2019-20[1]	2020-21[1]
OESP, RRRP, First Nation rate		398	419	433	447
Conservation Programs through Tax Base	110	450	450	450	450
[Trillium Trust]	TBD	TBD	TBD	TBD	TBD
Departure Tax		TBD	TBD	TBD	TBD
DRC removal for Class B	110	450			
Proposed Program Total:	**220**	**1,298**	**869**	**883**	**897**
OREC	300	1,100*	1,100*	1,200*	1,200*
Ending DRC	330	330	--	--	--
NIERP	120	120	120	120	120
NOEC	25	25	25	25	25
OEPTC[2]	450	460	470	481	481
Existing Program Total:[3]	**1,225**	**2,005**	**1,715**	**1,826**	**1,826**
TOTAL[3]	**1,445**	**3,303**	**2,584**	**2,709**	**2,723**

1. Based on forecasted numbers
2. OEPTC amounts in all years based on energy component of the rebate.

* Sourced from Energy PRRT submission

3. Total would be significantly larger with the TBDs crystalized.

Corporate and Electricity Finance Division / Ontario Financing Authority
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