Re: Call with OPG

From: Ronald Kwan <ronald.kwan@ofina.on.ca>
To: "Nelms, Scott (ENERGY)" <scott.nelms@ontario.ca>
Cc: "Mayman, Gadi (OFA)" <gadi.mayman@ofina.on.ca>, "Thompson, Scott (MOF)" <scott.thompson@ontario.ca>, "McLean, David (MOF)" <david.mclean@ontario.ca>, "Kandeepan, Ken (OFA)" <ken.kandeepan@ofina.on.ca>, "Wynberg, Lynsey (OFA)" <lynsey.wynberg@ofina.on.ca>, "Kennedy, Nancy (MOF)" <nancy.kennedy@ontario.ca>
Date: Wed, 15 Feb 2017 21:11:11 -0500

Hi Scott,

Not sure about the less than the cost of debt or the Province would not be able to cover its debt cost on the equity and could raise an accounting question on recording it as equity -- or a potential write down. But I'd leave it to the accountants to weigh in on the likelihood or magnitude of such a risk.

Ron

> On Feb 15, 2017, at 8:59 PM, Nelms, Scott (ENERGY) <Scott.Nelms@ontario.ca> wrote:
>
> I agree. It would be a direct cost to ratepayers. There is a 5 percent cost of capital assumption embedded in the model, so we would want to get as close as possible to that (or less) on an all in basis. Not sure if that is feasible with 50 percent equity.
>
> We can confirm with OPG what is being assumed - last I heard they needed some amount of potential for profit (but it can be small) in order to meet the test to consolidate the Trust to OPG's financials.
>
> Sent from my BlackBerry 10 smartphone on the Rogers network.
> Original Message
> From: Gadi Mayman
> Sent: Wednesday, February 15, 2017 8:46 PM
> To: Nelms, Scott (ENERGY); Thompson, Scott (MOF)
> Cc: McLean, David (MOF); Kwan, Ronald (OFA); Kandeepan, Ken (OFA); Wynberg, Lynsey (OFA); Kennedy, Nancy (MOF)
> Subject: Re: Call with OPG
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>
> I'd think, off the top of my head, but would be happy to be corrected by the accountants, that any ROE would be a one-for-one hit to the ratepayer for every dollar we give to the fiscal plan. I'm not sure how that would be explained to ratepayers: you're paying interest to private investors and a return on equity to the Province so that your bill is lower now, but will be higher later?
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> Original Message
> From: Nelms, Scott (ENERGY)
> Sent: Wednesday, February 15, 2017 8:19 PM
> To: Gadi Mayman; Scott Thompson (CAB)
> Cc: David McLean (MOF); Ronald Kwan; Ken Kandeepan; Lynsey Wynberg; Nancy Kennedy (MOHLTC)
> Subject: Re: Call with OPG
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>
> Hi Gadi,
>
> Thanks for passing this along. We had been hearing from OPG that the equity thickness would be relatively modest. 49 percent is certainly a departure from that. We also heard that some sort of return on the equity would be required in order to meet accounting objectives (although based on the email chain below perhaps that has evolved).
>

> If an ROE is included, would that help to offset the fiscal downside that you describe? We have to be careful in adding materially to the cost to ratepayers, so will have to look at this tradeoff.
>
> Scott
>
> Sent from my BlackBerry 10 smartphone on the Rogers network.
> From: Gadi Mayman
> Sent: Wednesday, February 15, 2017 6:59 PM
> To: Thompson, Scott (MOF)
> Cc: McLean, David (MOF); Kwan, Ronald (OFA); Kandeepan, Ken (OFA); Wynberg, Lynsey (OFA); Nelms, Scott (ENERGY); Kennedy, Nancy (MOF)
> Subject: Fw: Call with OPG
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>
> Hi Scott. In the roller coaster ride with whether the OPG solution for the GA works, we've just hit a pretty big bump, as you'll see from Ken's email below. I suggest that you scroll down and read that before carrying on with my email, as what I'm going to write next may be hard to follow without the context of Ken's email.
>
> If we inject equity in the quantity OPG Is suggesting, it should make it easier for them to borrow externally, although they'd have to sound out the market and find out whether they can, and, more importantly, at what additional cost relative to the Province's funding cost. It may require a provincial guarantee, which we used to give to the old Ontario Hydro, but I don't know whether that also is something that would affect their GBE status.
>
> Possibly of more significance is that IOD would rise substantially. If we make an equity contribution of half of the total amount they need for the GA, we'd have to borrow money without any offsetting earnings. It would start off in manageable amounts in the early years, but as the equity stake grows, the amount of interest does as well. In the scenario that Ron showed you this afternoon where interest made up up $30 billion of the total cost, about $15 billion in IOD would be added over the life of the option, if debt and equity are repaid at an equal pace to each other in the out years. Of course, if we discard this option and put this on the fiscal plan, IOD also goes up, but it would eliminate the need for OPG to borrow at a higher cost than the Province's borrowing cost.
>
> OPG apparently indicated on the call that they could increase their dividend to offset some of the cash that we're providing, which, on the surface would reduce our borrowing requirements and thus lessen IOD, but OPG would need to find the cash from somewhere else, so their interest costs would go up, reducing their earnings and hitting the fiscal plan that way. Since our cost of borrowing is lower than theirs, I'm not sure having them send us money makes fiscal sense. And, of course, hanging over this whole discussion is that OPG needs over $10 billion over the coming years to finance the Darlington refurbishment.
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> Happy to discuss further at your convenience.
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> Gadi
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> From: Ken Kandeepan <Ken.Kandeepan@ofina.on.ca>
> Sent: Wednesday, February 15, 2017 6:09 PM
> To: Gadi Mayman
> Cc: Lynsey Wynberg; 'Veinot, Cindy (TBS)'; Ronald Kwan
> Subject: FW: Call with OPG
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>
> Hi Gadi
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> As discussed pls find a quick summary of our call with OPG. I understand that you will be passing this on to Scott. Cindy, you may wish to so to Helen as well.
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> As requested by OPG, Cindy and I just finished a conference call with them. OPG is of the opinion that OEFC lending the full amount to either OPG or the Trust will seriously jeopardize the OPG’s GBE status.
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> In order to maintain the status they propose;
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> That funding from the Province be limited to 49% of the amount required by the Trust and be in the form of an equity injection from the Province. An equity injunction means that the Province's net debt is not impacted since the increase in total debt is offset by an equivalent increase in the investment in OPG.
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> OPG also asserted that the balance 51% has to be from an outside lender in order to preserve OPG's GBE status.
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> Another reason for OPG also preferring the equity option instead of the Province lending the 49% is that they believe incorporating so much debt in their balance sheet with no offsetting income to service the debt will jeopardize their credit rating and impact OPG's "going concern" concept.
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> From the Province's perspective there will be a material impact to IOD.
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> John Lee indicates that OPG can in fact increase dividends to offset the cash impact of the increased IOD, but that doesn't help from a fiscal perspective. Unless OPG's net income increases and I am not sure that is possible since setting up the Trust does not contribute to net income, IOD and consequently the fiscal plan will be impacted fairly substantially as the equity injection ramps up.
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> I indicated to John that I will run this by you and get back to him tomorrow, but given the possible fiscal impact, not sure how doable this is.
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> Thanks
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> Ken k
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> ________________________________
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